Lecture 7a. RELOCE 2010

The early years: Regional policy and its effectiveness in the UK up to 1979

The early years: Regional policy and its effectiveness in the UK up to 1979

Policy

Regional policy can be Macro or Micro based

- Traditional policy in the UK has been micro rather than macro based.
- Figure 9.1 Armstrong and Taylor, 2000) shows the policy options from the macro stream. These include policies that are devolved and those controlled by central government. In addition, there are policies that seek to co-ordinate policy between and within various jurisdictions.
- Figure 9.2 Armstrong and Taylor, 2000) shows the policy options from the micro stream this subdivides into two parts policy to relocate capital and policy to relocate labour.
- Policies to relocate labour aim to either move individuals between locations or between industries and/or occupations. They need to overcome 3 problems workers responsiveness to earnings differentials, awareness, impediments to mobility all of these problems are addressed.
- Capital relocation takes two forms transfer of capacity and indigenous development. These take 4 forms fiscal measures, administrative controls, improved access to resources and improved social capital.

For more details see Armstrong and Taylor Regional Economic and Policy (2000) pp 232 - 239)

Historical development

- Policies to relocate labour have been fairly small scale (e.g. 1951 Key Workers Scheme).
- Major regional policy centred on the relocation of capital both inter-regional and in situ.
- Initially the emphasis 1945-1960 was on encouraging inter-regional movement of capital through:
  - Industrial Development Certificates (IDCs),
  - small-scale loans (and grants)
  - advance factory building on industrial estates.

- 1950-1958 – "policy off" period

- 1963 reintroduction of control of industry location - backed-up by capital grants and tax incentives to manufacturing industries in DAs. Growth poles and growth zones with emphasis on more investment in public infrastructure.

- 1966 Industrial development Act created 5 large Das. In 1967/68 labour subsidies introduced Regional Employment Premium (REP).introduced into the DAs. In 1967 Special Development Areas (SDAs).
-
- In 1972 Industry Act reintroduced investment/capital grants which had been withdrawn in 1970 (replaced by accelerated depreciation) In 1977 REP finally abolished

For an extensive overview of policy throughout the period see Armstrong and Taylor Appendix A; <u>A chronology of regional policy in Britain</u> (1928 – 92)

Rationale for IDCs

Diversion of industry to DAs was intended to help diversify the regional industrial "mix".
Relocation followed "carrot and stick" approach

- Stick - IDCs,
- Carrot - advanced factories, interest-free loans, rent free periods etc.

Advantages

- Effective in diverting manufacturing to DAs
- Cost effective
- Flexible
- Open up lines of communication between government and firms.

Disadvantages

- Effect on firm's efficiency
- Adverse effect on national investment.

See Armstrong and Taylor (2000) pp 239 - 241

Rationale for capital subsidies

Tax incentives (free depreciation to "write-off" capital against tax liabilities) and capital grants not linked to job creation. These were the mainstay of policy in DAs and SDAs 1966-70 and 1972-82

Encouraged in situ firms to invest in plant, machinery and buildings in order to:

- Increase productive capacity in new profitable product lines, increase exports → healthier balance of trade
- Modernise the existing capital stock through replacement (efficiency and technology gains)
- Means of achievement through reducing the "cost of capital"

The effect of reducing c is two-fold

- "Output" effect - net investment results in a larger K, → higher Y → higher L
- "Substitution" K is relatively cheaper than L, firms reduce L, increase K.

The relative size of the two effects depends on
Elasticity of substitution between K &L and
Price elasticity of demand for output produced
To maximise the number of new jobs, elasticity of substitution should be small and price elasticity of demand should be high

Beneficial effects of capital subsidy:

- Induce higher gross investment levels
- Result in more jobs (under the right conditions)
- Improve efficiency in production
- Increase output (exports, new product line)

For more details see Harris (1991) pp38 - 42. For the application economic theory of output and substitution effects see Armstrong and Taylor (2000) pp 244 249 (this relates to labour subsidies but the effects are interchangeable)

Rationale for Labour Subsidies

Regional Employment Premium was a subsidy on wage costs in manufacturing industry. The major issue was traditionally high unemployment in DAs and capital subsidies and inward investment would not solve regional employment disparities in the short-term. Indeed the capital subsidies introduced in 1963/66 could potentially exacerbate problems (there is an inherent tendency to substitute L for K).

Therefore it was argued there was a need for a policy equivalent to an exchange rate decrease. Giving the same result as a balance of trade deficit by making a region's exports relatively cheaper.

REP was intended to give manufacturers in DAs a cost advantage over non DA competitors.

The policy was therefore designed to act through the "output" effect.
Viability depended on:

- The reduction in labour costs being large enough to significantly reduce overall production costs.
- Firm would be willing to lower prices to increase demand
- Subsidy would not "leak" away into higher wages and/or profits

See Harris (1991) pp 42 - 44; Armstrong and Taylor (2000) pp 250 - 254 (contrasts the 2 approaches)

Rationale for growth poles

Concept was of an industrial complex comprising dominant (propulsive) firms with strong input-output linkages to other local industries. The dominant firms have capacity to transmit growth impulses to the rest of industry in the industrial complex. ***See Harris (1991) pp 44 - 46***

The effectiveness of policy in the UK before 79

Prelude

Though not specifically covered in Armstrong and Taylor an analysis of the effectiveness of regional policy in the inter-war years can be found in an article by Scott P, ***The Audit of Regional Policy 1934-1939***, Regional Studies, Vol. 34.1 pp 55- 65. Scott argues that these schemes, despite being in existence for only a short period, were successful in the fact that they demonstrated that successful new manufacturing businesses could be set in depressed areas and what is more they represented good investments for the government and others.

Overview 1960 - 1981

A comprehensive study of the effects of regional policy between 1960 and the early 1980s was undertaken by Moore, Rhodes & Tyler for the DTI, (Moore, Rhodes & Tyler (1986), ***The Effects of Government Regional Economic Policy***. The broad findings of the study were that:

- In the period 1960 to 1981 regional policy created an estimated 604,000 (gross) manufacturing jobs in DAs. – (Scotland, NI, Wales, North, Merseyside and the South West) (29,000 p.a.).
- They estimate that of these 154,000 (25%) were lost before 1981 giving a net gain in employment of 450,000 jobs.
- Applying a multiplier of 1.4 the number of surviving jobs rises to 630,000.

Further analysis suggests that:

- Over the full period most of the jobs were created by indigenous firms
- In the 1st period 55% of new jobs came from immigrant firms whilst in the 2nd period they only provided 22%
- Immigrant firms also accounted for the majority of the 71 – 81 losses.

Industrial Development Certificates (IDCs)

IDCs were one of the three major planks of government policy. Introduced in 1948, they were finally abolished in 1982. They were the “stick" in the Government’s carrot and stick approach to encourage re-location of investment.

Moore, Rhodes and Tyler estimate that by 1971 89,000 jobs had been created in the development areas as a result of moving 474 firms into the areas. During the following decade fewer firms moved and the net number of jobs sustained was reduced to 74,000. Although they give no estimates as to the cost to the exchequer per job they claim that IDCs were by far the most cost effective of the instruments used. Armstrong and Taylor (1993) – suggests a strong correlation between the IDC refusal rate and the number of manufacturing plants moving to DAs

Twomey and Taylor (1986) identified those variables likely to have a significant effect on a company's decision to move from one region to another. Their work suggests that just over 40% all moves were due to regional policy measures, and of those almost 70% were due to location controls. However there are significant regional differences.

However, IDCs were also reckoned to have a detrimental effect to investment outside the Development Areas, Table 10.3 Armstrong and Taylor (1993). This suggests that:

- Only 18% of firms refused IDCs eventually moved to an area acceptable to government,
- 50% located in non-assisted areas but modified their proposals – to comply with the legislation
- 13% abandoned the project
- 18% of firms either closed or reorganised
- Only 1% located abroad.

The flip side of the coin thus was that jobs were not being created in the South East and Midlands. It is estimated by (Moore Rhodes and Tyler) that in the 60s between 20% and 30% of manufacturing jobs that might have been created in non-assisted areas were lost as a result of IDCs being refused.

Another detrimental effect of IDCs (i.e. the moving in of new production units due to policy instruments) has been the creation of a “branch plant” economy. Some of the implications of external ownership are given in Harris (1990)

Capital Subsidies (RDG & RSA)

Capital subsidies accounted for the majority of regional policy expenditure throughout the period. They were also responsible for the bulk of the surviving manufacturing jobs (78%). At their height companies in development areas could attract a 40% cash grant towards the cost of new plant and machinery and 25% towards new industrial buildings. Unlike IDCs the grants were available to both immigrant and indigenous firms. RDG and RSA spending actually peaked after 1979 mainly because of commitments already in the pipeline. They calculate that capital grants had been responsible for creating 157,000 manufacturing jobs Assisted Areas up to 1971 and almost 350,000 by 1981. Of the 1981 total 79% were from indigenous firms.

Twomey and Taylor (1986) suggest that just over 30% of moves into regions were due to investment incentives. However there are significant regional differences with their importance evident in Scotland and the North but of diminished importance in Wales and the North West. Moore Rhodes and Tyler also show that the distribution of grant was heavily skewed towards particular industrial sectors Chemicals 21.2%; Metal manufacture 16.3% and Food Drink and Tobacco 9.2%.

There is little doubt that companies were factoring in the available grants when making investment decisions. Begg and McDowall (1987) analyse a number of studies to suggest that investment incentives were crucial to companies in reaching decisions on whether or not to go ahead with a project..

Harris uses the coefficient of regional specialisation to measure the amount of structural diversification taking place as a result of investment grants. This means the extent to which a region r concentrates employment in particular industries compared to national specialisations in these same industries.

$$CRS^r = \sum_i \left[\frac{e_i^r}{\sum_i e_i^r} - \frac{E_i}{\sum_i E_i} \right]$$

Limits
CRS=0 (no specialisation) to
CRS=2 (Complete specialisation in one industry)

A further measure the Coefficient of Regional Redistribution (CRR) measures the extent to which there has been a redistribution of output between industries (the larger the coefficient the greater the change in the distribution of output over the period). He shows that while peripheral areas were becoming less specialised, and output redistribution (CRR) was higher in the peripheral regions, there was very little fundamental change in regional rankings.

Wren & Taylor (1999) in a more recent article show that RDG was used by larger capital-intensive manufacturing companies for re-structuring which resulted in a net loss of 35 jobs for every £1m spent, this was particularly evident in metal manufacturing, mechanical engineering and electronics. But probably more importantly this led to the structure of manufacturing industry in the Development Areas converging with that in the rest of the UK.

Why? There is little doubt that K rose at a much faster rate in assisted areas compared to non-DAs. However, the impact was possibly less through any “output effect, but more likely through the “substitution” effect, thus, although labour productivity increased in NI (for example) Total Factor Productivity fell after 1975. See Fig 7.1 (Harris 1991) for evidence.

Harris found that total factor productivity fell in NI after 1975, this suggests that too much capital investment occurred, (too much new plant and equipment), which raises the issue of deadweight loss. Wren (1987) suggest that 53% of all RDG projects were classified as deadweight spending but only 23% of RSA projects (the figures are higher for local authority projects and for start-up firms in all cases).

Labour Subsidies (REP)

The final of the three main generic policy instruments was the Regional Employment Premium (REP). The main idea was to help offset the displacement effect of capital subsidies. Through most of the period (1967-78) the subsidy was paid on a per capita basis to manufacturing companies throughout the Development Areas. One-off marginal worker subsidies came in after 1979 as part of the revised Regional Development Grant (1984 - 88).

Moore Rhodes and Tyler calculate that in 1971 63,000 jobs were being supported by REP of these about a third were in immigrant firms (240 firms). Moore, Rhodes & Tyler suggest that in the period 1960 to 1981 out of almost 450,000 policy induced net job gains in development areas, only 16% were due to REP. Further the cost per job was estimated at £73,000 as opposed to £25,000 from investment incentives (less for RSA). They suggest that at its peak REP and other labour subsidies were costing the exchequer £150m per annum. Wren (See Armstrong and Taylor 2000 Table 9.1) suggests that the total grant equivalent cost was nearer £490m. What is clear is that the instrument was the most costly of all the subsidies in terms of cost per job.

As with capital grants, REP was concentrated in particular industry sectors, Moore Rhodes and Tyler show that the main beneficiaries were Mechanical Engineering, Metal Manufacture and FDT and Electrical.

Harris suggests that the likely impact of REP on jobs was small since at best it probably only lowered total production costs by about 2% (and labour costs by at best 8% when first introduced). A Government survey (ILAG (1973) of regional development Incentives: Minutes of Evidence, House of Commons Expenditure Committee (T & I sub-committee) 1973-74, HCP85-1) examined the importance of REP to 346 plants in DAs during 1964-67. It found that:

- 46% used REP to lower prices
- 21% increased spending on sales promotions/distribution
- 42% said REP improved sales prospects
- 14% used part of REP for higher wages

Moore & Rhodes (1976) surveyed 300 plants finding that:
- 39% used REP to boost profits
- 49% to lower prices/promote sales
- 12% to pay out higher wages

Harris, (1991), ***The employment Creation Effects of factor Subsidies: Some Estimates for Northern Ireland Manufacturing Industry***, Journal of Regional Science, also suggests that the overall effect of REP was not large, boosting demand for labour by about 3% at its peak. Further it was relatively expensive compared with capital subsidies. The analysis does not however indicate how successful the REP was at safeguarding existing jobs.

Wren & Taylor (1999) suggest that although REP has positive employment effects across almost all manufacturing sectors, these are relatively weak compared with capital subsidies

Conclusions

- Early experimentation with interventionist regional policy began in the 1930s these were concentrated in the areas with chronic unemployment. The latter part of the period saw the policy of taking jobs to the workers enacted with some success and without a significant drain on the exchequer.

- Estimates suggest that through the 60s and 70s regional policy created 630,000 jobs in the Development Areas of these the majority were from indigenous firms.

- Location controls in the form of Industrial development Certificates ran from 1948 to 1982. They were at their most effective during the 60s and mid 70s. Estimates suggest that they had induced firms to provide 89,000 jobs in the Development areas by 1971. They were by far the most cost-effective measure (in treasury terms), although they induced a significant hypothetical loss of jobs in non-DAs. They were particularly effective in diverting firms to Wales, the North West and Yorkshire and Humberside. A spin-off from location controls was the mushrooming of branch plants in the DAs.

- Capital subsidies consumed the bulk of regional spending but were also responsible for the majority of new jobs created. They were particularly important in creating jobs in indigenous firms. They were also responsible for about 30% of the moves by immigrant firms into DAs and intermediate areas. They were particularly important in inducing moves into Scotland and the North. Analysis shows that the expenditure was concentrated in a few manufacturing sectors, notably Metal manufacture and Chemicals. They became important to companies when making investment decisions and help in industrial restructuring as industry structure in DAs became more diversified. However, there were undoubtedly problems of deadweight and displacement.

- Labour subsidies ran for only a decade, whilst the helped support an estimated 63,000 jobs at their peak they were far more expensive to the exchequer with estimates of 73,000 per job. Not only were they expensive but they failed to lower production costs by any significant amount, and their value was quickly eroded by inflation. In that the subsidy was supposed to assist firms in lowering their prices compared with their competitors it failed when significant numbers of employers revealed that the subsidy leaked out into higher profits and increased wages with employers seeing the subsidy as compensation for being located in DAs.

Reading

📖 Harris, R (1991), *Regional Economic Policy in Northern Ireland 1945- 1988*, Gower Publishing Company Ltd., Chapter 3.

📖 Harris, R (1987), *The role of manufacturing in regional growth*, Regional Studies, Issue 21, pp301 - 312.

📖 Armstrong & Taylor, (2000), *Regional Economics & Policy*, Blackwell, Chapter 9, pp 232 – 258.

📖 Scott, P, (1994) *British Regional policy and Structural Change in the Development areas: 1945:51*, University of Portsmouth Department of Economics Discussion Paper Number 39 – particularly strong discussion on dispersal of industry and government-funded industrial estates.

📖 Scott, P, (1994) *The costs of 'passive' British regional policy 1951-64*, University of Portsmouth Department of Economics Discussion Paper Number 45 – looks at the 'policy off' period of the post war Tory governments prior to the massive expansions of regional policy under the first Wilson government.

📖 Scott P, (2000) ***The Audit of Regional Policy 1934-1939***, Regional Studies Vol. 34.1 pp 55-65

📖 Moore, Rhodes & Tyler (1986), ***The Effects of Government Regional Economic Policy,*** DTI

📖 Armstrong & Taylor, (1993), ***Regional Economics & Policy***, Harvester Wheatsheaf, Chapter(s) 9, 10 & 14 (selective).

📖 Armstrong & Taylor, (2000), ***Regional Economics & Policy***, Blackwell, Chapter(s) 9.

📖 Harris, (1991), ***Regional Economic Policy in Northern Ireland 1945- 1988***, Gower Publishing Company Ltd., Chapter 4 & 7

📖 ***Regional Industrial Policy: Some Economic Issues***, DTI, (1983)

📖 Harris, (1991), ***The employment Creation Effects of factor Subsidies: Some Estimates for Northern Ireland Manufacturing Industry***, Journal of Regional Science

🕮 Begg and McDowall (1987***) The Effect of Regional Investment Incentives on Company Decisions***, Regional Studies Vol. 21.5 pp 459 – 470

🕮 Wren & Taylor (1999) ***Industrial Restructuring and Regional Policy***, Oxford Economic Papers pp 487 - 516