**ECONOMIC DEVELOPMENT COMMITTEE**

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| **Date:** | **1 December 1999** |
| **Venue:** | **Committee room 1, National Assembly Building** |
| **Title:** | **Operating Aid: work in progress** |

## Purpose

1 To inform the Committee of the work being carried out to develop operating aid and to provide details of schemes worked up so far.

## Summary

2 The paper sets out some general principles affecting operating aid and covers a number of descriptions of schemes being developed at present.

## Timing

3 New schemes of operating aid to business that are to be funded under the Objective 1 programme need to be developed in time for inclusion in the Objective 1 Programme Complement. That document needs to be presented to the European Commission' Regional Policy Directorate (DGXVI) no later than two months after the Objective 1 Single Programming Document has been approved. Present expectations are that the Programme Complement will need to be ready for Monitoring Committee consideration in April, or as soon as the final shape of the Objective 1 programme has been agreed.

## Background

4 Operating aid was discussed at the Economic Development Committee's meeting on 13 October. The Committee asked for a paper setting out specific proposals for operating aids that might be introduced, details of whether they required Treasury approval, and details of contacts with other Objective 1 regions.

5 An informal working group has been established to help develop programmes of operating aid. The group includes representatives from:

Business Wales;

Welsh Local Government Association;

North Wales Economic Forum;

South West Wales Economic Forum;

Welsh Development Agency;

Council of Welsh TECs;

The National Assembly.

The group has developed a number of new ideas, some of which are set out in the annexes to this paper. The working group is continuing to refine these ideas and to develop others.

6 Discussions have been commenced with other Objective 1 areas.

**General principles with regard to scheme design**

7 The working group has had regard to three main principles in developing its ideas:

- Operating aid must help to bring about positive and sustainable improvements in the competitive positions of the businesses likely to benefit and thereby increase the number and quality of job opportunities in the area, with a consequential effect on GDP per head. The group considers that merely enabling firms in the Objective 1 area to enjoy a profits bonanza would not be sufficient to secure such improvements. Although it is recognised that it is impossible to guarantee that all operating aid would secure such improvements in every case, schemes must be designed in such a way as to maximise the extent to which the resources involved would secure the Assembly's policy objectives. Accurate targeting of schemes is therefore a key issue.
- The group has noted that it is possible that Treasury agreement to tax relief in any form may reduce the National Assembly's block and that it would therefore be important to ensure, in scheme design, that any form of operating aid that is recommended for implementation by Treasury-controlled bodies should be the most cost effective way of securing the policy objective. A comparison with any alternative means of providing aid would be necessary.
- Any scheme must be designed for accessibility by qualifying firms.

**Brief summary of annexed schemes**

8 Research & Development (R&D) Tax Credit (Annex A) - this would have to be a scheme run by Inland Revenue and approved by Treasury. Its purpose would be to increase the amount of R&D work being undertaken by SMEs in Wales. The proposal is to double the additional tax credit offered to SMEs undertaking R&D in the Chancellor's recent pre-budget report in the Objective 1 areas of the UK. The First Secretary has been advised to write to the Chancellor with this suggestion.

9 Additional childcare assistance for business start-ups by single parents (Annex B) - the Working Families Tax Credit system will cover up to 70% of the costs of childcare, up to a maximum of £70 for the first child under 8, for single parents. While this may be sufficient to attract single parents into employment, it may not be so in the case of the self employed, because entrepreneurs normally work longer hours than employees and their childcare costs would be higher. In order to attract more women into self employment, the proposal is for an additional £25 per week to be paid to single parents who are being supported under the existing Business Start Up Scheme. We are checking with Inland Revenue whether such payments would have a "pound for pound" effect on beneficiaries' other entitlements. This scheme is not a state aid at all, but can have the same effect as a state aid.

10 Rates relief (Annex C) - existing powers enabling local authorities to use their discretion to give relief from business rates are being used very sparingly. An action plan has been prepared to encourage greater use of this discretion. The final stage of the action plan is to take advantage of a forthcoming opportunity for primary legislation, which would be the responsibility of the Department for Environment, Transport and the Regions.

11 Upskilling employees - training grant to SMEs (Annex D) - grants could be made available through TECs to subsidise:

design and delivery of bespoke training packages for firms; or

training leading to NVQ qualifications of employees.

12 Improving small firm management (Annex D) - grants could be made available through TECS to subsidise a number of relevant training programmes for the owners of small firms.

13 Extending the age limits for youth training programmes (Annex D) - eligibility for youth training programmes ends at 25 years. The proposal is to increase the upper age limit to 30. European Commission rules will classify any such programmes applying to people over 25 as State Aid, and therefore operating aid.

14 Employment subsidy (Annex E) - this scheme is not one we recommend should be pursued any further. The estimated costs are very high indeed and it has been included only for purposes of illustrating the very common effect of poor targeting on the costs of operating

aid. As a rule, it is not possible to target general subsidies or tax relief schemes tightly enough to avoid unacceptable deadweight costs. The calculations of the approximate cost of the scheme set out how deadweight works to make what frequently sounds like a good idea into a very expensive one. A comparison with the similarly structured New Deal illustrates the difference between good and poor targeting.

**State aid clearance**

15 The National Assembly would only need to clear the schemes summarised in paragraphs 11-13 above through the Competition Directorate. HM Treasury would need to take action to clear the R&D tax credit. The rates relief would operate, as do many schemes of operating aid, under de minimus rules.

**Other ideas in germination**

16 The working party is continuing to develop further ideas. Some that will be the subject of further work in the coming period are:

- enhancing RSA for firms undertaking "green" methods of production or transport;
- a job-sharing scheme;
- a scheme to assist in the occupation of unoccupied business premises.

**Cross cutting themes**

17 These ideas are being developed by a wide partnership, which includes representatives of the business community and local government.

**Compliance/finance**

18 At present, no compliance issues arise. This paper contains no firm proposals and is just to keep the Committee informed of progress.

**Action for the Committee**

19 To note that work is proceeding in consultation with a wide range of interested organisations.

**Contact**

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**ANNEX A**

## OPERATING AID: RESEARCH & DEVELOPMENT TAX CREDIT

### Summary

1 The proposed scheme would be open to small and medium sized companies in the derogation 87(3)(a) areas spending more than £50,000 a year on Research & Development (R&D). In addition to the existing rules for R&D, which give 100% relief for expenditure on R&D, the company would be able to claim a further relief (a "tax credit") equal to say 100% of the current spending on R&D, taking the total relief on current spending on R&D to 200% of cost. In the non-derogation (a) areas the amounts would be 50% and 150 % respectively.

2 Recognising that an increasing number of companies undertake R&D before they have any sales or profits to offset against costs, the proposed scheme would also benefit companies that are not in taxable profit. It would allow these companies to surrender unused relief for current spending on R&D, from both the existing relief and the tax credit, to the Exchequer at a discount from its nominal tax value.

### Rationale for the proposal

3 The basic rationale for an R&D tax credit is that business R&D produces spillover benefits for firms other than the originating firm both through the spread of ideas directly and through the transfer of people who embody new knowledge and skills. The case for doing something extra in West Wales and the Valleys is that it is an area where business R&D is very low compared to the rest of the UK and where, therefore, the spillover benefits are low. But it is a poor area where such spillover benefits would be particularly valuable and more R&D jobs would provide a valuable up-grading of the type of job on offer in the area.

4 The ratio of Business R&D to GDP in Wales as a whole is only 0.3 per cent, compared to a UK average of 1.2 per cent, and it is lower in Wales than in any other region of the UK. There are no official figures below the all-Wales level, but it seems likely that the ratio would be even lower in West Wales and the Valleys. The Yorkshire and Humber region, which contains the South Yorkshire derogation (a) area, also has a low Business R&D to GDP ratio, as does Merseyside. The South West, which includes the Cornwall derogation (a) area, has a ratio equal to the UK average. But this expenditure is almost certainly concentrated around Bristol rather than in Cornwall.

5 HMTreasury would need convincing about dead-weight and displacement.

### Dead-weight

6 Most R&D spending is carried out by large firms (at UK level just five enterprise groups account for almost 28 per cent of Business R&D). Therefore a scheme confined to SMEs only would not cost the Exchequer very much except via displacement effects (see below). The total R&D spending of the derogation (a) areas is likely to be less than 10 per cent of the UK total, ie less than £1bn, and the fraction performed by SMEs considerably less. At a corporation tax rate of 30 per cent and an R&D tax credit at 200 per cent instead of 150 per cent the total revenue cost (excluding displacement) is unlikely to exceed £20-30m across all four regions.

7 If all firms, not just small firms, were included, the cost would be greater. Allowing another half of the £1bn to be deducted from taxable profits at a corporation tax rate of 30 per cent would reduce tax take by £150m. However not all R&D would be eligible (eg capital) and not all firms would be profitable.

**Displacement**

8 There would be an incentive to transfer R&D work within the UK, and although this would benefit Wales and the other derogation (a) areas, it would redistribute benefits within the UK rather than raise the total. Transfers within the UK of work that would anyway have taken place would add to the revenue losses. It is difficult to estimate the likely size of the effect.

9 However, if the scheme were confined to small firms the effect would be unlikely to be very large. If small firm R&D were to double simply through displacement the total revenue costs should still be below £60m. Large firms might have more scope for relocating R&D establishments, and the costs could be larger, especially if there was scope for short-range "boundary hopping" (eg Manchester to Merseyside).

**Other considerations**

10 Another possible concern is the complexity of administering a regionally differentiated scheme. Although this would create complications, they do not seem sufficient to rule the scheme out.

**Financial Implications**

11 Past practice has always been that such schemes do not impact directly on Departments' budgets. However, there has been a suggestion that Treasury may wish to deduct the cost of tax breaks from Departments' allocations. For a small firms scheme the cost in Wales would be unlikely to exceed £10m and could be less. Although FP advise that we deal with this situation when and if it arises, we ought to consider whether an alternative means of providing aid exists. In this case, one does; SPUR.

## SPUR and R&D tax credits

12 Support for Products under Research (SPUR) provides grants to firms with fewer than 250 employees at a fixed rate (30% standard, with higher rates in the Assisted Areas) towards fairly broad-based project costs for product development, subject to an absolute ceiling of ECU 200,000. Applicants need to show that the project would not go ahead without the grant. This is very close in concept to the R&D tax credit proposals. The differences are:

- it covers projects rather than "all" R&D spending;
- additionality needs to be demonstrated;
- it covers a wider range of expenditures, not just direct staff and material costs;
- it has an upper ceiling (though since the R&D tax credit is classed as a state-aid, the value of the credit also counts in calculating aid ceilings).

13 The value of the tax credit depends on the marginal tax rate the firm faces and the timing of its tax return. However it seems likely that it would be of broadly the same magnitude as a SPUR grant in a non-Assisted Area, provided eligible expenditure was the same, but SPUR would be more valuable in Assisted Areas. However, the tax credit would be automatically available as part of a tax return, unlike SPUR for which application has to be made to the Assembly. Given the difficulties of reaching target firms by discretionary grants, there is something to be said for using a tax return mechanism instead (though the tax credit would have a deadweight problem which would need to be watched, while SPUR's deadweight is quite small because of the need for firms to show additionality).

## Who would benefit

14 The proposed tax credit scheme would be limited to companies that are SMEs. It would be difficult to devise rules which allowed the scheme to be extended simply and fairly to the self employed, consortia and other non-corporate bodies. The additional rules that would be needed are likely to make the scheme over complex and less fair in its coverage and application. Limiting the scheme to companies should not stifle or discourage innovation. SMEs that carry out significant amounts of R&D are almost invariably incorporated. Moreover, any small business which wishes to bring itself within the scheme would be able to do so by incorporating.

15 The company would need to be small or medium-sized by reference to the qualifying criteria set out in Section 247 Companies Act 1985.

16 The same criteria were used for the temporary first year allowances introduced for SMEs in the Government's 1997 and 1998 Budgets. They are familiar to companies and their professional advisers. Companies will generally already know whether they meet the criteria as this affects their obligations under the Companies Act.

17 The criteria in Section 247 Companies Act 1985 are at present that the company must satisfy two of the following conditions for the current or preceding year: turnover not more than £11.2m; assets not more than £5.6m; and not more than 250 employees.

18 The company would need to be small or medium-sized for the accounting period in which the R&D expenditure was incurred. If the company is a member of a group, which includes groups with foreign parents, the group would also need to be small or medium-sized.

**European Commission definition of SMEs**

19 If this measure is submitted to the European Commission for approval of any state aid elements, the definition of SME used would also need to satisfy the definition of SME adopted by the European Commission. This means that two further conditions would have to be met.

20 First, the company (and any group of which it is the parent) must have fewer than 250 employees in the current or the preceding year.

21 Second, the company may not be owned as to 25% or more of the capital or the voting rights by one enterprise, or jointly by several enterprises, falling outside the definition of an SME. This threshold may be exceeded in the following two cases:

> if the enterprise is held by public investment corporations, venture capital companies or institutional investors, provided no control is exercised either individually or jointly; or
>
> if the capital is spread in such a way that it is not possible to determine by whom it is held and the enterprise declares that it can legitimately presume that it is not owned as to 25% or more by one enterprise, or jointly by several enterprises, falling outside the definition of an SME.

22 In order to avoid disproportionate compliance and administrative costs being incurred on small claims, it is proposed that the qualifying R&D expenditure for the accounting period must be more than £50,000.

**Simple measure of R&D revenue expenditure**

23 In order for the R&D tax credit to be equitable and to keep the compliance burdens it

imposes on business to a minimum, the measure of expenditure used should be fair, easy to understand and to operate, and certain.

24 The accounting standard SSAP 13 "Accounting for R&D" does not provide a ready solution. A measure based on SSAP 13 would impose significant additional compliance costs as the accounting standard does not generally apply to SMEs. Moreover, the accounting standard does not provide precise and certain rules over the expenditure to be included, for instance with regard to apportionment of costs or hypothecation of indirect costs, financing costs and overheads. A measure based on SSAP 13 would lead to differences in the credit given to different claimants depending on the accounting treatment followed. It would also need to be adjusted to a tax basis by excluding depreciation and other disallowable items, which would add further complication.

25 In order to keep the measure simple, fair and transparent, it is proposed to define the qualifying R&D expenditure for the tax credit as the direct staff costs of people directly involved in R&D activity plus the cost of consumable stores used for R&D purposes. The same measure is used in the USA system of R&D tax credits. Consumable stores would have the same meaning as in the accounting standard SSAP 9 "Stocks and long-term contracts". Expenditure would be recognised for the R&D tax credit for the same period that it is allowed as a "Case 1" deduction.

26 This measure would be relatively simple and certain to operate. It would provide a sensible yardstick for investment in R&D as the value of R&D undertaken depends on the number and quality of personnel engaged in R&D. Moreover by encouraging investment in R&D personnel, the R&D tax credit would directly support the objective of the Government to help business fully to exploit the UK science base.

**What are direct staff costs?**

27 In the case of employees directly engaged on qualifying R&D, direct staff costs would be the salary (including basic salary, overtime and pension contributions but excluding capital expenditure on benefits such as cars) plus employers' NICs. Expenditure on leasing capital assets for the use of employees as part of their remuneration package would not be included.

28 The costs of sick pay and maternity pay of staff normally working on R&D could also count, including these costs to the extent that the employee concerned would have been expected to work on R&D had they not been absent.

29 The direct staff costs of employees working part-time on R&D could be included in proportion to the amount of their total time that they spend on R&D.

30 The system could also contain de minimis rules to achieve simpler administration and

compliance, for example by including in full the costs of staff spending more than 80% of their time on R&D and excluding the costs of staff spending less than 20% of their time on R&D. Between these two levels, claimants would bring in the costs of the employee according to the proportion of the employees' time spent on R&D.

**R&D for own benefit**

31 The claimant must be carrying on a trade. The R&D must be related to the trade carried on by the claimant and directly undertaken by him or on his behalf. In order to avoid double relief and limit the benefit of the relief to SMEs, it is proposed that R&D expenditure would only qualify if the person who incurs the expenditure is entitled to all the rights in the results of the R&D.

**How would the tax credit be given?**

32 Although the incentive considered in this note is referred to throughout as a tax credit, it would be given as a deduction in arriving at the trading profits as this would be the simplest way of accommodating it within the present Corporation Tax system.

33 Our suggestion is that the tax credit would be set at 100% of qualifying R&D expenditure in the derogation (a) area and 50% of the qualifying R&D expenditure elsewhere.

**How would companies claim the tax credit?**

34 The claim would form part of the company's self-assessment return. The tax credit would be deducted in the computation of the trading profit. The normal rules on taxing profits and relieving losses would apply to the resulting trading profit or loss.

35 The tax credit would be available to all qualifying companies. Companies that would otherwise have a corporation tax liability for the accounting period would benefit directly from both the existing 100% relief on qualifying R&D expenditure and the additional tax credit. The combined relief would reduce both the taxable profits and the tax liability.

36 As the existing 100% relief on qualifying R&D expenditure and the additional tax credit would be given as deductions in arriving at the trading profits, they may create or increase a trading loss which could be carried forward or back, or surrendered as group relief, in the usual ways. Trading losses which cannot be relieved directly can be carried forward and used when the company comes into profit. These various routes provide further ways in which the company could benefit through reductions in tax liabilities or repayments of tax.

**Companies that are not trading**

37 The proposals in this note build on the existing systems for taxing companies and giving relief for R&D and losses. In common with the existing systems, the proposals for the tax credit and the payment scheme would apply only to companies that are carrying on a trade.

## ANNEX B

## OPERATING AID: CHILDCARE ASSISTANCE FOR SINGLE PARENTS STARTING A NEW BUSINESS

### Aim of the scheme

1 There are about 150,000 self-employed in Wales; about 13 percent of the working population. Women are under-represented amongst the self-employed. The proposed assistance would contribute to improving that situation in West Wales & the Valleys.

### The proposal

2 The proposal is to provide additional help to people gaining assistance to start businesses under the Business Start-up Scheme.

### Background

3 The Business Start-up Scheme, which is operated by the TECs, provides a discretionary grant to people starting up a new business. The grant is £1,000. The Enterprise Allowance Scheme provided £30 per week for a year to unemployed people starting their own business. However, it was discontinued because it was found that very many recipients were simply adding the allowance to their income and not necessarily using it to help them run a serious business.

4 In Wales, the Business Start-up Scheme replaced Enterprise Allowances (elsewhere it was not replaced). The scheme is open to all, not just the unemployed, but the grant is conditional on the applicant being able to show a need and use for it. Depending on the proposed use, the grant might sometimes be an operating aid and sometimes an investment aid.

5 Since October, single parents have become eligible for Working Families Tax Credit. The Working Families Tax Credit system will cover up to 70% of the costs of childcare, up to a maximum of £70 for the first child under 8. Typical childcare costs are in the region of £90-£110 per week. While the new allowance will cover the majority of normal childcare costs, and is likely to be of real assistance to single parents entering employment, there are significant additional costs and risks for single parents starting a business, because the business is unlikely to make a profit for a period, and the amount of time a self employed person would need childcare cover would typically be longer than an employee.

## Scheme outline

6 The proposal is to provide additional assistance which would be equivalent to a tax concession - to fund 25 percent of average weekly childcare costs for six months. This works out at £650 per person assisted. After six months, it should be clear whether the business is likely to be a paying proposition. Since tax generally would not be payable, as profits might be expected to be small or non-existent, a grant would be the only way of providing the assistance. And since its payment would be linked to the payment of a Start-up grant, its administration by the TECs would be more efficient than any other delivery mechanism. Claimants would be required to provide evidence of their single parent status. The scheme would only operate in West Wales & the Valleys.

## Target group, costs and benefits

7 There are likely to be very few single parents among the unemployed - the requirement to be available for work would tend to exclude them from being classified as unemployed. However, there are 69,000 single parents among the inactive, about 46,000 in West Wales & the Valleys. About 40 percent (18,000) have children under five. We could aim, over the period of derogation 87(3)(a) coverage - until 2006 - to target 13 percent of them; about 2,500, or 360 a year.

8 The direct cost of such a scheme would be about £234,000 a year. However, each person taking up this form of assistance would only qualify if they were also qualifying for the discretionary assistance of £1,000. Since the purpose of the scheme would be to generate new businesses, this indirect cost would be £360,000; £594,000 in total.

9 The deadweight of such a scheme is likely to be very small. However, the failure rate could be fairly high; not all of those assisted would remain in business. Success in business requires more dedication than success in employment. The personal circumstances under which single parents operate mitigate against such dedication. Approximately 15 percent of new businesses supported by the Business Start-up Scheme close in the first year. For this particular group, it seems reasonable to expect a failure rate of double the norm. This would imply a job creation rate of about 252 a year, at a cost per job of about £2,400.

## Possible questions

10 Should people be allowed more than one chance? Costs, and cost per job, would increase if this were the case. However, a person may learn valuable lessons through the failure of a business. On the other hand, the possibility of freeloading would also need to be considered.

11 Should a person with two children be able to claim double the allowance? This would

increase the cost and cost per job much more than allowing people to have another period on the allowance - the extra cost would be entirely deadweight. Furthermore, both the childcare tax credit and child benefit would, in any event, be enhanced in respect of additional children.

12 Should the scheme be open to people already employed? Costs would be greater than the estimate but the likelihood of starting a successful business would be greater. This would tend to reduce the cost per job and have a bigger effect on the representation of women among the self employed.

13 This scheme, as designed, is demand related. Financial provision might be made to cover the targeted population, but there is no guarantee that this number of people will be attracted by the scheme. Equally, more people than estimated might come forward, and this would lead to greater expenditure than estimated.

## ANNEX C

## OPERATING AID: BUSINESS RATE RELIEF

### Summary

Rural rate relief scheme

1 Under the rural rate relief scheme mandatory relief of 50% is available to post offices and general stores which are the only post office or general store in a rural settlement with a population of less than 3,000 and whose rateable value is £5,000 or less. Councils have discretion to top-up the mandatory relief given to sole post offices or general stores with a rateable value of £10,000 or less to bring the relief up to 100%. The scheme also allows councils to grant up to 100% relief to help other small rural businesses (i.e. those with a rateable value of less than £10,000) which are a key feature of village life and provide an invaluable service to local people.

2 For the purposes of the rural rate relief scheme, most of Wales has been designated as a rural area, the exceptions being a few communities in towns and cities which are entirely non-rural.

3 In effect the non-domestic rating pool meets 75% of the cost of this discretionary relief with the remaining 25% being met by councils through increased council tax.

4 In 1998-99 only 8 out of the 22 councils exercised their discretionary powers in offering help to small rural businesses. And the total amount of relief given was just £128k.

Hardship

5 Councils also have discretionary powers to grant rate relief of up to 100% to businesses who would suffer hardship if they had to pay their whole bill. But again these powers have been used sparingly - in 1998-99 just 9 councils granted relief amounting to £152k in total.

Charities

6 Charities benefit from 80% mandatory rate relief and again councils have discretion to top-up the mandatory relief up to 100%.

Help for small businesses

7 There is evidence to suggest that rates, as a proportion of turnover and profits, are proportionately greater for small businesses than for large ones. Research has found that companies with a turnover of less than £100,000 a year pay over 30 per cent of their operating profits in rates - twice as much as larger companies and ten times as much as large multinational organisations, the major retail chains and banking and commercial institutions.

8 The Assembly recognises the problems faced by small businesses and is keen to work in partnership with business and local government to find the best way of reducing the rates burden on small businesses. Last year’s White Paper "*Local Voices, Modernising Local Government In Wales"* outlined proposals to help small businesses with their rates bills. These cannot be taken forward until the necessary primary legislation is brought forward by the UK Government. In the meantime, the Assembly is holding initial discussions with a range of business interests including chambers of commerce and the Federation of Small Businesses Wales.

**Action plan**

- National Assembly to issue revised guidance to councils on the use of discretionary powers reminding them that discretionary relief adds to council tax but does not divert resources from front line services such as education.
- National Assembly and councils **[any others, eg Business Wales?]** to publicise availability of rate relief.
- National Assembly to consider reducing councils’ contributions to rate relief schemes in Objective One area or more widely to encourage more extensive use of their powers.
- National Assembly to implement reduced rates burden on small businesses when the UK Government brings forward the necessary primary legislation.

## ANNEX D

## OPERATING AID: THREE SCHEMES TO ASSIST TRAINING IN SMALL FIRMS

**Aim of the schemes**

1 The schemes have two main aims:

> to improve the level of skills available generally, but particularly in Small Firms; and
>
> to increase the appreciation among Small Firms of the value of training in improving their competitiveness.

2 The Future Skills Wales project has shown that both employers and residents rate workplace skills as very important. However, the provision and take up of training is often low, and many employers say that their workforce does not have all the skills needed. Thirty percent of employers had experienced hard-to-fill vacancies. Smaller companies in particular find it difficult to provide adequate training. To improve the situation, help is required in overcoming the barriers that currently restrict the provision and take up of skills training. For individuals, the barriers include cost (including the cost of childcare and transport), lack of time and age restrictions. For employers, costs are important too, plus the need to provide cover for staff undergoing training.

**The proposals**

3 The proposals aim to provide additional assistance for training and a more liberal delivery regime to businesses in West Wales & the Valleys to stimulate demand. Four schemes are proposed.

<u>Scheme 1 - Access to Modern Apprenticeships and National Traineeships</u>

4 At present, payments of public money through the TECs for these skills programmes cannot be made after the trainees' 25$^{th}$ birthday and, as the schemes can last up to four years, limits people starting to those below 22. It also limits the scope for flexibility, for example from a National Traineeship (NVQ level 2) to a Modern Apprenticeship (NVQ level 3 and above). TECs pay a contribution towards the training costs.

5 It is proposed to raise the age limit to 30. It is considered that, in West Wales & the Valleys, this would increase the number of Traineeship starts by about 300 and Modern Apprenticeship starts by 500. The net additional cost to the public purse would be about £2 million a year.

<u>Scheme 2 - Training grants for employees</u>

6 A more radical approach would be to offer grants to Small Firms in West Wales & the Valleys for training undertaken by their employees. Grants would be more valuable to businesses than an equivalent tax credit on the training cost because they would be paid immediately. Firms would prefer to gain the financial benefit immediately rather than wait up to two years before their tax liability for the year in question is settled. The unassisted cost of training would still qualify as a tax deductible expenditure.

7 These grants could be offered both as a stand-alone form of assistance, which firms could apply for on an ad hoc basis, and as part of a (separate) programme to encourage Small Firms to become Investors in People (IiP). This programme would reward the attainment of IiP by:

a) providing a top-up to the Individual Learning Accounts (ILA) of all the firm's eligible employees (ILAs will be available to all employees above the age of 18);

b) provide guidance on how the ILAs might be used to the employees by the Careers Guidance Company; and

c) design a training package for the firm based on the needs identified in the IiP exercise.

It is expected that the costs of using grants to provide ILA top-ups and associated guidance will be of the order of £300,000 in the first year, rising to £750,000, then £450,000 in the subsequent years.

8 For 16 and 17 year olds in employment, the grants might be offered in association with Government financial support for training to NVQ level 2 under the new statutory right to time off to train or study. The latter support - up to £800 per employee per year - will be directed via the young people involved and will be used to pay for the costs of educational or training courses. But the grants to the Small Firms might be used to help defray the costs to the firms of releasing the employees in question for their periods of study or training and/or the costs of employing others during their absence. It is estimated that the cost of using grants for such purposes could be of the order of £1,500 per person per year.

9 Grants would be offered in respect of standard training courses leading to the attainment of transportable qualifications such as NVQ. They would also be offered in the form of a strategy which would include the TEC helping to design a bespoke package of training to meet the firm's needs. This might most frequently be offered in connection with the firm's attaining IiP accreditation, but would otherwise be linked to the achievement of other business goals such as an improved Business Excellence Model score, increased market share, penetration of new market, reduced product costs or improved quality indicators. Bespoke training packages need not necessarily lead to the attainment of transportable qualifications.

10 Grants would be available at a rate of 50 percent of the (discounted) cost of training.

11 It is difficult to estimate the extent to which such grants might lead to additional training, and the costs that would arise. This will very much depend on what training is needed, as well as on the level of take up. All elements of the scheme will need to be evaluated after two years to establish which are providing best value. Present estimates for the training grant element of this programme are of the order of £1 million in the first year, and £4 million in the second. (At a rate of 50 percent, £4 million would pay for NVQs for 8,000 employees. Perhaps double that number could be covered if other, cheaper, courses were chosen.)

Scheme 3 - Training grants for the proprietors of Small Firms

12 There is a general acknowledgement that the level of skills among the proprietors of Small Firms needs to be enhanced. Proprietors generally need different skills and knowledge from those of their staff: marketing; cashflow; stock control; business planning; and need to understand employment legislation and payroll practice. This perception does not apply to certain types of small firms; generally professional partnerships such as solicitors, accountants, doctors, dentists.

13 There are two difficulties:

> proprietors do not appreciate the potential gains from enhancing their skills and are therefore unwilling to pay for what are seen as irrelevant courses; and
>
> proprietors can rarely afford the time to attend courses, particularly if they are held during the normal working day.

14 In the hope that reducing the price will help overcome owners' reluctance, the proposal is to pay a 50% grant in respect of business relevant courses to the proprietors of Small Firms in West Wales & the Valleys. As with training grants, grant is preferred to a tax credit because it avoids the delay inherent in the tax system. Because there would be little benefit to the Assembly in offering the grant to professional firms, its availability will need to be restricted.

15 Effective marketing will be important to the success of this scheme. Its delivery will need to be designed so that courses are available in the evenings. And its promotion will need to be carefully thought out in order to attract proprietors.

16 There are around 40,000 to 50,000 Small Firms in West Wales & the Valleys. Targeting the proprietors of 1,500 firms a year over the period of the Objective 1 programme would be likely to give rise to an annual cost about £350,000.

**ANNEX E**

**OPERATING AID: A NATIONAL INSURANCE RELIEF SCHEME TO SUPPORT ADDITIONAL EMPLOYMENT**

## Proposal

1 The purpose of the scheme is to encourage additional employment by way of a subsidy given through a rebate on Employers' National Insurance contributions. Only firms which employed numbers of staff greater than those employed before the start of the operation of the scheme would be entitled to claim the relief, and only in respect of the additional staff employed in locations in West Wales & the Valleys.

2 The relief would amount to £30 per week per additional staff member and be paid for a year in respect of each of those staff, from the time of their appointment. The amount of subsidy would therefore be the same as provided under New Deal, but half as much would be paid, for twice as long. It would not be available in respect of employees subsidised by New Deal.

## Possible direct effect of a subsidy

3 New Deal is supporting about 1,000 employees in Wales at any one time, but there is no evidence that employers have been persuaded by the subsidy to create additional jobs. The proposed scheme would have the same total value to an employer as New Deal, but not require any specific person to be taken on. It is assumed that a similar subsidy, without strings, might persuade about twice as many employers to create additional jobs as the New Deal persuades to use it as a recruitment method. There is nothing very scientific about this assessment, but it seems about the right order of magnitude.

## Estimated costs and benefits of proposed scheme

4 Perhaps 2,000 additional jobs might be created across Wales as a direct result of the subsidy's availability, if it were available across the whole of Wales. However, the scheme would be limited to West Wales & the Valleys, which covers about 65% of the population. Thus, in that area, approximately 1,300 additional jobs would be supported. It is likely that a proportion of these jobs would disappear when the subsidy ended. It is also likely that some of the activity supported would not be additional but would simply displace activity in other firms. However, no allowance has been made for either of these effects, which would tend to reduce the cost effectiveness of the scheme.

5 The subsidy would, however, be paid to any employer who took on extra staff, over and above those employed at the reference date, not just to those whose behaviour was changed by the existence of the subsidy. Most jobs are created without the aid of any subsidy. In the year to June 1999, the number of employee jobs in Wales rose by 19,300. However, this is a

net change; many employers reduced the number of their employees, and many firms closed. Calculating the gross number of jobs that are likely to be created without the aid of the subsidy is not a simple matter, since no statistics are collected of the gross number of new jobs created. In order to form a ball park estimate of the number of these jobs, it is necessary to have regard to analogous types of statistics in which it is possible to look at flows.

6 There are two types of relevant information from which flows can be identified:

the claimant unemployment count - monthly flows onto and off the count are recorded; and

firms registering for VAT - the number of new registrations and deregistrations is recorded annually.

7 Both sources show a similar pattern over time. Their negative elements - firms deregistering - tend to remain at a roughly constant level each year. In times of recession, the positive elements - new registrtions - fall below losses so that the net effect is negative and the stock of firms falls. In good times, the number of registrations rises above deregistrations so that the net effect is positive and the stock of firms rises. The positive side is never zero - even in the worst of recessions, there are still some firms expanding, and new ones being started. But the positive side can fall to fairly low levels. This verified experience implies that it is possible to produce a rough estimate, actually an underestimate but good enough for the purpose of these calculations, of the usual annual number of job losses, by identifying the net change in the number of employee jobs in the worst years of recession. This is about 30,000 (between December 1981 and 1982).

8 From this, we can estimate that the gross number of jobs created in the year to June would have been of the order of 49,000. Two thirds of these jobs would have been in West Wales & the Valleys; about 33,000.

9 Had the scheme been running in this period, the subsidy would have been payable not only in respect of the 1,300 employees whose employers were influenced by the scheme to create extra jobs but to the employers of the 33,000 employees whose jobs would have been created anyway - this is the (underestimated) deadweight of such a scheme. The estimated total cost of the scheme would therefore have been £53.5 million over the year. In respect of the 1,300 additional jobs created, the cost per additional job would have been about £41,000 - significantly more than the cost per job of other possible schemes.

**Conclusion**

10 It is highly unlikely that Treasury would approve such a scheme unless ways could be found of reducing its deadweight costs very significantly. This is likely to be very difficult because the scheme does not require the employer to do anything additional in order to qualify for the

subsidy.