

**Economic Development Committee**

**Date:** 13 October 1999  
**Venue:** Committee Room 2, National Assembly Building  
**Title:** **OPERATING AID**

**Purpose**

1. The purpose of this paper is to provide a more detailed background for the Committee on what operating aid is and under what powers it may be given. Additionally, an example is given of how operating aid has been used to try to promote childcare provision by companies.

**What is operating aid?**

2. Operating aid is a type of State Aid that is permitted by the European Commission's regional aid guidelines in derogation 87(3)(a) areas (Objective 1 areas). It is a form of aid that is directed at reducing the operating costs of businesses; either by subsidising their activities or by reducing their tax bills. However, it does not cover employment subsidies such as NI reductions, or aid to capital investment, both of which fall within the scope of different sets of EC rules.

3. Operating aid may be given in either of two ways:

as a tax concession; or

as a grant.

All operating aid has to be agreed by the Competition Directorate of the European Commission (DGIV).

**Tax concessions**

4. Tax concessions may take two forms:

a reduction in the rate of tax (including excise duty or rates); or

a tax credit.

Reductions in tax rates might be applied in respect of all firms within a specified area - eg West Wales & the Valleys. Alternatively, they might be targeted at specific types of firms - eg those in particular sectors. Conceptually, they might also be applied to firms pursuing specific activities - for example, research & development work; or the provision of childcare facilities. However, the bulk of these costs are current expenditure and therefore are deducted in full to calculate profits, on which tax is then paid. In those cases, a tax credit could be given.

5. General tax concessions are poorly targeted. All firms would qualify, irrespective of whether they made any additional contribution to economic prosperity as a result of receiving the concession, or whether the concession made a material improvement in the sustainable long term competitiveness of the business. This also applies to tax credits for specific activities, because all firms undertaking such activities would be entitled to the tax credit, even if they would have taken the same decisions without a tax concession (known as "deadweight"). It may be possible, however, to devise concessions on **changes** in expenditure to mitigate this problem.

6. Most tax concessions are the responsibility of HM Treasury, which would have to be persuaded of the need for such concessions, and which would have to bear the financial consequences.

## **Business Rates**

7. However, the National Assembly has powers in respect of Unified Business Rates (UBR). Business Rate relief is controlled by the provisions of the Local Government Finance Act 1988 and may be granted in respect of individual business premises at the discretion of the local authority. The categories of firms for which this discretion may be exercised are:

not for profit organisations;

shops, post offices and other key small businesses in rural areas (all of Wales is designated as a rural area for this purpose); and

businesses, of any size, under threat of closure as a result of difficult trading conditions (hardship aid).

Any further extension of discretion would require primary legislation.

8. Although it is not possible to extend the grounds on which Business Rate Relief may be given, it would in principle be possible to encourage local authorities to make more use of the discretionary powers they already have. These powers are not used to any great extent at present. In order to encourage local authorities to make more use of their discretion, the National Assembly might offer to compensate local authorities to a greater extent than at the present rate of 75%. (The financial consequences would fall on the Assembly's budget.)

9. Additional compensation could be provided evenly across Wales, at different rates in West Wales and Valleys and East Wales, or solely in West Wales and Valleys. Compensation rates could also differ between the three categories of discretion. The proposition will be considered by the working party that has been set up to look at operating aid.

## **Grants**

10. Tax concessions operate at the marginal rate of tax for a firm. In most cases this would be 25%. Grants could be more or less generous, subsidising a greater or lesser proportion of the relevant expenditure. Since grants would be conditional on the firm pursuing specific actions, it would also be easier to ensure that the expenditure was correctly targeted. As with Business Rates, the financial consequences would fall on the Assembly's budget.

11. In addition to subsidising specific expenditures, grants could also make a contribution to firms' working capital.

12. There are two issues connected with giving grants for operating aid:

how large a proportion of the relevant expenditure needs to be subsidised in order to change firms' decisions; and

how long the subsidy needs to be maintained.

13. While the level of grant is a matter of judgement, the European Commission's guidelines require operating aid to be progressively reduced over time. A grant could, therefore, be set at 30% for the first year, 20% for the second, and so on. If operating aid is used as a subsidy to continuing activity, firms will bear in mind the financial consequences well beyond the end of the period of grant. If it is used to subsidise time limited activities - eg an innovation project - there will be no continuing financial consequences for firms to consider. In either case however, firms will take their decisions on the basis of the total package available.

## **Assistance with childcare provision**

14. This approach can be illustrated by the Childcare Demonstration Projects scheme, which was launched in Wales for a three year period to help fill the gap in childcare provision for children below school age. A main aim of the scheme was to demonstrate to employers that there would be significant benefits to them from forming partnerships to develop childcare provision for this age group.

15. The scheme was managed by Chwarae Teg and funding over four has been £350,000 for the first three years and £150,000 for 1999-2000. Grant aid is available for nurseries and for childminding networks and covers pump-priming support for start-up costs and early running costs. However, it proved difficult to secure the active involvement of private sector employers and, for the current year, efforts are concentrating on generating projects in the further and higher education

sectors. Using these as a core, it is hoped that it may be possible to encourage other employers in the local area to become involved.

16. Although this scheme has provided operating aid (under de minimus rules), the take up by the private sector has been very low. The reasons for this will need to be examined in association with Chwarae Teg.

### **Powers of the National Assembly**

17. Business Rate Relief may be given by local authorities under the authority of sections 47 and 49 of the Local Government Finance Act 1988.

18. Most forms of operating aid by way of grants to businesses may, in principle, be paid by the National Assembly under the authority of section 8 of the Industrial Development Act 1982, although there are some limitations to the purposes for which aid may be given which may rule out subsidies to certain activities. These will have to be examined on a case by case basis.

19. Payments to Training and Enterprise Councils (TECs) are made by the Assembly under Section 2(1) and (2) of the Employment and Training Act 1982 (as substituted by section 25 of the Employment Act 1988) and Section 11(1) and 12(1) of the Industrial Development Act 1982. Subject to their Articles and Memoranda of Association, and terms of contract relating to their operations, TECs may make payments as appropriate to organisations for the delivery of training and services specified in contracts with the Assembly.

20. Grants relating to childcare provision are being paid under the Employment and Training Act 1982.