

The Department for Trade and Industry:  
**Regional Grants in England**



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL  
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# executive summary

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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 issue<sup>1</sup> 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

<sup>1</sup> 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.