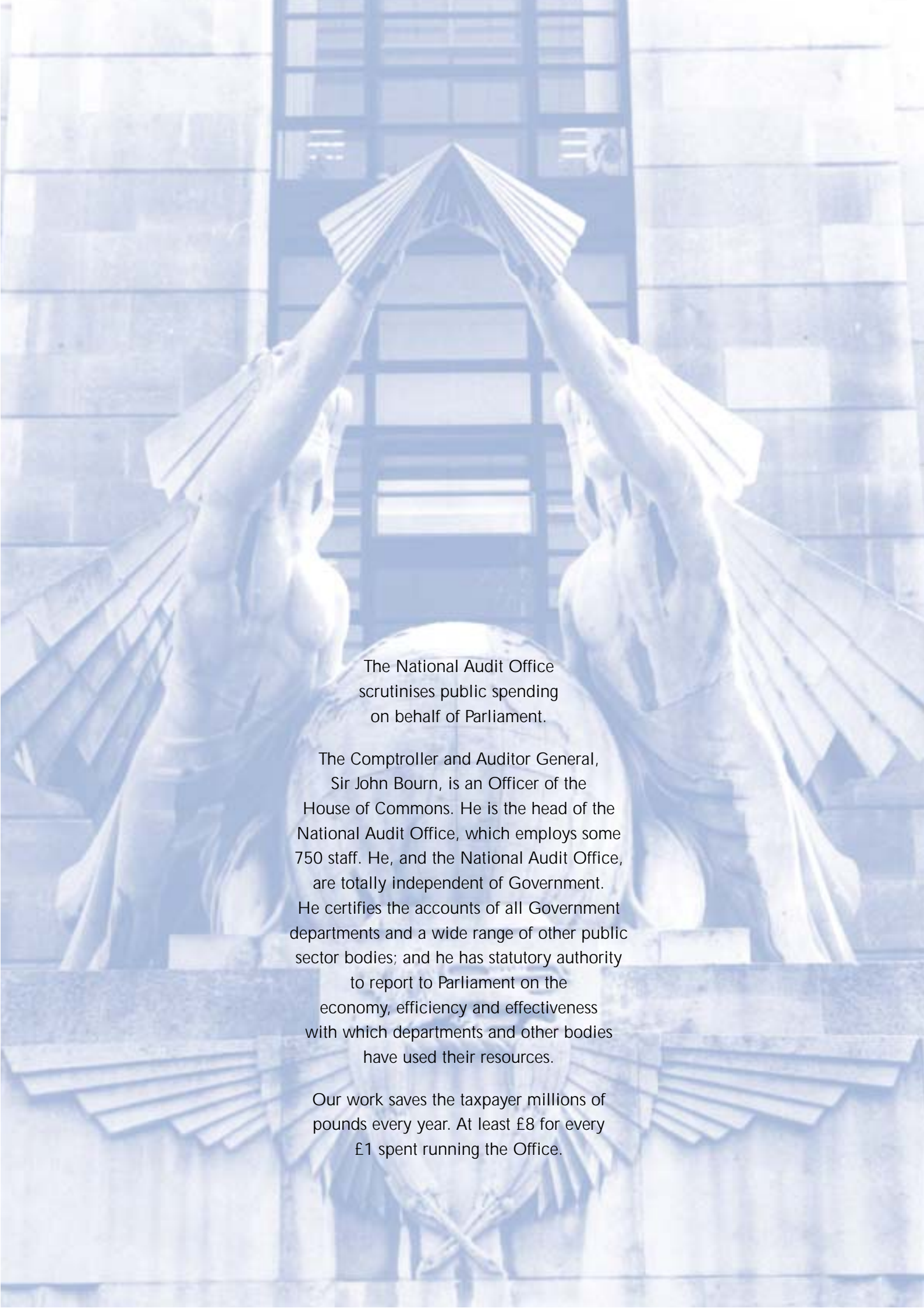


The Department for Trade and Industry: Regional Grants in England

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 702 Session 2002-2003: 17 June 2003





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The Department for Trade and Industry:
Regional Grants in England



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HC 702 Session 2002-2003: 17 June 2003

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

John Bourn
Comptroller and Auditor General

National Audit Office
13 June 2003

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Introduction

- 1 As part of their regional policy the Department for Trade and Industry offer two grant schemes, Regional Selective Assistance and the Enterprise Grant Scheme. These schemes support and promote investment that will create or safeguard employment in areas in which significant disparities from the national average exist in unemployment or employment rates, or in their dependency on manufacturing. The European Community Regional Aid Guidelines define two tiers of Assisted Area. To qualify for tier 1, the most disadvantaged areas, Gross Domestic Product per head has to be less than 75 per cent of the Community average. In England, Cornwall, South Yorkshire and Merseyside are currently designated as tier 1 areas. There is greater latitude in defining tier 2 areas, within an overall population ceiling determined by the European Community. A domestic tier 3 was created additionally to extend the coverage of the Enterprise Grant scheme through use of the European Community's Small and Medium Enterprise Guidelines.
- 2 Regional Selective Assistance began in the early 1970's as a scheme primarily devoted to reducing unemployment rates in disadvantaged areas. Scheme guidelines have been amended over time to reflect the changing needs of policy. The 1998 White Paper on Competitiveness included a new commitment to give more emphasis to upgrading skills and technology when appraising projects under the scheme. To reflect this change of emphasis, scheme guidelines and objectives were amended to reflect the competitiveness agenda. In 2000 a new scheme - the Enterprise Grant Scheme - was introduced in all tiers in England with criteria for project support specifically targeted towards the pursuit of competitiveness. In the Assisted Areas, it replaced that part of Regional Selective Assistance involving grants of less than £75,000.



- 3 To qualify for Regional Selective Assistance, projects must be: located in designated Assisted Areas; involve capital expenditure on fixed assets; have a positive impact on both the regional and national economies; be viable; show that without grant they could not go ahead and they must create or safeguard jobs. The Enterprise Grant scheme differs in three important respects: projects do not have to create or safeguard jobs; the application and appraisal process has been streamlined; and grant is available in a broader range of areas.

- 4 The Department have policy responsibility for the Regional Selective Assistance and Enterprise Grant schemes in England. Over the three years, 1999-00 to 2001-02, total expenditure amounted to over £300 million for Regional Selective Assistance and £14 million for Enterprise Grants. The Devolved Administrations in Scotland and Wales are responsible for Regional Selective Assistance in their territories. During the period covered by this report, the scheme was operated to broadly common guidelines across Great Britain, and has been evaluated, as a single scheme, jointly by the three administrations.
- 5 Our examination focussed on three issues:
 - Whether the schemes address clearly identified economic problems;
 - How well the schemes have been operated; and
 - To what extent the Department have established the effects of the schemes on the identified problems.

To assist us in our review, we engaged a firm of consultants, National Economic Research Associates (NERA), to examine the economic aspects of regional grants.

Main Findings

Whether the schemes address clearly identified economic problems

- 6 Regional Selective Assistance and Enterprise Grants support the regional Public Service Agreement objective, shared with the Office of the Deputy Prime Minister and HM Treasury, to make improvements in the economic performance of all English regions. It is the Department's policy that the schemes should be demand-led. The Department have established broad generic targets for both schemes, in terms of job creation and the ratio of grant to total capital investment, but because of the demand-led nature of the schemes they have not set specific annual targets or performance measures against which the achievement of the wider scheme objectives can be judged. It is a cornerstone of the schemes that the Department (and now the Regional Development Agencies) should pay only the minimum necessary to secure a project, subject to an overall value for money criterion. It would not promote value for money if they published target cost per job figures, for example. The Department normally identify specific market weaknesses that schemes are designed to mitigate so as to help ensure that the schemes address the cause of the problem. Although specific market weaknesses were not identified in the early design of the Regional Selective Assistance scheme in the seventies and have not been identified during subsequent revisions, the scheme aims to combat the effects of multiple market weaknesses in the Assisted Areas. It is the Department's view that the causes of the economic deprivation of these Areas are so manifold that a broad instrument such as Regional Selective Assistance is appropriate. Enterprise Grants similarly address labour and capital market weaknesses at a lower level. The unspecific nature of these weaknesses, however, makes it hard to assess whether the schemes represent a cost-effective choice of policy instrument to help address the underlying problems of the Assisted Areas.
- 7 Detailed scheme guidelines translate scheme objectives into criteria against which staff must judge applications for assistance. The guidelines have evolved over many years, cover most of the situations that staff will face in appraising and monitoring applications and provide worked examples of the sort of analyses



required. Larger cases requiring deeper market and economic analysis are referred to specialist staff in London for appraisal, led by the Department's Industrial Development Unit, formed of secondees from banking and accountancy firms.

- 8 In pursuit of competitiveness and productivity, the Department have shifted the emphasis of Regional Selective Assistance more towards high-quality projects providing skilled jobs. Recognising that this was a complex issue for appraisal, the Department had made advice available from London although it had not been possible to give precise guidance on how competitiveness and productivity should be assessed in every case.

How well the schemes have been operated

- 9 Regional Selective Assistance and Enterprise Grant are demand-led schemes, which the Department do not promote in any targeted way. Information is, however, available in brochures, on departmental and regional websites and through organisations such as the Regional Development Agencies and Invest UK. The schemes are not intended to be aimed at any particular sector or sub-sectors. In practice, Regional Selective Assistance grants continue to be awarded predominantly to manufacturing companies. Around 90 per cent of the value of grant offered in the period 1994-2002 was in the manufacturing sector. This high percentage was due partly to the scheme criteria, which reflect European Community rules on regional aid requiring projects to have capital investment and linked job creation or safeguarding, and partly to manufacturing companies' familiarity with the scheme. The additional flexibility of Enterprise Grants, which do not require job creation or safeguarding as a prerequisite, has been welcomed by regions in pursuing their regional economic strategies.
- 10 Another feature was the extent of repeated awards to companies. Analysis of Regional Selective Assistance and Enterprise Grant applications received between April 1994 and March 2002 showed that, of all companies accepting grant offers, 12 per cent had received more than one grant, amounting to 31 per cent of the total value of offers accepted. A small number of motor vehicle projects, subject to highly competitive international bidding, accounted for two-thirds of repeat awards by value. Repeated grant awards can run counter to the scheme aim that support should help firms become self-sustaining, and can obscure the full impact of the assistance given on both the company itself and other companies in the Assisted Area. This issue was addressed, for small value applications, in the design of the Enterprise Grant scheme, by limiting each firm to total grant of £75,000.
- 11 Applicants must be able to demonstrate that without the grant the project would not go ahead - the additionality criterion. Assessing additionality always presents officials with a challenge because they have to reach a view about what would happen without grant. Only the applicant has full knowledge of their reaction to this situation. The Department base their judgements on analysis of company policies, plans and the strength of arguments advanced in applications and associated meetings. They weigh the evidence against the backdrop that refusing assistance could jeopardise investment and employment in a disadvantaged area. The latest evaluation of Regional Selective Assistance estimates that only 45 per cent of assisted jobs have been additional. In expenditure terms, these additional jobs accounted for 59 per cent of total grant paid, reflecting greater additionality in respect of larger projects.
- 12 Another key requirement is that assisted projects should not displace other projects and jobs. The Department must judge whether an applicant's competitors, and other firms involved in the relevant line of business, will be adversely affected by the assisted project. In some cases, technological

advances in an industry may justify some adverse impact on existing businesses. Staff draw on general guidelines on the nature of certain types of business, and for larger projects, on market advice provided by experts. Their judgements, however, include a degree of subjectivity and cannot be entirely precise. Scheme evaluations estimated that 25 per cent of additional assisted employment displaced other jobs in the Assisted Areas. This effect was partly offset by the multiplier effect of assisted jobs on the local economy, creating further jobs in non-assisted firms. On Departmental estimates, displacement net of multiplier effects was around 11 per cent.

- 13 The discretionary nature of Regional Selective Assistance, and associated negotiation of grant levels, places considerable administrative burdens on the applicant and the Department. There are no official data available on firms' application costs. But companies we visited which had cost information quoted costs in the range of six to eight per cent of the grant award. Given the small number of companies involved in this sample, this estimate is broadly in line with the Department's estimate of five per cent of grant values. Building on Departmental costing systems we estimated their own administrative costs to be around five per cent of grant values. Taken together, we estimate that, on the limited information available, the costs incurred by applicants and the Department sum to an average of about 10 per cent of the grant award. The scale of administrative costs flows from the need to inform negotiations over the amount of grant needed, and assessments of additionality and displacement, under the discretionary nature of the scheme. The Department aim to make administration proportionate to the degree of risk and potential loss of value for money. The Department have responded to concerns about administrative burdens in designing the Enterprise Grants scheme, which is intended to minimise them. They have not reviewed the actual burdens but they have tailored the scheme so that wherever possible they work with the applicant's internal documentation.

To what extent the Department have established the effects of the schemes on the identified problems

- 14 Between 1994-95 and 2001-02, total Regional Selective Assistance of nearly £1.4 billion was offered. This assistance supported additional planned capital expenditure by companies in English Assisted Areas of nearly £13.4 billion (i.e. companies planned to invest an additional £9.50 for every £1 of assistance). These projects were expected to create or safeguard a total of 303,000 jobs at a gross cost per job of just over £4,600. For those projects completed to date the number of jobs secured represents 97 per cent of those expected. The Department monitor these two indicators of scheme progress and, as noted above, have evaluated scheme performance further back through three evaluation studies.
- 15 Analysing results from the most recent evaluation, published in 2000 and covering grants awarded from 1991-95, we estimate assistance has generated around 21,000 jobs at a net cost per net job of nearly £21,000, at 2002 prices. No quantitative information was presented in the evaluation on job quality or changes in competitiveness, because these objectives post-dated the range of cases covered by the evaluation. The evaluation did, however, find that about three quarters of assisted firms had gained a competitive advantage as a result of a Regional Selective Assistance project. The evaluation also found basic work training benefits in the projects supported by Regional Selective Assistance, but very few cases where training led to recognised qualifications.



16 Our review of the scheme's evaluation methodology and practice showed that the depth and frequency of evaluations compared well with other Departmental schemes (partly reflecting the length of time the scheme has been running) and with evaluation practices for similar schemes run by other countries. The focus of the evaluations has been to assess the impact of the scheme in delivering net additional jobs in the Assisted Areas and to assess cost-effectiveness. The Department were also concerned that evaluations should produce comparable results, so that trends over time could be tracked.

17 Our review of these evaluations also highlighted the following main points:

- the evaluations did not address the administration costs of the Scheme for Government or for the applicant. The Government does not collect centrally the costs incurred in the Regions in administering the Scheme, but in this period controlled them through corporate management of the Department's Regional, and latterly Government, Offices. The Department are aware that the transaction costs for companies vary depending upon the complexity of the project and the ready availability of the necessary financial data. Wherever possible, they seek to work with the applicant's internal documentation, in order to minimise their costs;
- the issue of additionality has been addressed by each of the three evaluations: in particular, the evaluations attempted to overcome the potential for bias in respondents' answers to the hypothetical, 'what would you have done without the grant?' In the most recent evaluation, for example, the additionality assessment was also informed by a range of indirect approaches which were included in the survey. Carefully framed and implemented surveys, such as that underpinning the latest evaluation, can counter inconsistencies in a firm's response. But they cannot deal with aspects of bias resting on a firm's judgements on the basis of consistent facts. A survey approach may not therefore fully establish the scale of bias present;
- The methodology for estimating scheme additionality and impact takes account of the length of time over which additional employment effects are deemed to last. A research study into the circumstances of assisted jobs from 1975 to 1981 indicated that the additional employment effects reduced more rapidly over time than assumed in the evaluation method. The Department do not believe that this study is applicable to the circumstances of Regional Selective Assistance in the 1990s. The National Audit Office observe that there is no other empirical research on the life of employment effects, and that the research calls into question the form and value of the assumption used to date in evaluations. More research would be required before substituting a different value;
- there was no analysis of the impact of additional assisted jobs on wages and demand in local labour markets. The only research study on this issue¹ was published after the last evaluation was done but, if its findings are generally applicable, such effects could substantially increase the estimates of displacement made by the evaluations. The Department accept that this is a valid issue, but do not accept, on the basis of current knowledge, that the results of the research should be taken as generally applicable. They note that the necessary economic models are not currently available to carry out this analysis for Assisted Areas; and
- the evaluations did not quantify displacement of jobs in non-assisted areas or the overall national benefit from regional assistance. Regional Selective Assistance is an instrument of Government regional policy, aimed at improving the economies of the Assisted Areas. Displacement of jobs from

¹ G. Gillespie, P. McGregor, J.K. Swales and Y.P. Yin, "The Displacement and Multiplier Effects of Regional Selective Assistance: A Computable General Equilibrium Analysis", *Regional Studies*, 2001, Vol 35, pp125-139.

other areas and potential national benefit, however, are assessed in appraising individual applications for all large cases, which have accounted for the bulk of scheme expenditure.

There are a number of ways of evaluating any scheme, and estimates of scheme impacts will, to some degree, be a function of the methodology selected. Nevertheless, in principle a more sophisticated methodology, catering for a greater range of known interactions, can provide deeper insights into scheme effectiveness. In practice the constraint on the use of such methods is usually availability of reliable, up to date data on local circumstances, used to define key parameters underlying the calculation of effects. So a more complex evaluation methodology does not necessarily lead to a more accurate assessment of additionality, displacement or cost per job.

- 18 There is some evidence to suggest that if the evaluation methodology was changed to capture more reliably the issues raised above, the effect could be to reduce estimates of net discounted permanent job equivalents and increase the net exchequer cost per net job. The scale of such effects cannot be known without more local and regional economic data and research. Similar methodologies would have to be applied in the evaluation of other schemes with similar objectives, before judgements about relative value for money could be made.
- 19 The evaluations have addressed scheme effects on competitiveness and support of internationally mobile investment but they have not quantified the benefits. The latest evaluation showed that while only 10 per cent of accepted offers were made in respect of internationally mobile projects those offers amounted to 40 per cent of the total grant offered. A review of other statistically-based research indicated that:
 - although plants in receipt of Regional Selective Assistance became considerably more productive in terms of labour productivity, they remained less productive than non-assisted plants in the Assisted Areas;
 - the attraction of foreign investment has been an important source of technical change which can raise the productivity of other plants, although this effect has been greater in non-assisted areas than in assisted ones; and
 - there was no strong evidence to suggest that the non-employment benefits of Regional Selective Assistance were substantial.
- 20 There is inevitably a time lag between assistance being granted and subsequent economic and employment effects, as well as a lag between effects and their periodic evaluation. The evaluations cover the period up to 1995 and there has therefore been no assessment of the added emphasis given to competitiveness and productivity announced in the 1998 White Paper. Gross cost per job has remained largely the same in real terms since 1994 - indicating that the Department have not paid more on average for jobs in recent years, as allowed by the revised guidance facilitating higher grant awards for higher quality jobs. The Department are monitoring the numbers of quality projects, but it is too soon to draw conclusions on the success or otherwise of the move towards more high quality projects.

Conclusions and recommendations

- 21** Our conclusion is that regional grants have led to a number of additional jobs in disadvantaged areas, but probably fewer jobs and at a higher cost than the latest evaluation had estimated. Evidence on broader effects on competitiveness is mixed, with some evidence of low-level training benefits, and technical benefits from inward investment. Plants supported by Regional Selective Assistance have improved their labour productivity, but so have non-assisted plants within the Assisted Areas. Overall effects on productivity were not large, and although evaluation methodologies and assumptions varied, the Department assessed the Scheme, as administered up to 1998, as relatively poor value for money in generating productivity improvements compared with some of its other schemes. Up to this point, productivity improvement had not been one of the Scheme's principal objectives. The factors that restrict value for money are displacement and a relatively low level of additionality. These effects are endemic to this type of assistance and have been evaluated at similar levels for many years.
- 22** As part of a general review of their Business Support arrangements, the Department are currently reviewing and rationalising their grant schemes, including Regional Selective Assistance and Enterprise Grants, to increase their contribution to improving productivity and competitiveness. They expect to create a new capital investment support instrument to replace the existing schemes. In taking forward their review of Business Support, the Department should:
- seek to set out more explicitly the market failings in the Assisted Areas (and elsewhere in the case of Enterprise Grants) which investment support aims to address and consider whether there are any conflicts implied by the job creation and productivity objectives;
 - clarify the extent of economic change required in Assisted Areas, and define the measures by which the success of any regional grants may be judged;
 - consider more active marketing of investment support schemes in line with regional economic and productivity improvement strategies;
 - review the scope to improve on the levels of net additionality of the current schemes - for example, by exploring greater use of qualifying criteria related to the Department's development strategies;
 - make sure that staff dealing with regional grants receive adequate training and understand the current scheme objectives and apply best practice in administering schemes; and
 - review the evaluation process addressing the following points: it should reflect the complete range of objectives for regional grants with specific attention to improvements in productivity; reconsider the treatment of non-additionality and displacement to make sure all important elements are addressed; factor in the administrative costs of both Department and applicants; and form a view on net national benefits as well as those to Assisted Areas.
- These recommendations are designed to focus assistance more closely on objectives, reduce administrative burdens on both applicants and officials, and give clearer information on whether grants have had the intended effects. They would help the Department to use regional policy funds in the most cost-effective way.

Part 1

Introduction

- 1.1 Section 7 of the Industrial Development Act 1982 allows assistance to be given to encourage the development of viable and realistic projects to provide or safeguard employment in defined Assisted Areas. Under the Act, assistance should be provided to support improvements in efficiency or productivity, promote modernisation, or encourage growth. The Department's main vehicles for providing such assistance are Regional Selective Assistance and Enterprise Grants, although the latter is actually funded under Section 8 of the Act because part of the spend is outside the Assisted Areas.
- 1.2 **Figure 1** gives some key data for Regional Selective Assistance and Enterprise Grant offers, in England, over the period 1999-00 to 2001-02.
- 1.3 **Figure 2 overleaf**, shows that the total number of applications for assistance has fallen steadily since 1995-96 and almost halved over the last six years.

Regional Selective Assistance and Enterprise Grants

- 1.4 Regional Selective Assistance provides discretionary grants to companies creating or safeguarding employment in the Assisted Areas - which have traditionally been characterised as areas with relatively low levels of Gross Domestic Product per head, high levels of unemployment and in the process of industrial restructuring. Whilst the main aim of Regional Selective Assistance has been to secure additional employment, it also aims to improve the competitiveness of regions and to secure internationally mobile investment. To be eligible for Regional Selective Assistance, projects must create or safeguard jobs in the Assisted Area; be viable; contribute positively to the national economy and show that the investment would not proceed without grant assistance.

1 Regional Selective Assistance and Enterprise Grants in England: Key Offer data: 1999-2002

	Regional Selective Assistance	Enterprise Grant	Total
Actual expenditure	£299.3m	£13.8m	£313.1m
Number of offers made	1,322	1,326	2,648
Total value of grant offered ²	£444.2m	£41.5m	£485.7m
Total capital investment by applicants	£5,417.3m	£335.1m	£5,752.4m
Expected new and safeguarded jobs	91,148	10,034	101,182

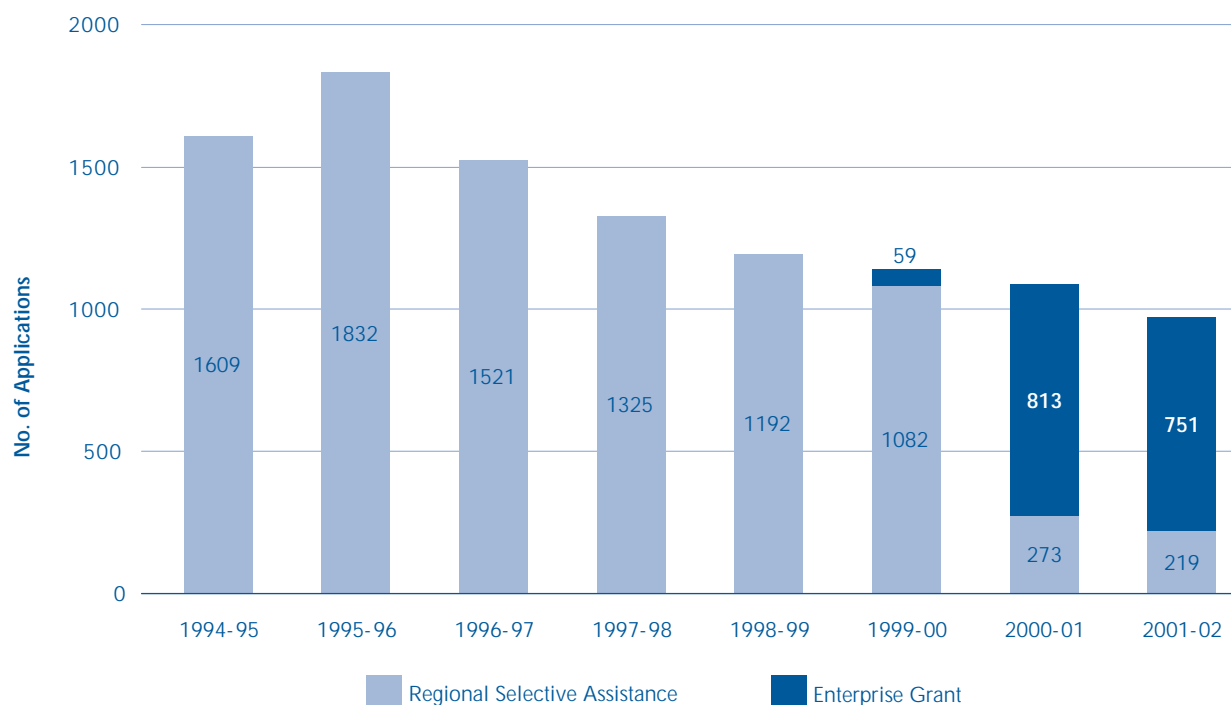
NOTE

Actual expenditure during the period is not related exclusively to the offers made during the period.

Source: NAO analysis

² Enterprise Grants are limited to a maximum grant of £75,000. There is no upper limit for Regional Selective Assistance.

2 Number of Regional Selective Assistance and Enterprise Grant Applications in England



NOTE

Enterprise Grant was introduced on 1 January 2000.

Source: NAO Analysis

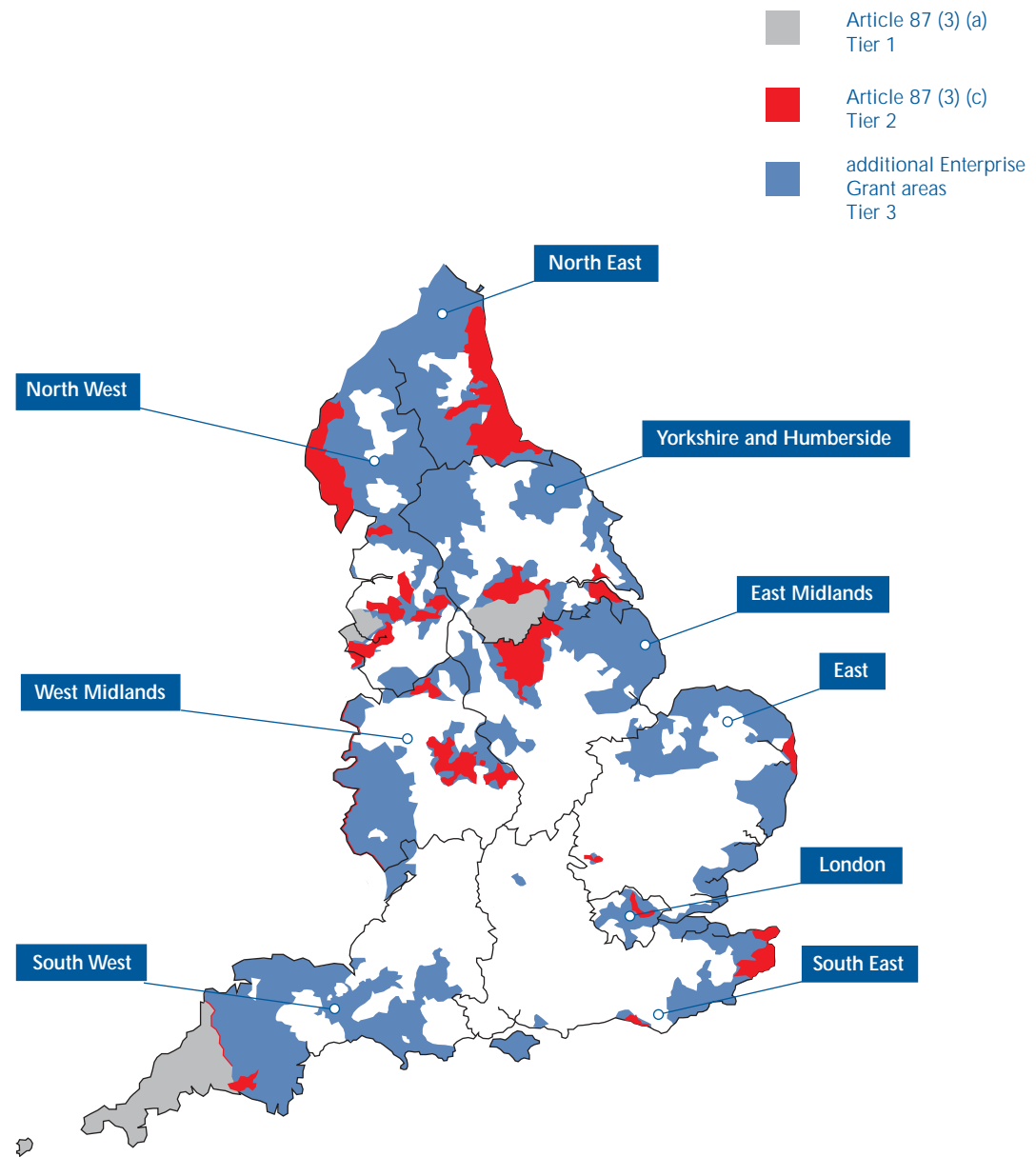
1.5 The last major revision to Assisted Area boundaries was in 2000. The main criteria governing the specification of Areas were employment and economic activity at ward level and, under European Commission regulations, these areas have to be agreed with the Commission. The Assisted Areas consist of tiers 1 and 2. In tier 1 areas, Gross Domestic Product per head will have been less than 75 per cent of the European Community average, based on data available at the time of designation. Tier 2 areas are based on groups of electoral wards where significant disparities exist from the national average in residential or work-place unemployment, employment rates, or their dependency on manufacturing. **Figure 3** shows the map of Assisted Areas.

1.6 Enterprise Grants were introduced in January 2000 to extend the coverage of grants to small and medium enterprises, beyond the Assisted Areas. They removed small projects from the ambit of Regional Selective Assistance and introduced a less complex application and assessment process. They are limited to a maximum grant of £75,000, which is 15 per cent of a maximum capital expenditure of £500,000. Enterprise Grant applicants commonly need to invest in

equipment or knowledge and often cannot meet the Regional Selective Assistance job creation criteria. Technological changes and the need for rapid development of machinery and processes does not necessarily lead to increased numbers of jobs. A key objective is to target support on growth firms. For this reason applicants for Enterprise Grants are not specifically required to meet any job creation or safeguarding criteria even though many such projects are successful in doing so but on a smaller scale than Regional Selective Assistance projects.

1.7 Until April 2002 both Regional Selective Assistance and Enterprise Grants in England were administered by the Government Offices in each region. These offices were responsible for the assessment of all grant offers up to £2 million and for the routine monitoring of all projects. The assessment of Regional Selective Assistance grant offers above this level was, and remains, the responsibility of the Department centrally. Since April, the responsibilities of the Government Offices have been transferred to the Regional Development Agencies in respect of Regional Selective Assistance and to the Small Business Service in respect of Enterprise Grants.

3 Assisted Areas in England



Source: Department of Trade and Industry

Scope of the examination

- 1.8 This report assesses the effectiveness and value for money provided by the Regional Selective Assistance and Enterprise Grant schemes operated in England. In particular we examined the economic justification for intervention and the effect of the schemes on specific market weaknesses in the national and local economies. The report specifically addresses three main issues:
- Whether the Regional Selective Assistance and Enterprise Grant schemes address clearly identified economic problems (Part 2);
 - How well the schemes have been operated (Part 3); and
 - To what extent the Department have established the effects of the schemes on the identified problems (Part 4).
- 1.9 During our examination we visited four English regions where we undertook semi-structured interviews with key staff responsible for the administration of Regional Selective Assistance and Enterprise Grants including regional policy directors from the Government Offices and the Regional Development Agencies and the staff responsible for the appraisal and monitoring of applicants. Appendix 1 sets out the full methodology used in undertaking this examination.

Part 2

Rationale and design of the schemes

Have the Department identified the specific problems to be addressed?

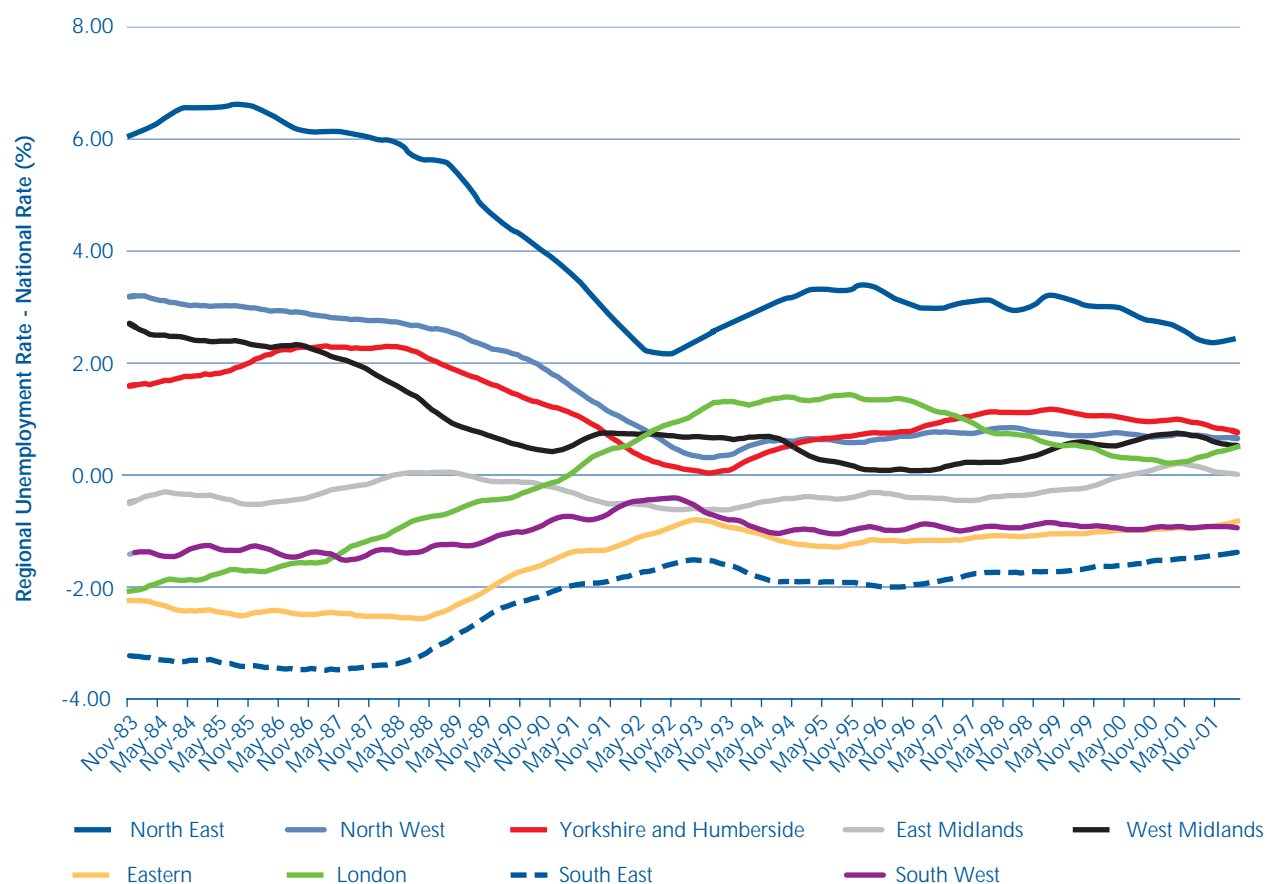
Regional disparities in unemployment

- 2.1 During the early 1980s, regional disparities in unemployment widened significantly, reaching a peak around 1985 (Figure 4) and the level of unemployment in the North East was especially high. However, following a sharp rise in domestic demand, disparities narrowed to around one per cent in 1992 except for the North East. There the divergence worsened again after 1992 but returned to two per cent above the average by August 2002. The proportion of the national workforce located in areas where unemployment is more than two per cent above the average has also fallen from 11 per cent in 1995-98 to six per cent in 1999-2002.
- 2.2 Whilst absolute unemployment differentials have fallen, the Department continued to be concerned about relative differences which have been diverging. In October 2002, male claimant unemployment in the North East was 6.8 per cent, more than double that in the East (2.8 per cent), the South East (2.2 per cent) and the South West (2.5 per cent). Disparities in unemployment rates have also been accompanied by persistent regional differences in Gross Domestic Product per head of population, mainly caused by regional differences in levels of productivity. The latest available figures, for 1999, show that regional differences in this measure have also widened since 1989. Problems of unemployment and weak economic activity have been concentrated in more tightly defined areas which have also generally been associated with traditional manufacturing industries and less skilled work, leaving a legacy of older workers who lack the skills required by modern industry. In general, skill patterns, worker attitudes, and infrastructure have militated against the growth of new technology based industries in these areas.

Rationale for Government intervention

- 2.3 During the 1980s, even though regional unemployment differentials were high, the Government recognised that the case for regional intervention was based on social rather than economic grounds. The effect of "crowding out" (ie: increased public expenditure displacing private sector investment and other activity) meant that Assisted Areas were thought to gain at the expense of other areas but with no net economic benefit nationally, apart from the social benefit gained through more equitable unemployment levels. This situation was acknowledged by HM Treasury in 1995, in their report *"A Framework for the Evaluation of Regeneration Projects and programmes"* which concluded that "only policies which produce supply side improvements will have employment benefits at the national level. Other policies only alter the composition and distribution of economic activity". Improvements, such as better productivity, which go beyond assisted companies to increase the productivity of other local companies, such as their suppliers, increase benefits at the national level.
- 2.4 As part of their normal practice the Department prepare a statement of the economic rationale justifying any scheme of Government intervention. But they do not have a statement for Regional Selective Assistance, which existed before the preparation of a rationale was mandatory. The economic performance of Assisted Areas has suggested that they are subject to multiple market weaknesses. The absence of a stated rationale means that it is not clear what market weaknesses are being addressed by Regional Selective Assistance or how appropriate the programme is as an instrument to correct these weaknesses. Without a stated economic rationale it is difficult to be sure that the scheme addresses directly the causes of the economic problems facing Assisted Areas or represents the approach most likely to yield sustainable improvements and good value for money.

4 Unemployment Differentials in England: 1983-2002



Source: NERA analysis

2.5 The Department, however, have a rationale for Enterprise Grants and the main sections are outlined in Extract 1.

Extract 1: from ROAME Statement for the Enterprise Grant Scheme - Dec 1999

"The rationale for Enterprise Grants lies partly in a failure in the local labour markets and partly in a failure of the capital markets. Experience, from previous Regional Selective Assistance evaluations, points to a capital subsidy, focused on higher quality projects being a cost effective way of addressing the failures."

"Like Regional Selective Assistance, Enterprise Grants therefore also has a redistributive and social objective of redressing persistent disparities in unemployment and job opportunities caused by the long term decline of demand for labour by industries on which local economies have become particularly dependent".

This rationale was based on the objectives of Regional Selective Assistance but is unspecific about the nature of the labour and capital market failures to be addressed. So it is difficult to assess whether grant support for individual projects is the most cost-effective remedy. The Enterprise Grant guidelines suggest that the scheme should address the following problems: barriers to outward migration of unskilled workers; wages in areas of high unemployment not adjusting downwards sufficiently to increase employment and workers having difficulty in getting on-the-job training. But the scheme addresses these problems only indirectly.

Are the schemes designed to address the specific problems?

- 2.6 The objectives of Regional Selective Assistance are to create or safeguard jobs in Assisted Areas; to help attract and retain internationally mobile investment; and to contribute to the regeneration and competitiveness of the regions. These objectives give a steer on the factors that will be taken into account in assessing scheme performance. They feed into the wider Public Service Agreement objective, shared with the Office of the Deputy Prime Minister and HM Treasury, to make improvements in the economic performance of all English regions. Because the scheme is demand-led, the objectives are not quantified and are not set in the context of any specific plan to alleviate the problems of the Assisted Areas as such. It is expected that the scheme should contribute to the implementation of the Regional Economic Strategies, which also address sub-regional issues. In these circumstances, it is difficult for the Department or external commentators to form a view on the schemes' contribution in solving the problems of disadvantaged areas.
- 2.7 The Department operates the Regional Selective Assistance scheme with the consent of HM Treasury as required by the Industrial Development Act 1982. The scheme guidelines and criteria must have the approval of HM Treasury. The criteria that define the Regional Selective Assistance and Enterprise Grant schemes explicitly address concerns about jobs and economic activity. **Figure 5** sets out the main appraisal criteria for both schemes. The Department have prepared guidelines for officials to help them interpret those criteria. The additionality and displacement criteria are designed to guard against risks of poor value for money and are common to many of the Departmental grant schemes. The first three criteria give the schemes their unique character, and are the main elements in designing the schemes to address the problems of disadvantaged areas and create added value.
- 2.8 Our discussions with Department and Development Agency staff revealed a general belief that Regional Selective Assistance remained an important and effective tool for attracting inward investment and encouraging indigenous companies to remain in the Assisted Areas. This was particularly the case where companies had a choice of possible locations in Britain and overseas. Staff also believed that assisted projects provided a substantial 'knock-on' effect beyond the assisted firm, raised skill levels and productivity through the supply chain and in competing firms, and created further jobs although they were unable to quantify the effects. Staff identified, however, a number of challenges in the administration of the schemes and the appraisal of individual grant applications.

The jobs and competitiveness criteria

- 2.9 The requirement for Regional Selective Assistance projects to create or safeguard jobs is justified in terms of the social policy objectives of the scheme. The 1998 Competitiveness White Paper, however, announced the refocusing of support more towards high-quality knowledge-based projects which provided skilled jobs. When Enterprise Grants were introduced, job creation was not made a prerequisite for project eligibility. The Department believed it unnecessary to tie assistance to jobs for small projects. This flexibility has been welcomed by regional staff who said that Enterprise Grants had become a more useful tool in the implementation of Regional Economic Strategies. But that flexibility does not prevent employment effects being considered in appraising applications. In the North East, for example, where unemployment is relatively high, securing jobs has continued to be the main objective for the scheme.
- 2.10 Regional Selective Assistance scheme guidelines set various limits for gross cost per job, designed to help officials secure value for money - as well as staying within European Commission limits. In England, these guidelines were amended to reflect the new emphasis on high quality jobs. In 2000, the Department introduced guidance based on their four indicators of a quality project: number of sustainable new jobs; wage levels; level of Research and Development; and level of training. This guidance sets out expected cost per job ranges that are payable for different standards of projects, ranging from a maximum of £5,000 for projects offering low quality employment with few or no wider benefits to an unlimited figure for projects of exceptional quality. In England, exceptionally high cost per job offers and/or total grant offers of £7 million or more must be cleared with HM Treasury.
- 2.11 The low quality ceiling of £5,000 is equivalent to the actual average gross cost per job, although it is not clear on what basis the Department judged this figure to be value for money. Some officials in the regions, however, did not feel confident about applying the guidelines as they viewed the £5,000 cost per job benchmark as a limit that should not normally be breached. And an academic reviewing Regional Selective Assistance in 2001 stated "...No doubt the application of discretionary powers can allow the Department to shift some funding at the margin towards higher-skill jobs but given the pressure to take jobs of any kind, one must question how far this new direction can be taken"³. An analysis of assistance offers made (**Figure 6**), shows that the average cost per job figure in England has been stable in recent years, indicating there has not yet been a move to pay more for higher quality jobs, as allowed by the revised guidelines. The Department are monitoring the numbers of high quality projects assisted, but it is too soon to draw conclusions on the success or otherwise of the move towards more high quality projects.

5 Appraisal criteria for Regional Selective Assistance and Enterprise Grant

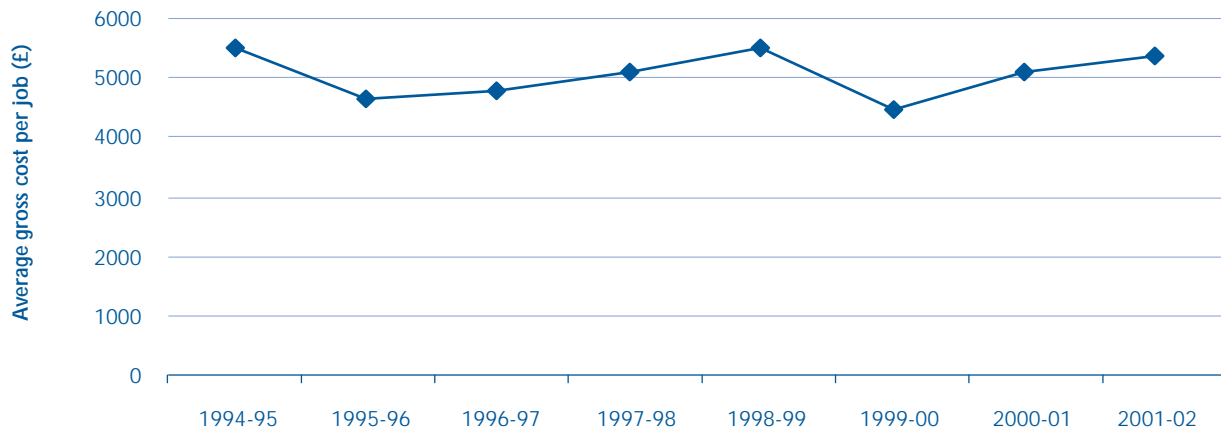
	Regional Selective Assistance	Enterprise Grant
Location	Projects must be undertaken in the 'Assisted Areas' as recognised by the European Commission.	Applicants must be Small to Medium - sized companies in designated Enterprise Grant Areas. These are the Assisted Areas and further areas designated by a flexible national measure to aid regional development and to respond quickly to local crises.
Quality	Additional emphasis is given to upgrading skills and technology. Four key factors are used to determine the quality of projects: wage levels, sustainable employment, Research and Development, and training.	Preference is given to high growth businesses seeking to maximise value added projects with quality output. Projects are measured against quality factors, these include supply chain improvements; Research and Development; training; salary levels; innovation; environmental sustainability; and national and regional benefit.
Jobs	The project must create or safeguard jobs. Those service sector projects which serve purely a local market do not generally qualify.	It is not essential for a project to create jobs in order to qualify for the grant.
Maximum Grant	There are no limits on the number of Regional Selective Assistance grants a company may apply for. Grants are subject to European Community 'Net Grant Equivalent' ceilings ranging from 10% to 35% of the value of the eligible capital expenditure, according to the status of the Assisted Area. There is a separate calculation for job grants, based on wage costs.	Enterprise Grant applicants are allowed any number of grants up to a combined total of £75,000. The maximum grant available is 15% of eligible expenditure, apart from medium sized firms in Tier 3 areas who may receive up to £37,500 or 7.5% of eligible costs.
Eligible Expenditure	Expenditure exceeding £500,000.	Maximum eligible expenditure is £500,000.
	The project must involve capital expenditure on fixed assets, such as property, plant and machinery.	Eligible expenditure must relate to equipment, plant and machinery; some associated one-off costs such as the acquisition of patents; and associated land, site preparations and buildings.
	Where this expenditure is insufficient, salary costs for new jobs created may be capitalised and used for assessing grant.	
Viability	Businesses should be viable and projects should have good prospects of becoming self-sustaining.	Businesses and projects should be viable; and the project will normally be expected to become profitable within three years.
Additionality	Applicants must demonstrate that a grant is necessary to enable the project to proceed.	
Displacement	Projects which are likely to create over-capacity, or which simply displace jobs from other areas, or aim to relocate jobs from one part of the country to another, are not eligible for assistance.	

Source: Regional Selective Assistance and Enterprise Grant scheme criteria

2.12 Although competitiveness and productivity have now been identified as important factors in achieving regional policy aims, our interviews with staff revealed some concern that the guidelines from the Department were not clear on how these factors might best be assessed. The guidelines do not stipulate what the judgement should be in every case but they do set out the considerations that staff should take into account. For example, labour productivity can be estimated using gross value added (that is, labour costs plus profits divided by the number of employees) and job quality

may be assessed by comparing project wage levels with those for the sector and region. The assumption is that in a broadly competitive market higher wages indicate a more skilled and productive workforce. While the Department assume that high quality projects will contribute to improved competitiveness, no direct competitiveness measures feature in project appraisal or monitoring. The viability and sustainability of both company and project are, however, assessed as part of the appraisal process.

6 Average gross cost per job for Regional Selective Assistance in England: 1994 - 2002 (at 2002 prices)



Source: NAO Analysis

Are the schemes adequately resourced?

2.13 In the eight years between 1994-95 and 2001-02, the Department offered total Regional Selective Assistance in England of nearly £1.4 billion, around £175 million on average annually. Firms apply for assistance given awareness of the scheme and in light of their own plans. The level of Departmental resourcing flows from the appraisal of these applications, rather than any plan of activity necessary to solve the problems of Assisted Areas. Scheme budgets have been based around historical demand and affordability considerations. In these circumstances, it is not possible to form a view on whether the overall level of funding has been appropriate - since scheme objectives have not been framed in a way that enables such a judgement. It is clear, however, that the level of support is small in relation to the level of economic activity within Assisted Areas.

2.14 Scheme criteria result in a step change in available support between Enterprise Grants and Regional Selective Assistance. In tier 1 Assisted Areas, a Small or Medium Enterprise spending £499,000 could get up to £75,000 from the Enterprise Grant scheme without the need to create jobs. By spending just a few thousand pounds more, say £501,000, the company could more than double this grant under Regional Selective Assistance, to £175,000, if it succeeded in convincing officials that the additional grant was needed, but to do so they would need to create or safeguard up to 35 jobs to satisfy the cost per job guidelines. If the project were assessed as high quality, the jobs requirement would be mitigated but not eliminated. Such a step change could make it difficult for smaller companies and those in the less labour intensive, higher technology areas to access the level of grant they require from Regional Selective Assistance even though the Department want to encourage such firms to apply for grant.

Part 3

Administration of the schemes

How are the schemes marketed, and what is the pattern of take-up?

3.1 The Department provide general publicity material on their regional grant schemes. Investment promoters such as the Regional Development Agencies and Invest UK and information on departmental and regional websites also give a public visibility to the scheme. But the schemes are not actively marketed to particular sectors or geographical areas. There is no general plan for the desired distribution of grant awards to sectors or areas although the Department do monitor the pattern of distribution. Under European Community rules, grant must be available equally to all eligible sectors and it is not therefore permissible to limit grant to specific sectors. Around 50 per cent of the schemes budget, however, is allocated to the Regional Development Agencies, and is available to support their Regional Economic Strategies.

Sectoral availability

Regional Selective Assistance guidelines state that:

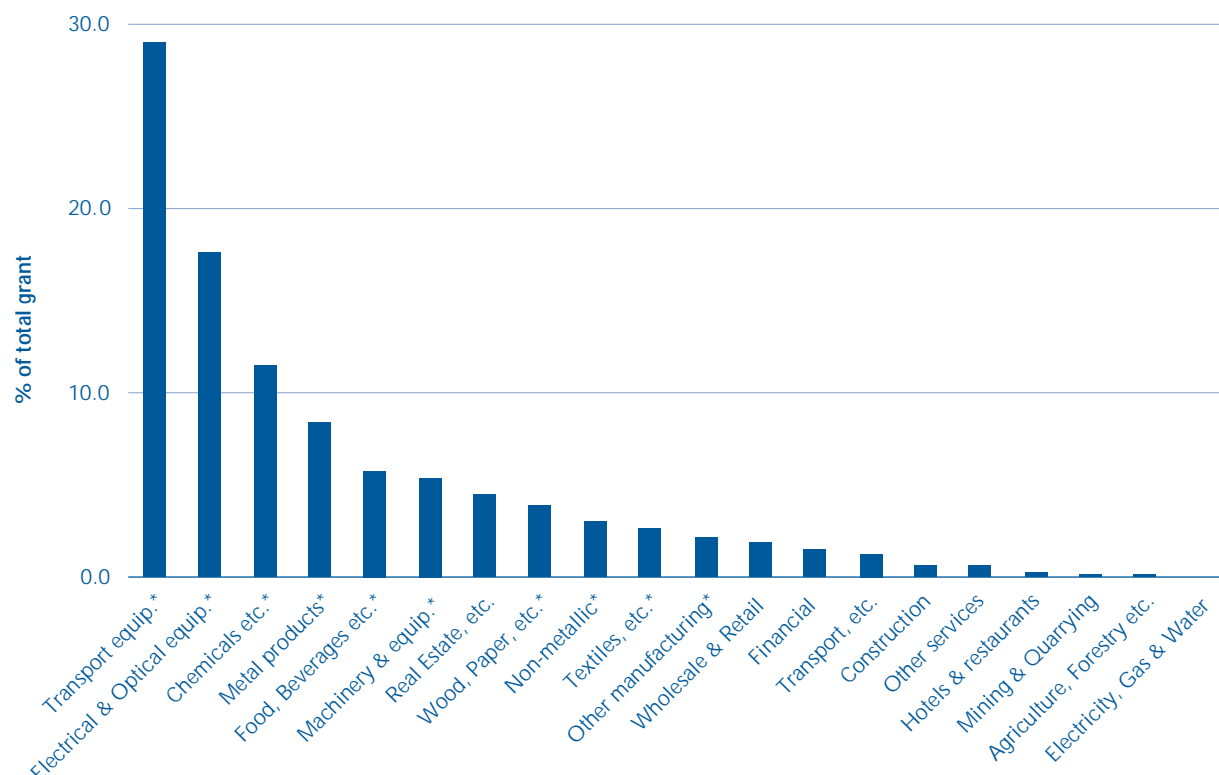
"The appraisal criteria will rule out assistance to most consumer type services serving a purely local market, because of their displacement effects. Such services will not be eligible for assistance in the normal situation where a region as a whole is adequately provided with the service concerned."

3.2 **Figure 7 overleaf** shows that, by value, offers of Regional Selective Assistance are dominated by a relatively small number of industrial sectors. Manufacturing sectors are the main beneficiaries of grant both by number and by

value, with 82 per cent of applications and 84 per cent of offers falling in the manufacturing sector, representing 90 per cent and 89 per cent respectively, by value of grant. The Trade and Industry Committee (Fourth report, 1995) recommended that the Department reconsider the criteria for awarding Regional Selective Assistance to service sector projects, taking particular account of business services which may contribute to the competitiveness of local firms. The Department agreed that it would be advantageous to support service projects, provided they could demonstrate a net national benefit, but have observed that many service projects serving local markets would merely displace jobs in other firms. It is nonetheless striking that the service sector has grown nationally by some 30 per cent since 1994 while manufacturing output has remained constant - but manufacturing firms have continued to dominate Regional Selective Assistance.

3.3 This pattern of assistance gave rise to a concern that the history and design of Regional Selective Assistance favoured traditional manufacturing industry and was less well suited to promoting modern, high technology industry and services - notwithstanding the added emphasis given to high quality projects and competitiveness from 1998 onwards. Part of the response has been to allow, where necessary, higher levels of aid, where capital spend is low but where jobs will be created. The new capability to take into account salary costs, which tend to be higher in Research, Technology and Design based projects, should afford more scope to support more high quality, value added projects. The scheme therefore now provides for support to a wider range of projects and sectors, but perceptions and use of the scheme continue, to a large extent, to reflect its original orientation.

7 Distribution of Regional Selective Assistance in England, by Sector: 1994-2002 (by value of grant)



NOTE

Categories marked with an * are classified as manufacturing.

Source: NAO Analysis

Repeat applications

3.4 Under Regional Selective Assistance rules, grants should be provided only to companies that are viable and to projects that *"should have a good prospect of being self-sustaining within a few years."* The Department are concerned that some companies could become 'grant reliant', applying for and receiving several grants. This is of particular concern where grant is given to safeguard jobs that have previously been created or safeguarded with grant assistance. The Guidelines state that *"To give assistance more than once on the same jobs can rarely be justified"*; yet they allow for factors such as *"the desirability of the new project in regional and industrial terms"*, thus placing the onus of balancing value for money against the possible loss of jobs on the judgement of regional officials. This issue was considered in the rationale for Enterprise Grant, which states that once a company has received total grant of £75,000, they may not apply for any further Enterprise Grant.

3.5 The evaluation of Regional Selective Assistance grants offered between 1985 and 1988 showed that 30 per cent of firms sampled had received previous grants. These were mainly larger cases and accounted for 40 per cent of grant payments made. Our analysis of Regional Selective Assistance applications received between April 1994 and March 2002, showed that some 12 per cent of all companies with accepted offers were in receipt of more than one grant, representing around 31 per cent of the total value of offers accepted. The Department addressed this issue in the design of the Enterprise Grant scheme, by initially allowing one application only, although this was subsequently changed to allow more than one, but only within the maximum grant ceiling of £75,000. For Regional Selective Assistance, the Department state that around two thirds of the value of repeat applications is accounted for by a small number of motor vehicle cases - the subject of intense international competition and that the remaining cases do not justify such a restriction.

CASE EXAMPLE 1

Freshway Foods: Wolverhampton, West Midlands

Although this company has grown rapidly and successfully, this growth has been supported by a number of grant awards and there is a danger that the company is becoming grant dependent.

In 1995, the Company was operating as a small family business processing seafoods and sandwich fillings. Since then, they have received five separate grant awards:

1995	£10,000	Regional Selective Assistance; to support project expenditure of £41,000 and the creation of three new jobs;
1996	£35,000	Regional Selective Assistance; to support project expenditure of £106,000 and the creation of eight new jobs and the safeguarding of five;
1997	£35,000	Regional Selective Assistance; to support project expenditure of £210,000 and the creation of ten new jobs;
1998	£95,000	Regional Selective Assistance; to support project expenditure of £450,000 and the creation of 38 new jobs;
2000	£70,000	Enterprise Grant; to support project expenditure of £499,000. Enterprise Grant does not require the creation of new jobs as a condition of grant.

All of these grants were aimed at expanding the company's capabilities for the production and storage of sandwiches, sandwich fillings and seafoods, either through the purchase of new equipment or through expansion of the factory. Nevertheless, these repeated small awards would not have been allowed under Enterprise Grant rules, where a company's eligibility ceases once it has received total grant of £75,000.

Although officials had some doubts, when appraising the fourth of these grants, over the continued need for grant, the company claimed, in each case, that the project would not go ahead without grant because of the lack of funding and the financial risk. Over the period the company invested around £1.5 million and grew from 33 employees to 215, far exceeding the employment targets attached to the grants.

- 3.6 In this case, the company has said that the grants made a valuable contribution to the success of the respective projects enabling the levels of growth and employment to be achieved quicker than would otherwise have been possible. In most instances, the company exceeded the forecast capital expenditure and the grant provided a buffer against such cost variances.
- 3.7 There are mixed views over the benefits of such cases. Repeat applications can be seen as an indicator of successful assisted growth. However, repeat applications may be a concern because:
- the provision of further grants is contrary to the Department's aim of encouraging self-sustaining projects;
 - a 'grant culture' may be encouraged and companies may become 'grant dependent';
 - applying for grant becomes a business skill. Those who have received grant once may be better placed to receive grant again, producing a biased system which effectively favours a small number of companies over their competitors; and
 - Departmental evaluations are based on the total number of jobs created or safeguarded by the scheme. Where grant is used to safeguard jobs that have already been created by grant, the jobs may be counted twice in any evaluation, enhancing the results and distorting the overall assessment of value for money.

CASE EXAMPLE 2

Mueller Europe Ltd: Bilston, West Midlands.

Although the company had a traditional base in the West Midlands, the Department considered that there was a real risk that they would move their activities elsewhere.

The Company received a Regional Selective Assistance grant of £2.25 million (plus other local support of £250,000) in 2000, to modernise and rationalise their copper tube plant in Bilston. Prior to the project, the company employed 381 staff at the Bilston plant and the project involved safeguarding half of these jobs, at a cost per job of just over £11,700, whilst losing the other half. The total eligible expenditure was £23.8 million.

The Bilston plant originally operated as Wednesbury Tube Ltd and was taken over, in 1997, by Mueller Industries Inc. an American company, operating from 19 sites in the United States, Canada, France and the United Kingdom, and the largest producer of copper tubing in the world. However, the Bilston facility was loss making, which was attributed to the inefficiency of operating antiquated machinery. The project aimed to transform the plant into one of Europe's most productive copper tube facilities through the purchase of state of the art copper casting and extrusion equipment. The site would also become the company's European headquarters and as such would absorb increasing business from European manufacturers.

The company had already identified an alternative site in Northern France, for which they had received an indicative offer of incentives comprising direct cash, training and tax benefits amounting to £4.9 million. The Company had also held discussions with the National Assembly for Wales and the Welsh Development Agency where grant of £3.25 million was believed to be available.

The judgement of the need for grant to retain the company in the West Midlands was based on the availability of these other offers and the importance of retaining jobs in a locality in which two wards are ranked in the top ten per cent of deprived wards in England. The Regional Development Agency also considered the case to be fully in line with their Regional Economic Strategy - with engineering as a priority sector and the retention of Mueller in the United Kingdom was also predicted to improve exports and import substitution.



How do staff apply tests of additionality and displacement?

Additionality

- 3.8 For Regional Selective Assistance to be offered, scheme criteria require that a company must prove that their project is 'additional' i.e. that without assistance the project would not take place in the Assisted Area (Figure 5). In the majority of cases, companies base their claim on the argument that without grant support, the project (and the associated investment and jobs) would be located elsewhere, usually overseas. Alternatively, companies may argue that their internal group policies require a certain rate of return on the investment and that this is unachievable without grant support to reduce their costs. The unavailability or unaffordability of project finance is a variant of this argument. The example opposite illustrates the sorts of arguments advanced.
- 3.9 In assessing the applications staff obtain detailed costings for any proposed alternative locations and documentary evidence of company plans and policies in order to assess the reasonableness of such arguments. The final decision, however, can never be more than a subjective judgement. Officials must form a view on the credibility of the various courses of action open to the applicant, keeping in mind the possible missed opportunities to disadvantaged communities, if the project moves away. Evaluations of the scheme have estimated that only around half of the jobs in accepted projects have in fact been additional. These additional jobs accounted for around 60 per cent of total grant paid, reflecting greater additionality in respect of larger projects.

Displacement

- 3.10 In appraising grant applications, staff have to assess the likely displacement of jobs within the Assisted Area which might arise from assisted projects. Such assessments are made by reference to general sectoral circumstances - for example, European aid rules prohibit regional assistance to sectors such as coal and steel, where there is already European over-capacity. And scheme guidelines suggest that displacement will normally be severe for purely local retail and service enterprises. In other circumstances, regional officials refer to market information and knowledge of the specific sector but they have no special expertise to assess this information. Help on such assessments is provided centrally by the Department's sectoral economy teams, and where necessary, by other government departments such as the Department for the Environment, Food and Rural Affairs. But, over the years, the Department have reduced their central contribution to market assessment and there is some concern that regional staff no longer have access to the necessary

detailed market information, across various sectors. As a result, officials often have to rely, in part, on information provided by applicants to assess market circumstances and growth potential. Departmental evaluations have estimated that a quarter of additional assisted jobs displace other jobs in Assisted Areas. The Department acknowledged that the level of sectoral advice could vary. However, the internal review of their Business Relationship organisation was expected to bring improvements in this area in the future.

Do the structures, systems and staff skills support effective management of the schemes?

Lack of integration

- 3.11 The guidelines for Regional Selective Assistance describe it *"... as assistance of last resort. This means that all commercial sources and other public sector funding should be explored fully before considering eligibility for Regional Selective Assistance."* However, many staff felt that consultants and agents, employed by companies to advise them on their applications, had insufficient knowledge of the full range of support mechanisms available, from both the public and private sectors. This problem was exacerbated by the range of assistance mechanisms operated by the Government Offices, Regional Development Agencies, the Small Business Service, Local Authorities and others, with the result that few individual officials had a full picture of all the public sector support available. The multiplicity of schemes is one of the main drivers of the Department's current review of their Business Support activities.
- 3.12 In April 2002, the Department transferred responsibility for Regional Selective Assistance grants of less than £2 million to the Regional Development Agencies and for Enterprise Grants to the Small Business Service. Previously, Government Offices had administered both grants. Grants in excess of £2 million were, and continue to be, the responsibility of the Department centrally. Regional pilot schemes were also planned, starting in 2002, moving the administration of the Small Business Service business advice agencies - the Business Links - to the Regional Development Agencies. The Department intended that these changes would provide benefits for applicants by bringing responsibility for a number of support mechanisms under one roof. These transfers have, however, meant the loss of experienced appraisal staff who, in many cases, have chosen not to transfer to the Regional Development Agencies. The Department expect that the continuing review of their Business Support services will bring further improvements in their communication with business.

Regional variations in appraisal of Enterprise Grants

3.13 The specification of Enterprise Grants requires regions to address a core set of criteria, but regions are free to give differing emphases to the criteria, or to add further criteria. In the North East, they see Enterprise Grants as a 'cushion' against the risks inherent in the project. A company that has a 'cash gap' in the planned funding of their project would be refused grant on the basis that the project may be non-viable. However, in the South West, Enterprise Grants are seen as simply another piece of the funding 'jigsaw', and such a company would receive grant on the basis that the project would not be able to go ahead without it. The North East region also apply a formal job creation criterion to Enterprise Grant applications, even though this is not a requirement of the scheme. East Midlands have set a minimum limit on capital expenditure of £30,000, on the basis that anything less than the £4,500 grant available, (at 15 per cent) would be unlikely to influence the company's investment decision, thus negating the additionality argument. Other regions do not apply a minimum grant level because they argue that although it may appear marginal, £5,000 could make a difference to small companies because the banks will feel more comfortable. The Department were, however, comfortable with such variations given the small scale of the projects. The scheme was launched with the aim of having greater flexibility to meet regional preferences.

Do the schemes minimise transaction costs to both applicants and the Department?

3.14 Over the years, there have been considerable concerns over the complexity of the Regional Selective Assistance appraisal process and the burden that this places on both the Departmental staff and applicants. In 1995, the Trade and Industry Committee recommended that the Department make a more systematic attempt to simplify Regional Selective Assistance procedures and reduce the cost to firms of applying. The Department responded in 1995-96 with a number of simplifications and increases in the thresholds for some specific elements of the appraisal procedure. Wherever possible, they seek to work with the applicant's internal documentation, in order to minimise costs.

The Committee's recommendation was also a factor in the design of the Enterprise Grant scheme and further changes have continued to be made, for example, in raising the threshold for the full economic appraisal, carried out by the Department centrally, from £1 million grant to £2 million.

3.15 The application process for a Regional Selective Assistance award is extensive, with company directors and their staff needing to devote considerable time to the application process. The companies we visited had not kept detailed analyses of the costs incurred by them in the application process - which reflects the Department's experience. Nevertheless, they indicated that the overall costs could be substantial. In the absence of firmer information on companies costs, the Department estimate that they are probably about five per cent of the grant awarded - broadly in line with the example opposite - which estimates total company costs at around six per cent.

3.16 Whilst the Department have produced partial costings for their administrative effort in supporting Regional Selective Assistance, which they estimate to be around two and a half per cent, they accept that these do not include items such as head office accommodation costs, central services and staff overheads. In discussions with the Department, we have sought to build on this estimate, and based on the number of staff involved in appraising and monitoring Regional Selective Assistance projects in the regions and in London, we estimate their administrative costs to be around five per cent of programme costs.

3.17 For smaller grant applications, and Enterprise Grant, the Department have recommended that staff apply a 'lighter touch' to their appraisals, particularly in respect of additionality. To assist this process, regional offices try to have as much involvement with prospective applicants as possible, to advise them on the presentation of their project and the information that will be required, before they submit a formal application. However, this approach is not always practicable, especially where the company has employed consultants to advise them, and the initial application is often unsatisfactory and requires further information and amendments to be made. No information on the costs of administering Enterprise Grants has been collated.

CASE EXAMPLE 3

Proctor and Gamble Technical Centre: Newcastle upon Tyne: North East

A Regional Selective Assistance grant of £1.85 million was awarded in May 2001 to support the development of a Research and Design centre in Newcastle. The project was expected to create 69 new jobs and safeguard 58, at a cost per job of £14,567. The project is still ongoing and as at July 2002, £300,000 had been paid. The 58 jobs had been safeguarded and 41 of the new jobs had been created.

Proctor and Gamble were looking either to re-locate work undertaken in Mexico to their existing plant in Newcastle, or to transfer both the Mexican and Newcastle work to a small existing Technical Centre in Beijing. This latter option would have been considerably cheaper and the Regional Selective Assistance grant represented around 60 per cent of the costs incurred by the company by remaining in Newcastle. The company felt that the remaining additional cost was justified by the advantages of retaining a presence in England. As part of this project, the Company has transferred 22 staff and their families from Mexico to the Newcastle plant.

However, Procter and Gamble felt that the application process was very difficult - their internal costs of applying were estimated at around £50,000 to £75,000 and their consultant's fees at nearly £50,000. The requirements of forecasting expenditure allocations were difficult since the nature of the project was bound to change as it progressed and in addition, the company had to redraw its accounts, which are normally prepared in an entirely different format, for Latin America and Beijing as well as for this site. The company felt that the capital spend and jobs criteria were old-fashioned, since expenditure on this kind of project goes mainly on services, salaries and materials. Although the Government Office were very supportive in allowing flexibility in meeting the detailed targets once the project had begun, the company felt that this was only necessary because of the unrealistic stringency of the forecasts required at appraisal stage.



3.18 Our analysis of Regional Selective Assistance applications received between April 1994 and March 2002, shows that of the 7,279 offers that were made, 20 per cent were either declined by the company or were initially accepted but then did not actually go ahead. The reasons for rejecting an offer of grant, after going through the full application process are unclear but may be due to a change in circumstances either with parent companies or changes in the market. Smaller companies, it is claimed,

are often put off by the duration of the conditions period, set by the European Community, which extends for five years from the first grant payment and during which jobs should be maintained or grant repaid. A greater understanding of the reasons for such rejections would enable steps to be taken to minimise the wasted effort and to ensure that the scheme can be tailored to address better the needs of applicants.



Part 4

The impact of the schemes

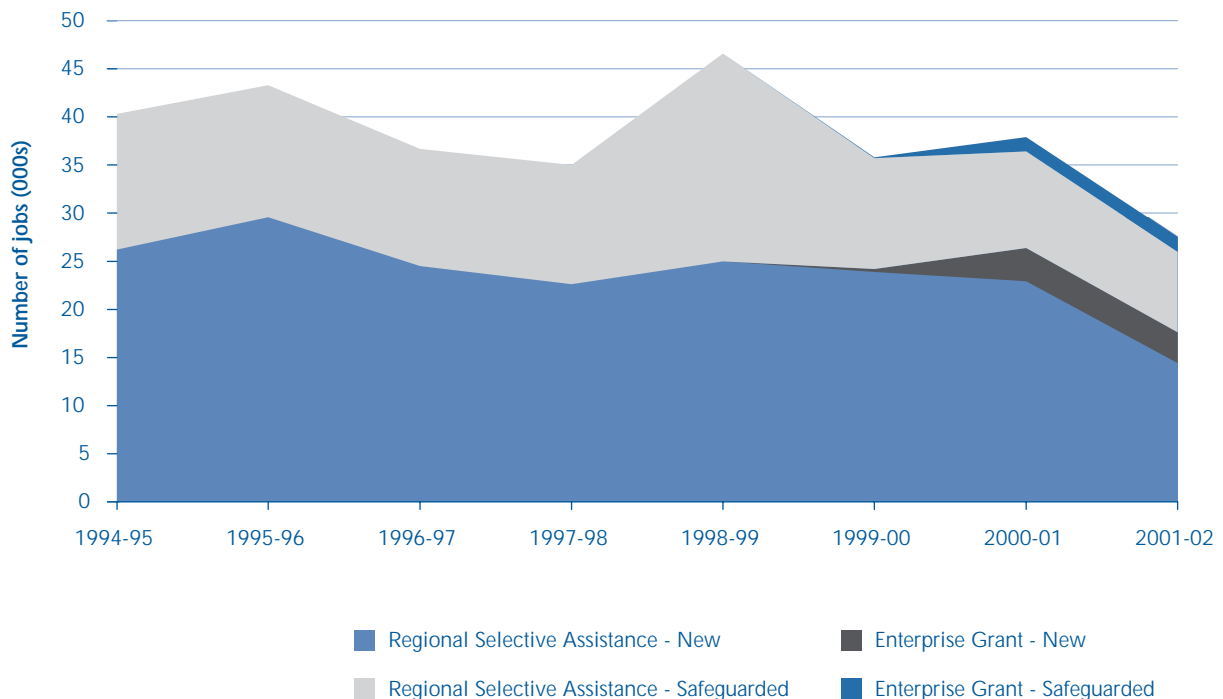
4.1 The Department collect information on the pattern and results of regional grant awards from two main sources. Their management information systems provide activity and output data, which are summarised in routine monthly reports. Periodically, deeper research and evaluation studies assess the broader effect of regional grants.

Grant awards and project results

4.2 Nearly 7,300 Regional Selective Assistance offers were made in respect of applications received, in England, in the period 1994-2002, and 1,300

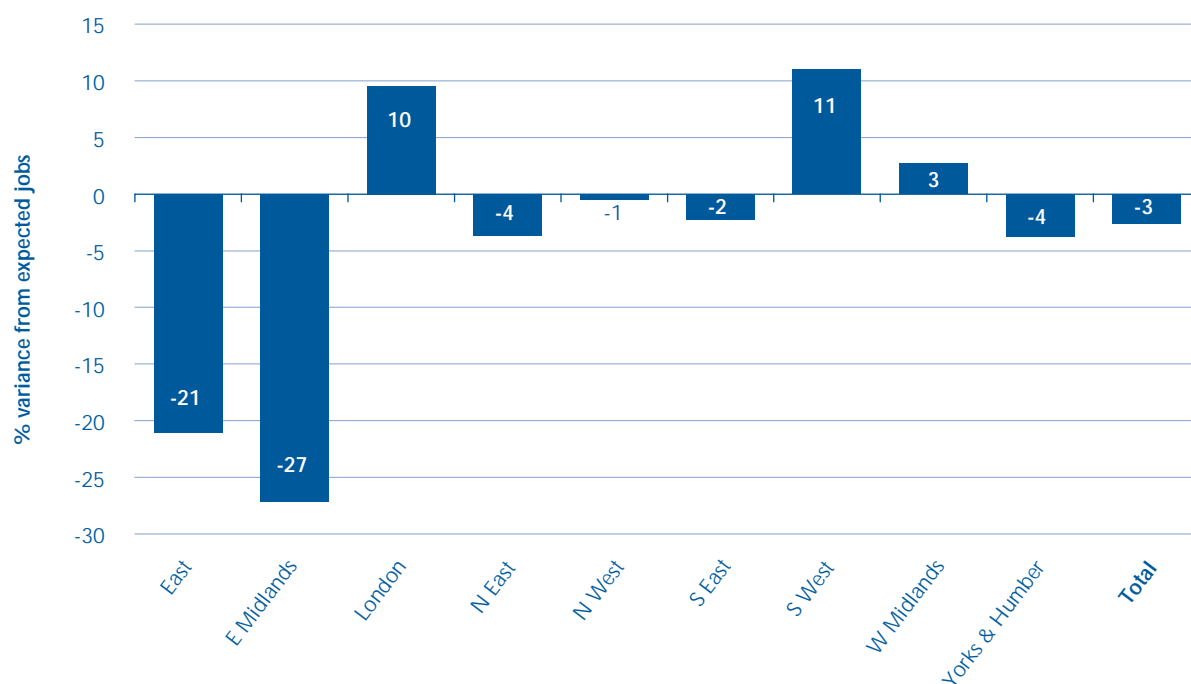
Enterprise Grant offers were made in respect of applications received between January 2000 and March 2002. These offers were expected to create or safeguard a total of around 303,000 jobs. Of these, 196,000 (or 65 per cent) were new jobs and 107,000 (35 per cent) safeguarded. **Figure 8** illustrates the annual breakdown of expected jobs over that period and shows that, with the exception of 1998-99, the total number of jobs expected (represented by the uppermost line of the graph) has been falling fairly steadily, reaching a level of around 27,500 in 2001-02. Full analyses of the applications received are given in Appendix 4.

8 Expected New and Safeguarded jobs: Regional Selective Assistance and Enterprise Grant in England: 1994-2002



Source: NAO Analysis

9 Jobs achieved as a percentage of those expected (at Offer): 1994-2002



Source: NAO Analysis

- 4.3 Of the 7,300 Regional Selective Assistance offers, just over 3,000 projects had been completed at the time of our analysis, which were expected to create or safeguard a total of nearly 69,000 jobs. **Figure 9** shows the variance between jobs achieved by each region and those expected. It shows that in total 97 per cent (67,000) of these expected jobs were achieved. However, there were some significant regional variations in this performance, with the East Midlands achieving 27 per cent fewer jobs than expected while the South West achieved 11 per cent more.

- 1991-1995 - produced by Arup Economics & Planning in 2000 (Evaluation of Regional Selective Assistance, 1991-95).

Starting with King's study, the three evaluations developed and refined a methodology.

- 4.5 **Figure 10** shows estimates of the key results based on the two latest evaluations, which concluded that the cost effectiveness of Regional Selective Assistance had been maintained at or around the same level as achieved in the early 1980s and that it was an important instrument to attract inward investment that would otherwise have been located in other parts of the world. The evaluation for 1985-88 concluded that Regional Selective Assistance had reduced the unemployment rate in the Assisted Areas by half of one percentage point.

Have the Department carried out periodic evaluations of their achievements?

- 4.4 The Enterprise Grant scheme was introduced in January 2000 and to date no evaluation has been made. There have been three evaluations of Regional Selective Assistance covering the following periods:

- 1980-1984 - produced by J King in 1990 (Regional Selective Assistance, HMSO, London);
- 1985-1988 - produced by PA Cambridge Economic Consultants Ltd. in 1993 (Regional Selective Assistance, HMSO, London);

Do these results provide a basis to assess the effectiveness of the schemes?

- 4.6 The last two evaluations have established a consistent methodology based on the main objective of Regional Selective Assistance to create or safeguard jobs in Assisted Areas. Indeed it was one of the constraints on their terms of reference that their findings should be comparable with those of earlier evaluations. We consider that the evaluations were competently executed in accordance with the specification and that

10 Estimates of key results, for England, based on the last two Regional Selective Assistance evaluations

	1985-88	1991-95
Project offers	3,788	3,847
Project value	£4.3 billion	£3.8 billion
Grant value (outturn prices)	£432 million (10 per cent of project value)	£494 million (13 per cent of project value)
Gross jobs	120,000	111,000
Gross permanent job equivalents	67,000	52,000
Job additionality	48 per cent	45 per cent
Displaced jobs in the Assisted Areas	33% of additional jobs	24% of additional jobs
Linkage and multiplier factors	1.29	1.18
Net permanent job equivalents (allowing for additionality, displacement etc)	28,000	21,000
Net cost per net job (at 2002 prices)	£21,500	£21,000

Source: NAO Analysis of Departmental evaluations⁴

they were substantially more thorough and soundly based than the evaluations of regional programmes carried out by other European countries. Few of these had addressed additionality or displacement at all. On the other hand, we have highlighted a number of ways in which the evaluations could cater for a greater range of known interactions, and which could yield a deeper insight into scheme effects.

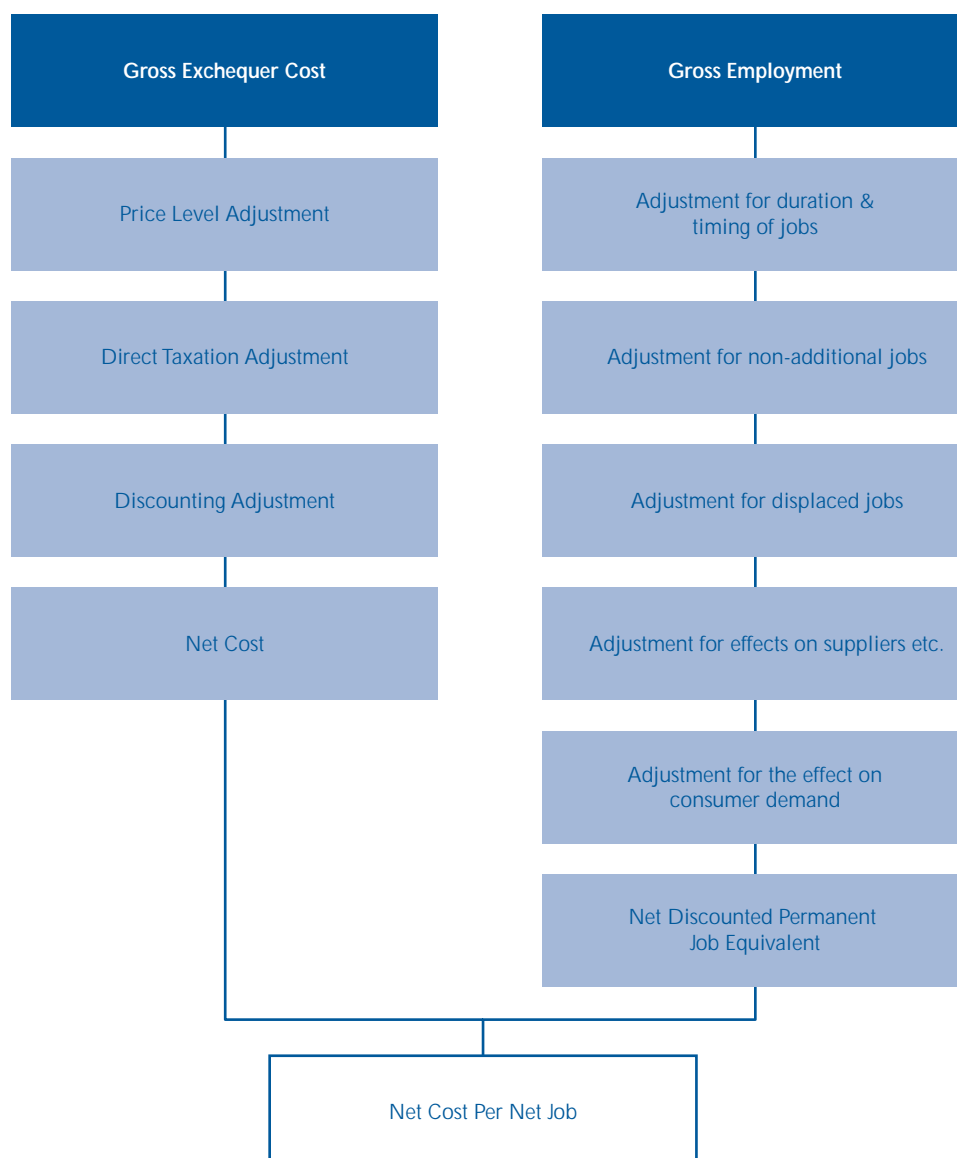
- 4.7 The evaluations have concentrated on the estimation of the Net Cost Per Net Job, so as to provide an indicator of the cost effectiveness of the program. This estimate is based on the gross number of jobs created or safeguarded by the projects and the total grant funds used to achieve them, discounted for a number of factors as shown in [Figure 11](#). There are however, no comparators for this estimate either in terms of the scale of impact planned or for the relative costs of other employment schemes. This estimate cannot, therefore, be used to assess relative value for money. The evaluations address only the effects of assistance awarded: they do not aim to assess the extent to which decisions to reject grant applications were justified, or to probe the reasons for project withdrawal or company failure. The findings of the evaluations have been put to Ministers for consideration and they have given their support to the continuation of the programme.

- 4.8 We reviewed the detail of the methodology used and the reasonableness of the assumptions made. We identified that different assumptions or approaches could materially affect the evaluation results as follows:

- The evaluation of employment effects and costs excluded any changes in employment outside the Assisted Areas. Direct or indirect displacement (or creation) of employment outside the Assisted Areas was not included as either a cost or benefit.
- All jobs were given equal value so long as they had the same expected life. No distinction was made between new or safeguarded jobs, or between various quality dimensions of the jobs created, for example, average levels of skills or value-added per worker.
- The evaluation did not consider any other sources of public support and funding received by Regional Selective Assistance projects, for example local authority support, or help with infrastructure or training, because there were no readily accessible records.
- The evaluations were not asked to address administrative costs incurred by either applicant or Department. We estimate, on the limited information available, such costs to sum to an

⁴ Figures for project offers and grant values have been taken from the evaluations. Figures for gross jobs, gross permanent job equivalents and net permanent job equivalents have been pro-rated according to the Department's estimate of the total jobs expected from offers made during that period. Figures for additionality, displacement and linkage and multiplier effects are taken from the evaluation findings for Great Britain as a whole. The Department have no separate information on these factors for England only.

11 The sequence of adjustments to obtain the Net Cost Per Net Job



Source: NERA analysis, based on Arup "Evaluation of Regional Selective Assistance, 1991-95"

average of about 10 per cent in England, recognising that there is not likely to be a linear relationship between costs and size of grant.

- The evaluations recognised that surveying successful applicants about the level of additionality could lead to a strategic bias. While the last two evaluations have adjusted additionality downwards to counter that bias, we believe that greater adjustments would be needed to eliminate it.
- The evaluations based the expected lifetime of additional jobs on the expected life of the associated capital investments. But the actual time for which jobs remain additional can be considerably different from that assumed in the evaluations - which affect estimates of scheme impacts.

- In the absence of good local data, the method assumed that wages and prices in local labour markets were not affected by the number of jobs created by Regional Selective Assistance projects.

4.9 If job creation and displacement outside the Assisted Area were considered this would give a better sense of national benefit at the expense of a less close focus of the effects in Assisted Areas, which is the aim of the policy. Such an approach would almost certainly cut the number of additional jobs and increase their unit cost. The effect of attaching a weighting to the quality or nature of jobs created is less clear although all other things being equal, higher skilled, higher paid jobs are more likely to increase productivity and competitiveness.

- 4.10 On additionality, the 1991-95 evaluation suggests that only about 45 per cent of the jobs supported were additional, a low level compared to other Departmental grant programmes. Overall, projects creating jobs demonstrated higher additionality than those safeguarding existing jobs. And large projects showed slightly higher than average levels of additionality - particularly when creating jobs, when for the largest projects additionality rose to 63 per cent. Additionality has been estimated from survey responses from assisted companies. The evaluators recognised the likely presence of strategic bias from respondents - that firms would see it as in their interest to confirm the claims they made for the need for grant when they submitted their application for assistance - and incorporated questions in the survey with the aim of cross-checking of firms' estimates of additionality.
- 4.11 The last two evaluations have been particularly concerned with claims that projects, without grant, would have gone ahead abroad - although there are differences in treatment between the evaluations. In the latest evaluation, interviewers' suspicions about firms' claims that projects would, without grant, have gone ahead in other parts of the European Union led to sensitivity analysis, rather than an adjustment of the evaluator's estimate of additionality, as in the previous evaluation. The sensitivity analysis provided for a reduction in firms' claims for additionality by 25 percentage points. The previous evaluation reduced firms claims in such circumstances by 40 percentage points.
- 4.12 A review of the academic literature on bias in survey responses, on the effect of assistance on employment over time, and previous evaluation reports, provide some support for a more sceptical view of additionality. The difficulty of using survey methods to gauge a value where a respondent has an incentive to answer strategically in their self-interest is well established, and studies have shown the difference between asserted values and actual values, where they can be checked, can be large. Carefully framed and implemented surveys, such as that underpinning the latest evaluation, can counter inconsistencies in a firm's response. But they cannot deal with aspects of bias resting on a firm's judgements on the basis of consistent facts. A survey approach is therefore unlikely to fully establish the scale of bias present.
- 4.13 The methodology for estimating additionality and impact takes account of the length of time over which additional employment effects are deemed to last. Research carried out into the effects of a range of assistance in the period 1975-1981 in the North East⁵, indicated that the employment effects decreased over time, as the action of external factors caused firms to change their business independently of the effects of assistance. The research found that five years after assistance was given, employment effects fell to less than five per cent (large firms) and 25 per cent (small firms) of peak values. Such findings need to be interpreted with caution in relating them to more recent assistance. First, although the research design provided a degree of resilience to market circumstances, the recession of the early 1980s may have affected the results. Secondly, Regional Selective Assistance has been modified since the date of the research, making it likely to demonstrate higher levels of additionality, although not necessarily less susceptible to the effects of external factors in eroding that performance over time. These circumstances militate in favour of longer estimates of the life of employment effects. But the research nevertheless questions the reliability of the evaluation assumption that additional job life can be associated with the life of assisted assets, and raises concerns that the 10 year average job life resulting from that assumption is too long. But more research would be required before substituting a different number.
- 4.14 The evaluation approach could also be changed to capture a wider range of possible scheme effects. In the most recent evaluation methodology, the evaluator did not take into account the effect of additional jobs on the workings of local labour markets - there was no full set of regional economic models on which to draw. But recent research⁶, using a model in which wage rates and labour supply can vary in response to the creation of additional jobs, shows that such changes can have material effects on the estimates of the net number of additional jobs resulting. The main conclusions of this research were:
- in the short or medium term, the assumption of local wage bargaining in a model with flexible labour markets, suggests that the effect of regional grants on job creation will be about 44 - 69 per cent (depending on the extent to which workers migrate between regions) of the effect projected by the model on which the evaluations are based which assumes no impact on local wages and prices;

5 C. Wren: "The build-up and duration of subsidy-induced employment: evidence from UK regional policy", *Journal of Regional Science*, 1994, Vol 34 pp 387-410. In reporting, this research did not distinguish between Regional Development Grant and Regional Selective Assistance (including local authority grants) results for large firms, because it found no significant differences between them. It did conclude, however, that lower employment effects were found when firms could more easily substitute private for public funds. These were the type of cases for which changes in eligibility criteria in 1980 were intended to deny grant.

6 G. Gillespie, P. McGregor, J.K. Swales and Y.P. Yin, "The Displacement and Multiplier Effects of Regional Selective Assistance: A Computable General Equilibrium Analysis", *Regional Studies*, 2001, Vol 35, pp125-139.

- this effect is calculated for the region as a whole - only a proportion of the extra jobs displaced within the Region will fall within Assisted Areas. That proportion will vary according to the circumstances of each Area;
- where wage or unemployment differentials cause workers to migrate to other regions, the long-term estimates of job creation resulting from fixed and flexible wages are similar.

In considering these factors in the round, the evaluations to date may overestimate scheme impacts. Changes to the methodology that reflect more reliably the points above could reduce the estimate of net discounted permanent job equivalents and increase the net exchequer cost per net job. It is difficult to quantify the potential impact of any such changes because of the absence of sufficiently broad and up-to-date research that captures the dynamics of regional and Assisted Area economies.

Competitiveness and Internationally Mobile Investment

4.15 As long ago as 1995, the Trade and Industry Committee recommended that the Department develop a methodology which would permit a better assessment of the effect of regional policy on the competitiveness of firms and regions and that they place this at the heart of their evaluation of regional policy. They also recommended that the Department should examine how techniques and concepts of cost benefit analysis could be incorporated into the evaluation of regional policy. The Department stated that they would consider whether any further refinement of their evaluation methodology were necessary. Subsequently, they chose to maintain the approach they had used previously because in the period covered by the most recent evaluation, covering projects completed between 1991 and 1995, it was not a requirement for scheme appraisals to take competitiveness into account.

4.16 Issues of competitiveness were later addressed in the 1998 Competitiveness White Paper. The latest evaluation, published in 2000, showed that around three-quarters of assisted firms thought they had gained a competitive advantage. And half of those identifying an advantage attributed that to product innovations, and around a third to financial benefits. The evaluation did not seek evidence of the scale of such benefits, however, or explore the impact of grant on productivity - now a key policy objective.

4.17 The Department commissioned a report, *"Productivity Contribution of the Major Department Programmes and their Value for Money"* in 2002. This report drew on Departmental evaluations from a number of schemes and programmes to rate Regional Selective

Assistance's success in promoting productivity improvements. The review found that the scheme did not have objectives or rationale strongly oriented towards productivity improvement. And while they found some evidence of productivity improvement effects, they were relatively small in comparison to scheme expenditure. Regional Selective Assistance therefore received a low value-for-money rating on its contribution to improving productivity.

4.18 Regional Selective Assistance continues to be regarded as an important way to attract mobile international investment. Foreign-owned companies with quality projects often demonstrate innovation and promote successful management methods that feed into the indigenous businesses in the area, raising competitiveness, regionally and nationally. They also train staff and are instrumental in encouraging the introduction of more cost effective management systems by their suppliers. The 2002 Annual Report on the Industrial Development Act 1982, shows that while only 11 per cent of grant offers accepted by companies in the ten years to March 2002 were made to foreign-owned companies, those offers amounted to 53 per cent of the total grant offered.

4.19 We asked NERA to review the literature on the impact of Regional Selective Assistance and inward investment on productivity and competitiveness. Their conclusions were:

- Compared with all plants in the United Kingdom, those that received Regional Selective Assistance had lower levels of total productivity both prior to and after receiving grant. Their productivity increased after receiving grant, but by less than the original deficit.
- Foreign-owned plants receiving Regional Selective Assistance were nearly 10 per cent less productive than United Kingdom-owned plants receiving Regional Selective Assistance, even though foreign ownership was associated with high productivity.
- There were ambiguous results about the impact of foreign ownership on efficiency. Some analyses showed that foreign-owned plants were more efficient than domestic plants, but this might be the result of their greater scale. However, the evidence suggested that where foreign-owned plants were more efficient than their domestic counterparts, this effect was stronger in non-assisted regions than in assisted regions. Thus, to the extent that the goal of promoting inward investment was to raise efficiency, location of such investment in Assisted Areas was not ideal.

- Domestic firms gained from the presence of foreign firms, but only if they were in the same sector and region. However, less developed regions, with a larger technology gap between foreign and domestic firms gained less from such effects than other regions.

4.20 These findings suggest that there are some competitiveness and productivity benefits from inward investment supported by Regional Selective Assistance. But there is no strong evidence that the scale of benefit is substantial. And there is also evidence that there is some tension between maximising productivity and competitiveness benefits, and securing location of the investment in Assisted Areas.

Appendix 1

Study Methodology

1. The main aspects of our methodology were:

Regional Visits:

2. We visited four of the English regions:

- The South West;
- The North East;
- The East Midlands; and
- The West Midlands.

3. During each visit we:

Undertook semi-structured interviews

4. With key regional staff responsible for the administration of Regional Selective Assistance and Enterprise Grants. This involved regional policy directors from the Government Offices⁷ and from the Regional Development Agencies and the staff responsible for the appraisal and monitoring of applicants. These interviews explored the following issues:

- The role of Regional Selective Assistance and Enterprise Grants and how well they fit with the region's economic strategies;
- Opinions on how effective the grant schemes are in achieving the identified aims of job creation and promoting competitiveness and productivity;
- Complications and hurdles in the administration of the grants, and;
- The characteristics of applicants.

Visited Regional Selective Assistance/Enterprise Grant recipients

5. In every region we went to, we also visited two project sites. At these sites we could get first hand experience of projects funded by the schemes. We also interviewed the directors of the projects to discuss how the scheme had affected their company and their experience of the entire process of applying for and winning a grant award.

Conducted file reviews

6. We examined a number of Regional Selective Assistance and Enterprise Grants case files in each of the regions and in the Department headquarters in London. These file reviews enabled us to see how cases were appraised, the information requirements and investigations made by the regional offices, and the monitoring process employed to assess when payments were awarded.

Data analysis

7. We obtained and analysed data from the Department's SAMIS database for all Regional Selective Assistance applications, in England, received between 1 April 1994 and 31 March 2002 and for Enterprise Grant applications received since the start date in January 2000. April 1994 was selected as the start date for Regional Selective Assistance, because 1994-95 was the first full financial year after the changes to the Assisted Area map introduced in 1993.

Economic analysis

8. We employed the economic consulting body National Economic Research Associates (NERA). They were commissioned to review the economic aspects of the schemes, including the scheme evaluation methodology.

⁷ At the time of our visits some regions were still in the process of handing over responsibility for Regional Selective Assistance from the Government Offices to the Regional Development Agencies. Hence we interviewed staff with experience of Regional Selective Assistance in the Government Offices and at the Regional Development Agencies.

Appendix 2

Bibliography

Bibliography of recent papers on Regional Selective Assistance, Foreign Investment & Productivity

N. Driffield, M. Munday & A. Roberts	'Foreign direct investment, transactions linkages, and the performance of the domestic sector'; Working paper, Birmingham Business School, University of Birmingham, April 2002.
R. Harris & C. Robinson:	'Spillovers from foreign ownership in the United Kingdom : Estimates for UK manufacturing using the ARD'; Working paper, Department of Economics, University of Durham.
R. Harris & C. Robinson	'An analysis of current DTI industry support policies'; Working paper, DTI, April 2001.
R. Harris & C. Robinson	'Industrial policy and its effect on total factor productivity in UK manufacturing : the impact of RSA 1990-98'; Working paper, Department of Economics, University of Durham, August 2002.
J. Haskel, S. Pereira & M. Slaughter	'Does inward foreign direct investment boost the productivity of domestic firms'; Working paper, Department of Economics, Queen Mary College, London, July 2001.
F. Hubert & N. Pain	'Fiscal incentives, European integration, and the location of foreign direct investment'; Working paper, National Institute of Economic and Social Research.
F. Hubert & N. Pain	'Inward investment and technical progress in the United Kingdom'; Working paper, National Institute of Economic and Social Research.
G. Gillespie, P. McGregor, J.K. Swales & Y.P. Yin	'The Displacement and Multiplier Effects of Regional Selective Assistance: A Computable General Equilibrium Analysis'; Regional Studies, 2001, Vol 35.
S. Girma & K. Wakelin	'Are there regional spillovers from FDI in the UK'; Working paper 2000/16, Centre for Research on Globalisation and Labour Markets, University of Nottingham, 2000.
N. Oulton	'Increasing returns and externalities in the UK manufacturing : myth or reality'; Journal of Industrial Economics, Vol XLIV, March 1996.
N. Pain	'The impact of inward investment on the UK economy'; Working paper, National Institute of Economic and Social Research.
C. Wren	'The build-up and duration of subsidy-induced employment: evidence from UK regional policy'; Journal of Regional Science, 1994, Vol. 34.
C. Wren & M. Waterson	'The direct employment effects of financial assistance to industry'; Oxford Economic Papers, Vol 43, 1991.

Appendix 3

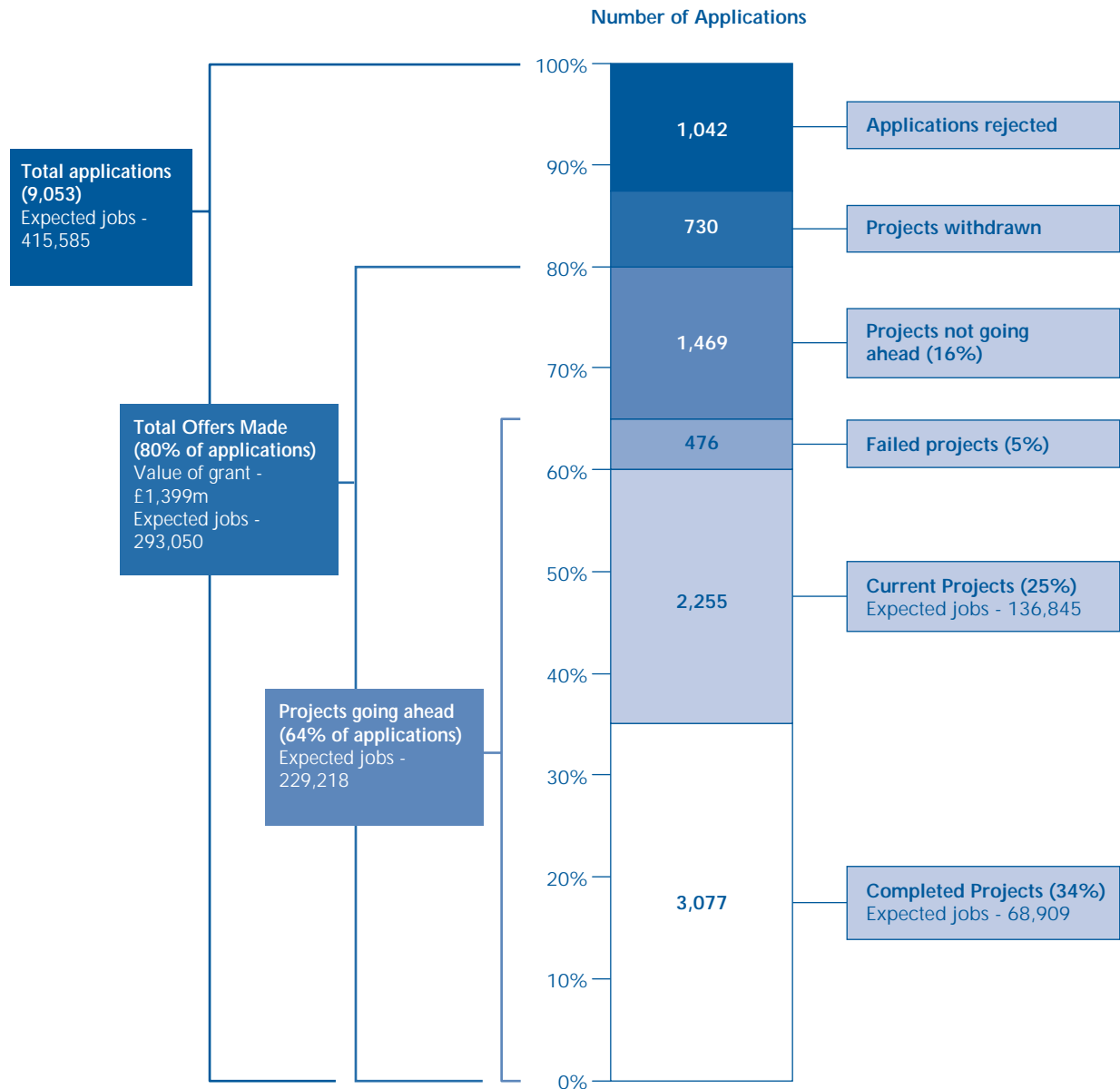
Glossary of terms

Additionality	That proportion of the scheme benefits that would not have been achieved without grant assistance.
"Additionality" criterion	The requirement for applicants to show that the project would not go ahead without grant.
Assisted Areas	Areas of relatively high unemployment and industrial decline, defined by the Department and agreed by the European Commission.
Conditions period	The period, specified by the offer of grant, during which assisted jobs and capital expenditure must be maintained, or the grant repaid.
Cost per job	The average amount of grant paid for each job created or safeguarded by an assisted project.
"Crowding out"	The process by which it is believed additional public expenditure, e.g. through effects on interest rates, will in time displace private sector investment and other private activity. Thus additional public supported investment in an Assisted Area will be at the expense of private investment there and elsewhere.
Deadweight	The proportion of grant awarded in excess of that needed for assisted projects to proceed.
Displacement	The extent to which the impact of sales by assisted projects prevents or replaces other projects and jobs. In the context of the evaluations this applies only to affected activity in the Assisted Areas.
Internationally mobile investment	Investment arising from projects which could be located in a choice of countries.
Safeguarded jobs	Existing jobs that would otherwise be lost without grant assistance.
Tier 1 and 2 areas	Divisions within the Assisted Areas determining the level of grant available (see Figure 5).
Tier 3 areas	Additional Enterprise Grant areas outside the Assisted Areas (see Figure 5).

Appendix 4

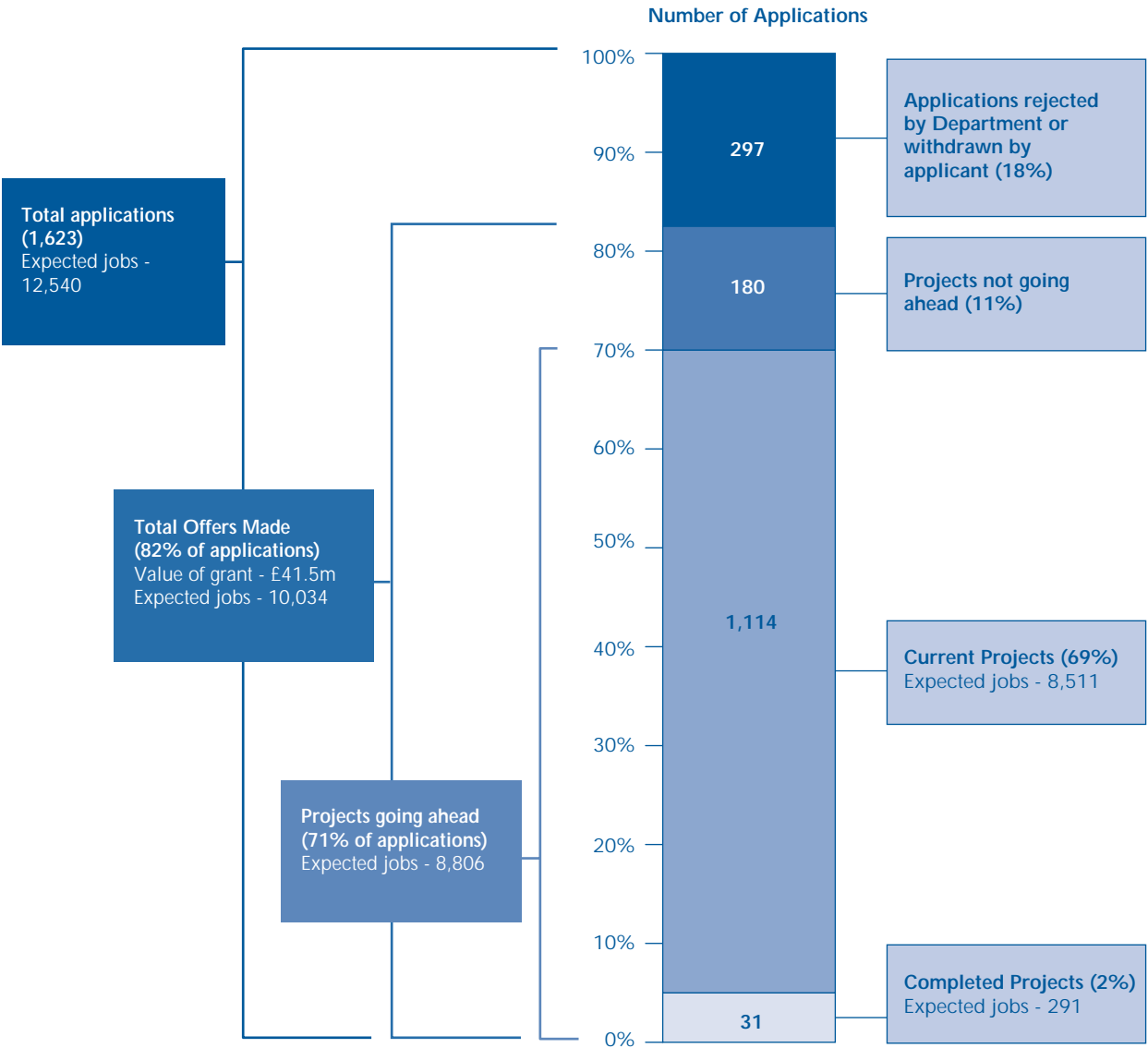
Analysis of Grant Applications

Regional Selective Assistance Applications in England: April 1994 to March 2002



Source: Departmental SAMIS database

Enterprise Grant Applications in England: January 2000 to March 2002



Source: Departmental SAMIS database