PO-CH/N4/0083

PART E

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Ends: 24/5/88.

PO -CH /NL/0083

PART E

Chancellor's (Lawson) Papers:

THE NATIONAL ECONOMIC DEVELOPMENT COUNCIL

Disposal Directions: 25 Years

[signature]
28/7/95

PO -CH /NL/0083
PART E

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21 April 1988

TO ALL COUNCIL MEMBERS

Dear Council Member

NEDC Meeting, 26 April 1988
Briefing Note by Director General

I attach a briefing note covering the 3 items for discussion at the Council's meeting on Tuesday, 26 April.

Yours sincerely

John Cassels

NEDC Meeting, 26 April 1988
Briefing Note for Council Members from the Director General

Item 1 - SKILLS

There is much ground common to all 4 papers. In particular:

- The skills and competence of the workforce are a key factor in success or failure. The UK has ground to make up on its competitors;

- there are important short-term skill shortages requiring action in specific areas, but the problems are less acute than at previous economic peaks;

- the tasks for the longer term are substantial despite all that has already been done;

- responsibilities rest on public authorities, on employers, on trade unions (acting for their members) and on individuals.

The Office paper focuses on 3 specific questions which the Council may wish to pursue:

(1) The future development of training for young people: as numbers of school-leavers decrease and job opportunities for them increase, what can be done to ensure that 16 and 17 year olds are not attracted into jobs offering good pay but little or no training?

(2) How can our comparative weakness in ensuring an adequate supply of middle-range skills, for example technicians and foremen, be remedied?

(3) How can opportunities for training and re-training for adults who have jobs, be vigorously built up? What obstacles stand in the way of the provision of training for the existing workforce?

The Council may be able to agree that:

- all have a responsibility to raise awareness of the key importance of skills and competence to competitive success and to the job prospects of individuals;

- continuing new initiatives are needed to bring about advance as exemplified by the Local Employer Networks, the compacts between employers and schools in inner city areas, the WISE campaign (Women into Science and Engineering), the growth of the private sector training industry and advances in open learning;

- advantage be taken of the TUC's willingness to encourage joint action in companies and at the workplace.

To these points may be added any action which the Council can agree on the 3 points raised in the Office paper.

Item 2 - REPORT FROM COTTON AND ALLIED TEXTILES SG

Mr Hollander's report raises points relevant to both the other topics on the agenda. It shows how a Sector Group has addressed the problems of motivating small firms to change and to invest in training. The Group has helped its industry to serve the end market for its products by creating better working relationships in the supply chain of which it is part. Thus the industry's customers have become the principal agents of change.

Item 3 - SMALL FIRMS

There is considerable agreement between the 4 papers on 3 questions: the need for the balance of support for small firms to switch from start-up help to the encouraging of established businesses to grow further; the need for the proprietors and employees of small firms to improve their range of skills; and the need for the market to work better to help small firms in such areas as finance, innovation and relations with large companies.

The Council might find it useful to discuss the following questions in particular:

(1) The Government has done much to bring together its services to small firms: what more can be done to make advice available to small firms in a form usable by them rather than simply convenient to the providers?

(2) What more can be done to encourage larger firms to make a positive contribution to the development of smaller enterprises in their mutual self-interest? This issue goes beyond such matters as the prompt payment of bills into such areas as partnership sourcing and corporate venturing;

(3) How can the training problems of small firms be tackled more effectively?

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NH8/5Jo

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01-270 3000

Mr J Edmonds
General Secretary
General Municipal, Boilermakers
and Allied Trade Union
Thorne House
Roxley House
Claygate Esher
SURREY KT10 OTL

22 April 1988

Dear John

I understand that your current two-year term on the National Economic Development Council is due to expire at the end of April. After consultation with the TUC, I am now writing to invite you to remain on the Council for a further two-year period. May I take this opportunity to express my thanks for the contribution you have already made to the work of the Council. I hope you accept this invitation to continue.

Yours ever
Nigel

NIGEL LAWSON

NH8/6J8

mp

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

Mr W Jordan
General Secretary
Amalgamated Union of Engineering
 Workers
110 Peckham Road
LONDON SW15

22 April 1988

Dear Bill

I understand that your current two-year term on the National Economic Development Council is due to expire at the end of April. After consultation with the TUC, I am now writing to invite you to remain on the Council for a further two-year period. May I take this opportunity to express my thanks for the contribution you have already made to the work of the Council. I hope you accept this invitation to continue.

Yours sincerely

Nigel

NIGEL LAWSON

Flan/041

FROM: S J FLANAGAN
DATE: 22 April 1988

1. MR MACAUSLAN
2. CHIEF SECRETARY

cc Chancellor
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Monck
Mr Burgner
Mr R I G Allen
Mr Pickford
Miss O'Mara
Ms Roberts
Mr Wynn Owen

Mr Reed - IR

NEDC - 26 APRIL, 10.00 AM

You are attending NEDC on the morning of Tuesday 26 April at Millbank Tower. I understand that the Economic Secretary will take over from you after the first hour.

2. I attach a copy of the Steering Brief which is also being submitted to Mr Fowler and the other Ministers attending. Also attached is a summary of points to make on particular Treasury concerns. Those on **Item 1 (Skills)** and **Item 4 (NEDO Plan and Budget)** derive from Treasury responsibility for the NEDO grant-in-aid and general arrangements.

3. The TUC (and possibly the CBI) may raise policy on **interest rates** and **exchange rates**. We understand that the TUC are likely to raise exchange rates during **Item 2 (Cotton and Allied Textiles)**. Para 2.11 of the Brief provides a standard defensive, tailored to the Textile industry. MG division will consider whether any developments between now and close on Monday warrant further briefing.

4. On **Item 3 (Small Firms)**, you should be aware that the CBI proposal for **Local Investment Companies** (para 3.25 of the Brief) bears a close resemblance to the Budget representation made by Lord Young for "Local Enterprise Companies". This was not carried forward by the Chancellor. Mr Fowler and Mr Maude may be sympathetic to the idea, so you might have to stiffen the line.

Wh I have slightly amended.

5. It is also likely that the TUC will raise the Budget and the NHS (and there is no DHSS Minister present).

Events near the NEDC Meeting

6. You should be aware of 3 events near the NEDC meeting:

- **Employment Training:** The TUC's employment and training committee meets on Monday 25 April to consider whether or not to co-operate with the Employment Training programme. They will be making a recommendation to the full TUC General Council on Wednesday 27. NEDC falls in the middle. Paras 1.28 and 1.33 of the brief deal with this subject.

- the **TCSC report** on the Budget will be published on Monday 25 April.

- the latest **CBI Industrial Trends Survey** will be published on the morning of Tuesday 26 April. EB will be providing their usual briefing note on the Survey on Monday 25.

Steven Flanagan

S J FLANAGAN

SPECIFIC TREASURY POINTS TO MAKE

Item 1: Skills

Transfer ITSA activities to NEDO? Must be carefully considered by all parties through usual channels. NEDO only willing if **full costs** met by private sector. Unrealistic to expect Government to pay [Brief: para 1.52].

Item 2: Cotton and Allied Textiles

Exchange rate damaging exports/trade balance? Greatest threat to output and employment would be if Government relaxed anti-inflationary strategy. Textile exports at record levels - increased 12% 1987 over 1986. Competitiveness determined as much by quality as by price. [Brief: para 2.11 (v)].

Item 3: Small Firms

Budget tax measures benefiting small firms: **inheritance tax** threshold up, 4 tax rates replaced by single 40% rate; small companies **corporation tax** rate down to 25%; tax on pre 1982 **capital gains abolished; capital gains retirement relief** increased; **VAT registration threshold** increased to EC legal maximum. [Brief: para 3.16].

Local Investment Companies (LICs): proposal seems inconsistent with policy of broadening tax base to allow lower rates. Special reliefs have to be narrowly targeted, like BES. [Brief: para 3.25].

Business Expansion Scheme (BES): **ceiling** will improve targeting on small firms. Restrictions on BES relief for people investing in **own companies** to avoid "deadweight". Also risk of abuse. [Brief: para 3.33].

Demand inadequate? (TUC). Now entering 8th year of growth averaging 3 per cent. Growth during 1987 above trend. Not surprising if some deceleration in 1988.

Item 4: NEDO Plan and Budget

NEDO Budget too low? **Entirely consistent** with decisions on number of Council meetings and Sector Groups. Grant-in-aid includes £320,000 to cover **transitional costs**. All **redundancies** voluntary. NEDO recognise opportunity to **increase efficiency**. [Brief: para 4.6].

NATIONAL ECONOMIC DEVELOPMENT COUNCIL

TUESDAY 26 APRIL 1988 AT 10.00 AM

	Agenda Item	Suggested Timing
1.	Skills	1 hr
2.	Sectoral: Cotton and Allied Textiles	30 mins
3.	Small Firms	50 mins

4.	The NEDO Plan and Budget	0

MEMBERS

HMG: Mr Fowler will chair. Mr Cope will attend for item 3.

Mr Major will attend for Treasury until 11 am.
Mr Lilley will attend thereafter.
Mr Ridley will be present
Mr Jackson will attend for DES.

Mr Maude will attend for DTI.

Mr Parkinson will not attend.

TUC: Mr Edmonds, Mr Jenkins and possibly Mr Jordan will be absent.

CBI: Dr MacFarlane will be absent.

GUESTS

Mr S D (Stuart) Hollander, CBE Chairman of Cotton and Allied Textiles SG since 1981. Born 1932 Educated King's Cambridge. Senior VP and MD European Division, Kurt Salmon Associates Inc to 1981. Chief Executive Compton Webb Group 1982-86. Group MD Aquascutum Group Plc since 1987.

NATIONAL ECONOMIC DEVELOPMENT COUNCIL: MEMBERSHIP LIST

HM GOVERNMENT

Rt Hon Nigel Lawson MP	Chancellor of the Exchequer
Rt Hon Norman Fowler MP	Secretary of State for Employment
Rt Hon Nicholas Ridley MP	Secretary of State for the Environment
Rt Hon Lord Young of Graffham	Secretary of State for Trade and Industry
Rt Hon Kenneth Baker MP	Secretary of State for Education and Science
Rt Hon Cecil Parkinson MP	Secretary of State for Energy

CBI

Sir David Nickson	President
Mr John Banham	Director General
Sir T (Thomas) Risk	Governor Bank of Scotland
Dr J (Jim) McFarlane	The Engineering Employers' Federation
Mr D A (Alec) Monck	Chairman & Chief Executive, The Dee Corporation
Mr T (Tom) J O'Connor	Chairman and Managing Director, Elta Plastics Ltd

TUC

Mr N (Norman) Willis	General Secretary, TUC
Mr R (Ron) Todd	General Secretary, TGWU
Mr C (Clive) Jenkins	General Secretary, ASTMS
Mr W (Bill) Jordan	General Secretary, AUEW
Mr R (Rodney) Bickerstaffe	General Secretary, NUPE
Mr J (John) Edmonds	General Secretary, GMBATU

INDEPENDENTS

Rt Hon Robin Leigh Pemberton	Governor, Bank of England
Mrs Rachel Waterhouse CBE	Consumers' Association
Mr Bryan Nicholson	Chairman, Post Office

NICG

Sir Robert (Bob) Haslam	Chairman,British Coal

NEDC

Sir J S Cassels CB	Director General, NEDO

SIR DAVID NICKSON

[Sir David Nickson is leaving the post of CBI president, to be succeeded by Sir Trevor Holdsworth. This is his last NEDC meeting. You might like to say a few words].

- Understand this is Sir David Nickson's last Council meeting. Sure that all Council members would agree that his contribution to Council meetings, like his presidency of CBI, has been exemplary. Wish him well in future.

ITEM 1: SKILLS

Handling

1.1 You should start by introducing the joint DE/MSC paper. You might then invite Sir John Cassels and then TUC and CBI to introduce their papers. Mr Jackson may also wish to comment.

Objectives

1.2 (i) Gain acceptance that the three factors identified in the DE/MSC memorandum - **demographic change, technological change** and **occupational change** - will shape skill needs and the necessary training response for foreseeable future.

(ii) Seek acceptance that those factors require **flexible training response** from individuals, employers and Government. Existing training and working practices should not impede essential change.

(iii) Secure acknowledgement that continuing development of initial training for young people now needs to be supplemented by more and better **training for adults** to meet growing demand for certain skills. Higher investment by employers and employees in training needed to complement Government efforts to equip the unemployed with skills.

(iv) Secure agreement that prime responsibility for investment in training **employees** lies with **employers**.

(v) Obtain recognition of major expansion of **investment by HMG** in education and training and resist pressure for additional public spending to meet skill needs.

The papers

1.3 The **DE/MSC memorandum** starts with the strong performance of the economy and identifies three key determinants of skill needs and training responses, to which a response is necessary if economic performance is to be sustained:

- **demographic change** will reduce the supply of young entrants to the labour market available for training and stabilise the population of working age in the 1990s. Employers will have to train more adults, both employed and unemployed, to meet their skill needs.

- **continuing, unpredictable technological change** needs to be fully exploited if the economy is to remain competitive . The consequent demand for higher level skills will require employers to invest in the upgrading of the skills of their employers, and the unemployed will need skills to obtain jobs.

- consequent **occupational change** will continue to be reflected in a shift towards employment in the service sector rather than in manufacturing, growth in self employment, and more flexible employment patterns. Skills and their delivery need to reflect those developments.

Short term trends manifest in the latest MSC Skills Monitoring Report, show that those influences are already being felt in the form of growing demand for higher level skills while, at craft level, short run demand reflects recent growth in construction and manufacturing. **Government training policy and investment** (about £3 billion planned for 1988-89) has already responded to those challenges by equipping the young with skills (YTS, TVEI, NAFE, Compacts) and, now, giving the adult unemployed the skills they need for modern jobs through Employment Training. It also encourages **employers' training investment**. Employers need now to respond especially by upgrading skills of existing employees and providing training for the unemployed. **Unions** can assist by reducing impediments to acquiring and applying new and changing skills. Individuals need to recognise the growing need to acquire and adapt skills.

1.4 <u>Sir John Cassels' paper</u> detects an expansion of training by employers brought about by growing awareness of the importance of human resource development, changes to the tax regime and improvements in industry's ability to fund training due to increased profitability. Nevertheless, it highlights the need to address issues concerned with YTS, adult training and middle range skills within the context of an enlarged labour market, demographic trends, technological change and the shift in demand towards higher level skills. In the case of YTS, NEDO express concern that the **tightening of the youth labour market** will result in higher wages attracting young people into jobs with little or no training and suggests that (unspecified) action will be needed to prevent this. On **adult training,** the paper questions whether employers will be prepared to offer more broad based skill training to their employees without (unspecified) encouragement from MSC. The role of the new Employment Training Programme is training the adult unemployed is acknowledged, but primarily as a means of adding to the supply of lower level skills. The need to minimise restrictive practices is the deployment of skills is hinted at. There is little on increasing individuals' responsibility for their own development. On the third area - middle range skills - the paper concludes that British industry suffers from less well educated and trained people in middle range technical and managerial positions than competitor countries.

1.5 <u>The TUC paper</u> recognises the crucial role of skills in generating economic success but claims significant under-training within the UK, compared with our international competitors. It is critical of the emergence of skill shortages during a time of high unemployment but fails to address the issues of skills mismatch analytically. The problem is seen as stemming from an overall lack of training, especially the decline in apprenticeships. The TUC calls for co-operation between Government, employers trade unions and public sector education and training institutions, (private sector training organisations are ignored). Emphasis is placed on **Government intervention** in, and funding of, training. The paper argues for rights to training and education and paid educational leave; an expansion of apprenticeship and special help for women, eg in non-traditional occupational areas. It asserts that training - for young people and adults - should be voluntary. While acknowledging that unemployed adults need training for jobs, it claims that Employment Training is under-resourced. MSC research on non-statutory training organisations is cited as proof that the move from ITBs to a voluntary approach to sectoral training was wrong. In advocating the consensual approach to training at the enterprise and national level, it laments proposals to give employers a stronger voice on MSC and locally.

1.6 The CBI paper emphasises the **role of employers** in meeting their present and future skill needs. It recognises past UK under-investment in this area but rejects the case for statutory intervention. A tightening of the skills market over the last twelve months is identified but suggestions of crisis are rebutted. While there is perceived to have been improved management of skills in UK firms, and increased training investment, demographic and technological changes are likely to lead to increased demand for higher and wider skill levels. **Government initiatives** to remedy deficiencies in basic education and training are acknowledged; and the CBI expresses its commitment to Employment Training and the Enterprise and Higher Education Initiative. However, the **main response** to skill shortages is placed firmly in the workplace; with employers and employees. The CBI believes training by employers to be more extensive and effective than has been acknowledged hitherto. The MSC Funding Study may show this to be the case. **Employer involvement** in improving training responses to skill shortages is identified as crucial: Local Employer Networks and the proposed code of practice on management development are mentioned. The paper identifies the need for non-training responses to skill shortages. Increased flexibility, partly arising from the disappearance of restrictive practices, has eased the pressure on skills supply, but other factors are relevant including employment costs, pay differentials, recruitment procedures and geographical mismatch of skills.

Views of the TUC/CBI

1.7 The CBI will help to counter any TUC criticism of Employment Training agree employers should invest more in training, given increased profitability; mention the Management Development initiative; and urge the Council not to panic over skill shortages. John Banham will present the paper.

1.8 The TUC paper will be presented by either Ron Todd or Norman Willis. Their exact line on Employment Training may depend on the emergency meeting of the relevant TUC sub-committee on Monday, which will be putting a recommendation (possibly for a national boycott) to the TUC General Council for decision on Wednesday, so they may use NEDC on Tuesday to seek assurances from you.

Follow up

1.9 (i) **NEDC/NEDO** - avoid specific follow up by Office or to Council. But SGs could encourage employers to invest more in training (eg in Information Technology).

(ii) **HMG** - continued improvement in the responsiveness of YTS to skill needs; rapid implementation of the Employment Training programme to equip the adult unemployed with skills they need for jobs and employers need to compete; continued development of MSC policies to encourage employers to train more and better. **Avoid commitment to further papers.**

(iii) **CBI** - should be encouraged to step up their efforts to get their members to respond to the Government's lead by investing more in training of their employees and to provide opportunities for unemployed.

(iv) **TUC** - should encourage members to ensure that the training arrangements in which they are involved are responsive to changing skill needs. They should co-operate in changes in working practices to allow the full exploitation of skills.

Conclusions

1.10 (i) Government's **overall economic policies** have fostered a climate of steady growth and confidence. This should encourage investment in training.

(ii) Wide measure of agreement that **demographic, technological and occupational change** necessitates major reassessment and upgrading of adult training arrangements, together with continued qualitative development for young people.

(iii) Employers and employees need to recognise the **growing importance of acquiring modern skills** to achieve and sustain business and career success. As CBI acknowledges, "the prime responsibility for...the skills of employees...rests with employers".

(iv) Government already investing substantially in [the declining number of] unemployed people through Employment Training.

(v) **Existing training arrangements** must not impede change, otherwise the necessary investment in training will not be forthcoming. Scarce skills need to be deployed effectively to maximise cost effective training investment. Costs of training need to be minimised to improve incentives to train - in particular, trainee wages are unusually high in Britain compared to other countries.

Presentation of DE/MSC paper

1.11 To sustain progress in economic performance, faced with increasing international competition (cf. 1992 Single European Act), vital to make skills provision even more responsive to key influences of demographic change, technological change, and consequent occupational change

1.12 Demographic change, will stabilise population of working age by mid 1990s and cut the number of 16-19 year olds by nearly a million (to 2.6 million). Employers will have to improve quality of training for young people and provide more training to upgrade existing skills of employees and, with HMG's help, the unemployed. Scarce skills must be put to the best possible use.

1.13 Unpredictable technological change must be fully exploited and skill requirements need to respond accordingly. Many of the new jobs created will require higher level skills. The unemployed will need skills for jobs, and employers will have to invest more in upgrading the skills of existing employees. Individuals will need to recognise the importance of acquiring and updating skills. Training providers will have to respond to new skill needs by taking full advantage of the advances in the delivery of training which new technology will bring.

1.14 Occupational change will flow from these demographic and technological influences on labour demand and supply. Further scope for increasing manufacturing productivity will continue to produce fewer jobs in that sector than in the service and commercial sector. New technology will continue to provide scope for more flexible employment patterns including self employment. Training will have to be responsive to individuals' occupational changes and the aptitudes required to succeed within an enterprising framework.

1.15 The latest MSC Skills Monitoring Report (Annex) suggests these influences are already manifest in growing demand for a limited range of higher level, including management skills. At the lower skill level demand reflects the strong and spreading recovery in manufacturing and construction. Employers continue to be reluctant to hire qualified but inexperienced people.

1.16 The <u>response required</u> must involve individuals, their representatives, employers and HMG. HMG has already taken major steps, through YTS, TVEI, Compacts, work related NAFE and Enterprise in Higher Education initiative to prepare young people in education for the challenges of work, and to provide 16-18 year olds with their initial skill base. 'Training for Employment' tackles the challenges of providing the adult unemployed with the skills they need for jobs and employers need for the future. Also backing industry efforts to train its employees by providing a framework of qualifications (NCVQ), special help for smaller firms, information for individuals and employees and promoting employer investment in skills. HMG investment in training has grown massively since 1978, and will reach around £3 billion when Employment Training is underway. Vital that Training Commission gets the best out of this major investment.

1.17 Looking to <u>employers to step up their efforts</u> accordingly:

- need to continue to take full advantage of YTS by continuing to improve quality of training and subsequent training for higher skills, to provide smaller number of young people with incentive to join. Deepen links with education

- develop new training strategies for training through working life, to get the best out of existing employees.

- provide more training opportunities for unemployed, and women wishing to return to work, to tap an undervalued source of talent.

1.18 Training will succeed in attracting investment and meeting skill needs if it is <u>relevant</u> and if skills can be <u>applied</u> to best effect. Employers, and unions, needs to recognise their responsibilities to reform the priorities for pay and working practices to this end. Both can help in <u>developing an appreciation by the individual</u> that the acquisition and adaptation of skills has become vital to sustain job and career prospects, and merits investment of time and income.

Supplementary Points to Make

Factual

1.19 TOTAL NUMBERS IN TRAINING/EDUCATION (millions)

	Spring 1984	Spring 1985	Spring 1986
People of working age	4.6 (13.8%)	4.7 (14.1%)	4.8 (14.4%)

1.20 TOTAL NUMBERS RECEIVING JOB RELATED TRAINING (millions)

	Spring 1984	Spring 1985	Spring 1986
People of working age who we economically active (included in 1 above)	2.1 (8.3%)	2.5 (9.7%)	2.6 (9.9%)

(Source Labour Force Survey)

1.21 PROGRAMME EXPENDITURE ON MAIN MSC TRAINING PROGRAMMES

	1979-80 (outturn)		1989-90 (PEWP 1988 adjusted)
Adult training	£306m		£ 63m (other than Employment Training)
YOP	£114m	YTS	£1,189
Employment Training	-		£1,409m
TVEI	-		£ 118m
NAFE	-		£ 118m
Total	£419m		£2,899m

1.22 NUMBERS HELPED ON MAIN MSC TRAINING PROGRAMMES

	1979-80 (outturn)		1989-90 (PEWP 1988 adjusted)
Adult training	95,200		* (other than Employment Training)
YOP	216,400	YTS	363,000
Employment Training	-		600,000
TVEI	-		906,500
Total	311,600		1,869,500

* Schemes other than Employment Training Programme will be mostly project based.

1.23 MSC TRAINING EXPENDITURE AS PERCENTAGE OF GDP

1978-79 0.22% 1986-87 0.36%

1.24 NUMBERS OF APPRENTICES IN GREAT BRITAIN

1979 367,000 (9% female) 1986 318,000 (19% female)

c/f 1979/80 (YOP) 216,400 YTS 1986/87 360,000

Positive

1.25 Government policies have fostered training. Sound financial policy, stable macroeconomic environment, steady growth combined with low inflation, higher profits, all ideal for confidence and investment in training. Improvements in supply side also help.

1.26 Government expenditure on training

(i) Government has given a lead by massively expanding public investment in training to **nearly £3 billion by 1990** compared with less than £500 million in 1978-79.

(ii) Unprecedented provision for initial training of young people through **2 year YTS** and now for unemployed through **Employment Training.**

(iii) Creation of a **market for training**, involving public and private providers, a more efficient use of resources than uncompetitive public provision alone coupled with statutory rights.

(iv) **Employers and individuals** need to take greater responsibility for assessing their skill needs and taking appropriate training decisions - main shortcoming compared to our main competitors identified by "Competence and Competition" (1984 MSC/NEDO study).

1.27 Development of YTS

(i) Welcome consistent TUC support for continued improvement. Experimenting with more employment contracts in compacts, and continually improving quality. But **important to hold down remuneration element** in training costs, which (according to NEDO) is high in UK.

(ii) Welcome CBI recognition that 2 year YTS, along with other measures, will help to tune **output of education system** to the needs of industry. Agree with NEDO that "as some [YTS] training content is always specific to the firm, employers must expect to bear a share of the costs..." - indeed, the lion's share.

1.28 Employment Training Programme

(i) TUC: Government aiming to secure that available public resources bear, as far as possible, on **training quality** rather than labour costs.

(ii) Welcome CBI commitment to support the Employment Training programmes. But support needs to be demonstrated by participation as training managers or providers of practical experience placements. Firms not keen so far (re: New JTS) to take on the long term unemployed despite their potential (25 per cent of the 6 month plus unemployed have in A level or more). How can CBI help overcome resistance?

1.29 Common ground on target groups (TUC) especially initial training for young people and the unemployed - but TUC in focusing on Government ignores **essential contribution of employers and individuals.**

1.30 Employer responsibility for investment in training

(i) Welcome CBI acknowledgement that responsibility for **training employed** rests heavily with employers and individuals who derive benefit.

(ii) Agree that there are signs employers are recognising this. But good intentions need to be **translated into action.** 1987 CBI/MSC Annual Survey showed that employers faced shortages of some experienced staff but tended not to be prepared to give basically qualified people the experience. Latest IMS IT Manpower Monitor notes major improvement in supply of IT graduates in last 2 years and easing of shortages but highlights reluctance of employers to train, despite relatively low staff turnover. Existing training arrangements and skill requirements should not stand in the way.

1.31 Training through life necessary

(i) Welcome TUC recognition that adult training through working life needed to meet present and future skills needs. Adult training will need to be stepped up to meet **demographic decline of young.**

(ii) Hope TUC will help to minimise obstacles to rapid implementation of adult training:

- if employers are to have incentive to train more, vital that **training costs** are contained (Annex to NEDO papers show that wage cost element in UK high by international standards)

- **restrictive practices** must neither impede application of scarce skills to maximise productive effect, nor inhibit new training responses to changed skill needs (multi-skilling, adult craft and technician training).

(iii) Agree with CBI that the way to get employers to invest more in training to meet skill needs is to persuade them of the **benefits of training.** Countries with best training performance are those which accept this (eg Japan, FRG).

1.32 Greater individual commitment to training necessary: MSC experimenting with ways of improving access to training information (Training Access Points - TAP); NCVQ working on qualifications to aim for. Cost Sharing needs to be explained by employers and employees.

Defensive

1.33 Employment Training:

(i) Sir John Cassels envisages too limited a **role** for Employment Training in meeting future (intermediate) skill needs. Many 6 months unemployed have qualifications (25 per cent have an "A" level). Exceptions to the 6 month rule for special skills.

(ii) More Government support for improving skills of unemployed releases employer resources for upgrading the skills of the employed.

(iii) **Training allowances** based on needs and giving a lead over benefit, appropriate for a training programme. MSC proposals, accepted by HMG, recognised that "**rate for the job**" inappropriate for practical training. Interests of unemployed best served by concentrating resources on training content.

(iv) Have confirmed (frequently) that Employment Training is **voluntary**. No present plans to designate as "approved training". [NOT FOR USE: which would mean refusal leading nearly automatically to loss of benefit]. Legal rules governing availability for work remain consistent with principles of National Insurance Act 1946, accepted by successive Governments.

(v) Arrangements for **local approval** of schemes as recommended unanimously by Commission.

(vi) Employment Training responds to special needs of single parents by offering generous support for **childcare**.

(vii) Employment Training a massive redeployment of funds in favour of equipping adult employed with basis for skills. Far in excess of "**old" Job Training Scheme** (eg skillcentre courses), which was never intended to substitute for skill training by employers. Up to employers to build higher level skills into Employment Training, exploiting special skills provision where necessary.

1.34 Skillcentre Review: review of skillcentres announced in November. Considering initial report received recently. TUC ignores very substantial private training providers.

1.35 Funding Study: MSC Funding Study reporting later this year. Incentive for firms to invest in training depends on training costs - monthly wage costs (relatively high in UK according to annex to NEDO report) - and ability to apply skills to maximum productive effect. "Competence and Competition" (MSC/NEDO 1984) said HMG should maintain spending, which has since grown substantially.

1.36 National Council for Vocational Qualifications:

(i) Propagation of standards of competence for skills by objective of **NCVQ**. Government funding for NCVQ now around £2 million a year. Some advances: accreditations in hotel and catering, road transport. But pace conditioned by response of bodies involved in training, especially employers.

(ii) agree with NEDO that some international comparisons point to a gap in the development of **intermediate qualifications** and training in UK. A function of historic tendency to minimise formal qualifications and place on premium on experience rather than professional standards. Important, in developing new standards, not to create new rigidities.

(iii) more difficult to establish **consequences** of relative absence of such qualifications, in terms of ability to make the most of technological change. National Institute (NIESR) research less convincing on that issue. Other impediments (eg level and productivity of capital investment, restrictions on the deployment of skills).

1.37 Local Employer Networks: Agree with CBI that effective Local Employer Networks can help to secure local employer commitment to training. But employers must demonstrate commitment by contributing to (low) running costs.

1.38 Non-statutory training organisations: Welcome CBI thoughts on ways to improve performances of Non Statutory Training Organisations: initial study by MSC suggest majority (56 out of 90) are effective; but that poorer performers need to learn lessons from the best.

1.39 Industrial Training Boards

(i) ITBs had many years to prove themselves. The 17 abolished in 1982 had failed. Fiscal measures would distort the economy. They, and levies, are no substitute for persuading employers to recognise the need for adequate training to meet skill needs as in many competitor countries.

(ii) Many countries with the best training records have relatively few **statutory arrangements**, but high employer investment in training (eg USA, Japan, FRG).

1.40 Paid educational leave: Rights to paid educational leave would add significantly to labour costs and damage job prospects. Difficult to focus on vocational development of individuals, and would tend to reduce incentives for employers to invest in meeting skill needs. Need to concentrate resources on that task.

1.41 Contract Compliance: **Race Relations Act 1976** makes it unlawful to discriminate in employment on grounds of ethnic origin. Public contracts awarded on grounds of merit, within the terms of existing law. **Quotas** - implied by some interpretations of contract compliance - inconsistent with principles of Race Relations law. Training is one way to help ethnic minorities: they are well represented on MSC programmes.

1.42 Little recent improvement in training performance: Agree that more investment by industry in skill provision essential to sustain economic success. But TUC substantially undervalue recent improvement in performance: 1986 Labour Force Survey shows 14 per cent of people of working age had received education or training in preceding 4 weeks, 10 per cent job related training alone. [NOT FOR USE: TUC figures of 4 per cent in 1984 outdated - wrong even for 1984!]

1.43 Decline of apprenticeship: This decline might have been greater without YTS support. But YTS has also opened wider training options for more school leavers and employers. Demographic trends mean that role of apprenticeships bound to be limited in future. If apprenticeships are to develop, they will have to be more responsive to changing skill needs and improve cost effectiveness. Labour cost element has tended to be high, access limited, duration and content ossified, and testing of skills insufficient.

1.44 Evidence of shortfall in skills is growing: Not surprising that shortfall in some skills growing, given 7 years of economic growth averaging 3 per cent a year. But **CBI Quarterly Survey** - the only basis for long term comparison - shows that, through growing, level of **shortages still well below levels of 1970s**. Then, apprenticeships were main source of craft skills. Now need more flexible training responses to meet (mainly higher) skill needs of 1990s. No evidence that remuneration of trainees on obstacle to recruitment and every indication that acquisition of relevant skills leads to greater job security.

1.45 Shortages of nurses and science teachers: DES and DHSS tackling limited shortages of specialised teachers and nurses respectively [DES and DHSS Ministers present may wish to add]. Specific steps to address particular problems needed, not generalised responses.

1.46 Increased employer representation on training bodies: Main reason for seeking greater employer representation on training bodies (eg Training Commission) is to encourage the greater commitment needed from them. As the TUC acknowledges, employers are the main source of funds for training employees, which needs to grow in response to demographic and technological factors.

1.47 Higher education

(i) **Access:** Increase of 180,000 in number of students since 1979. Age participation index up from around 12 per cent to over 14 per cent. Proportion of women up from 42 per cent to 46 per cent since 1979 - particularly marked among mature students. Number of mature students (male and female) up by 42 per cent since 1979 to 186,000 in 1987-88 academic year. A third of mature students (over 40 per cent of those aged 25+) enter higher education without traditional qualifications.

(ii) **Student loans:** Government is considering. No decisions reached yet.

1.48 Education maintenance allowances: No evidence that education maintenance allowances needed to encourage 16 year olds to pursue education: 45 per cent stay on at school. Relevance of education main incentive: TVEI helps to develop relationship between curriculum and vocational aspirations of young people. Note from NEDO paper that in trance no allowances paid, despite larger vocational element.

1.49 Withdrawal of benefit entitlement from 16-17 year olds: Will not prevent study: no need for young people to be unemployed given Government commitment to find YTS places. Benefits not intended as a means of educational support. Beveridge wrote that "for boys and girls there should ideally be no unconditional benefit: their enforced abstention from work should be made an occasion for further training".

1.50 Higher paid jobs without training will lure young people away from VET? (i) attractions of higher paid jobs, without training, for 16-18 year olds as unemployment falls are **overstated**. Many young people (about a third) prepared to stay on at school without pay. Employers may prefer to recruit unemployed with appropriate practical experience to meet low intermediate skill needs. Hence Government's investment in Employment Training.

(ii) way to overcome attractions of higher paid unskilled jobs is to continue to enhance the **attractiveness of YTS** for young people as a gateway to training leading to a career. That is why Government aiming for 75 per cent of YTS trainees to obtain recognised qualifications by 1991. Parents, teachers, employers, unions and Government all have a hand in persuading young people of the merits of initial training, despite any short run income penalty. That understanding lies behind success of initial training in FRG, where training allowance are very low relative to average pay.

1.51 Higher skills differentials needed: Agreed that need for adequate rewards for skills should be a priority **within non-inflationary settlements**. Important to get best use from scarce skills.

1.52 Information Technology Skills Agency (ITSA): Despite employer involvement, ITSA has not secured a better training response from IT employers. It was not just ITSA members who provided £24 million to contribute to Engineering Technology Programme, which was funded largely by HMG. [**IF RAISED:** transferring ITSA activity to NEDO must be carefully considered by all parties through usual channels. Understand that NEDO have made it clear they would only take this on if full costs were met by interested employers/CBI. Unrealistic to expect Government to pay for activity currently in the private sector].

1.53 Management Education: Welcome CBI involvement in Council for Management Education and Development (**CMEAD**) and steps to get employers to collaborate to improve the cost effectiveness of their training investment.

1.54 Small firms and self-employed create training problems? MSC training provision targetted at the needs of small firms (Local grants to employers) and the management training needs of the self-employed (MACE and now Employment Training). Small firms can also exploit general training provision to the full (eg YTS, Employment Training)

1.55 Why is MSC Chairman not an NEDC member? MSC/Training Commission is in a state of flux. Sir James Munn is chairing MSC **on an interim basis**. Chancellor decided it was not appropriate to invite him to join the Council.

1.56 Paper is attributed to DE **and** MSC - where is MSC Chairman? Sir James Munn is busy elsewhere. I will cover any points raised within his field.

ITEM 2; COTTON AND ALLIED TEXTILES SECTOR GROUP

Handling

2.1 You should ask Mr Stuart Hollander, the SG Chairman, to introduce his paper. You might then turn to the CBI and the TUC. Mr Maude might then reply for the Government.

Objectives

2.2 (i) congratulate Group on its work

(ii) avoid making commitments to funding future work - either projects or life of Group as a whole (due to expire shortly)

The Paper

2.3 The Sector Group will reach the end of its two-year life in September 1988. No decisions have yet been taken on whether or not to reconstitute it. Union representation on the SG is mainly from the GMB, but the TGWU and the National Union of Dyers Bleachers and Textile Workers are also represented. Industrial representation includes subsidiaries of Courtaulds and Coats Viyella.

2.4 Profits in the industry are described as "healthy". Imports account for 60 per cent of the UK market. 25 per cent of UK production is exported.

2.5 For historical reasons, a prominent role in the UK industry is played by "Merchant converters", who buy in grey (ie unfinished) cloth, and arrange for it to be printed and finished on a commission basis for sale to the end-user. They act as middlemen at all stages of the supply chain.

2.6 SG activity has been concentrated in 3 approaches:

a) improving response to the market place: two export initiatives (a trip to Scandinavia and a market study of France); a "Better Converted in Britain" exhibition; and a "Computer and Creativity" seminar;

b) dealing with vulnerabilities in the textile supply pipeline: mainly trying to improve relations between converters and weavers/finishers, aimed at improving speed of response to changing fashions. Also developing "best practice" demonstration projects, together with Clothing SG;

c) attracting and developing talent: report "Management Training and Development" just published; self-help strategic planning scheme; part-time training course developed with Manchester Business School and MSC.

Views of the CBI/TUC

2.7 The CBI will welcome the work of the SG, especially its emphasis on technology and market-led activity. They will note that many CBI initiatives (eg partnership sourcing) complement the Sector Group's work and offer help where appropriate. They will welcome the Manchester Business School/MSC Specialist management course, but will recommend other, more general, management courses as alternatives.

2.8 The TUC will welcome the work of the Sector Group. They may claim that the rising exchange rate is damaging the sector's export prospects and further damaging the trade balance.

Conclusions

2.9 (i) congratulate the Group on all the useful work it has undertaken and has in hand

(ii) with consumer demand increasingly volatile the need to react quickly to market requirements at all stages of the supply chain is clearly important for long-term success.

Supplementary Points To Make

Positive

2.10 (i) targets of Sector Group activity seem right. If full advantage is taken of latest information and other electronic technology, proximity to the market should provide competitive advantage: but only if UK firms can compete effectively with European counterparts in terms of design, quality and service - and only if they can attract and maintain a skilled work-force and talented managers.

Defensive

2.11 (i) Need EC strategy for textiles and clothing industry? [Mr Willis has advocated a Community Advisory Panel for Textiles and Clothing (unions, industry, Governments, and Commission), to arrive at strategic overview of the European industry]. This kind of sectoral strategic approach has failed in the past and would run counter to our general policies. No reason to assume European version would work.

(ii) Protection needed against low cost imports? [Multi Fibre Agreement (MFA) - which TUC think not tough enough - expires 1991]. Most imports of textiles, knitwear and clothing from low cost sources are subject to bilateral agreements negotiated by EC. Must operate in accordance with those agreements and principles of MFA. Future of MFA past 1991 is one of many complex issues for discussion in current round of GATT Multilateral Trade Negotiations.

(iii) Will SG continue past September 1988? Has to be considered via usual channels. For Group of 4 to decide.

(iv) Will DTI support particular projects? (eg Sector Group Quick Response). Only limited DTI funds available for SG projects; each case will be looked at on its merits.

(v) British industry suffering from exchange rate rise?

(a) If firms ~~accept financial discipline~~ implied ~~by exchange rate and~~ contain their costs, then no need for loss of competitiveness. Greatest threat to output and employment would be if Government relaxed its **anti-inflationary strategy**.

(b) Consistent trend of 1980s has been that British manufactures have **maintained their share** of expanding world trade, after decades during which Britain's share was steadily declining. In March, British Textile Confederation report "Trends in Textile and Clothing Trade in 1987" showed 12 per cent increase in value of textile and clothing exports between 1986 and 1987 to a record £3,532 million.

(c) Competitiveness determined as much by **quality** as by price. Increasingly true as textile industry invests in new technology and moves into more specialist and upmarket goods which are less price-sensitive.

ITEM 3: SMALL FIRMS

Handling

3.1 Mr Cope will attend to speak to this paper (using para 3.11 of this brief). Then ask Sir John Cassels, CBI and TUC to introduce their papers. Then invite any other comments, as necessary from Mr Maude. You might sum up, drawing on the conclusions in para 3.12 of this brief.

Objectives

3.2 (a) Emphasise importance of sector and amount of assistance available from both public and private sectors for small firms.

(b) Stress the importance of removing market failures which constrain further growth for established small firms and seek views.

(c) Invite discussion on need to make small firms more aware of appropriate sources of advice and of training opportunities that are available.

The Papers

3.3 The DE paper aims to summarise what assistance is available to small firms and to clarify how public and private sectors complement each other; also aims to raise questions of concern to Government in development of its policy towards small firms.

3.4 The NEDC paper, (see Annex to this brief for summary of conclusions) includes a detailed memo' examining the important contribution of small firms to the UK economy, and concentrates on the issue of barriers to the growth of small firms. It welcomes the role of DTI's Enterprise Initiative; draws attention to the need for more training for small firms' employees and a more positive attitude towards training from employers; welcomes moves by large companies towards supplier development and partnership sourcing. NEDO are developing a "Corporate Venturing Register" to help large and small companies find suitable partners for both financial investment and broader business returns.

3.5 The CBI paper (see Annex) concentrates on factors to encourage growth of established small firms, particularly in innovation and finance; argues small firms would be more successful innovators if there were a greater understanding of the strategic importance of marketing. Technology transfer opportunities could be exploited more. CBI is aware it has a role to play with NEDO in encouraging partnership sourcing and corporate venturing. CBI recognise importance of training (both for firms and their advisers) in making applications for funding and in all aspects of business. Advocates concept of Local Investment Companies (LICs), to act as intermediaries taking equity in, or making long-term loans to, established smaller businesses. Favours a network, rather than one-stop approach, to the provision of advice to small firms. Concerned there should not be duplication of provision between DTI/DE.

3.6 The TUC paper (see Annex) concludes that exaggerated claims have been made for small firms' importance. It denies the link between growth of small firms and economic success. More information needed on the sector, which has not been comprehensively examined since 1971 Bolton report. Policy should be focused on more mature firms with potential to expand. Emphasises importance of local economic initiatives, particularly those aimed at encouraging ethnic minority businesses. Issues of finance or demand are more important than deregulation - a "new form of financial intermediary" is required to provide long-term finance for small firms. Also attacks on health and safety audit requirement for small firms and BES.

Views of the CBI/TUC

3.7 The CBI (Mr O'Connor) will speak to their paper, noting considerable agreement with the papers; welcome recent DTI initiatives, especially the focus on established and growing firms; note the importance of training to small firms, perhaps suggesting it be made a condition of financial support; take a constructive line on HSE matters; and argue for Local Investment Companies (LICs).

3.8 The <u>TUC</u> (Mr Bickerstaffe) will speak to their paper. They may draw attention to the employment figures in Table 4 of the annex to the NEDO paper, inferring that job creation in medium sized companies in the US has been more successful than here. They may play up concerns over health and safety and agree with the Director General of NEDO that the growth of small firms might tend to make our skills problems more difficult to solve.

<u>Follow-up</u>

3.9 <u>If</u> there is pressure for the subject to be considered further in **NEDCs future agendas**, Ministers would not wish to commit themselves - refer matter to Steering Group on NEDC Programmes.

3.10 Continuing liaison with CBI and NEDO at official level on initiatives they are taking is also important. Try to avoid specific approval of NEDO "Corporate Venturing Register", about which too little is known.

POINTS TO MAKE (for Mr Cope)

3.11 (a) There has been a substantial increase in the number of small firms in recent years. They have made a major contribution to both employment and self-employment.

(b) Small firms have particular attributes of great value to the economy - flexibility, ability to innovate and readiness to take risks. They are also the seeds from which some of the large firms of the future will grow.

(c) The Government's role is primarily to create an economic climate which stimulates individual initiative and enterprise. We are also concerned to provide direct assistance where failures of the market lead to barriers to establishment and growth of small firms.

(d) The DE paper briefly outlines the main areas of assistance provided by both the public and private sectors, particularly in the areas of advice, counselling and consultancy and training.

(e) Our policy already encourages startups of new businesses. A question which all the other papers have rightly emphasised is - what can and should be done to remove constraints on the further growth of established firms in the small firms sector?

(f) In this context the DTI's Enterprise Initiative is aimed specifically at the small firm which can benefit from in-depth consultancy. Initiatives referred to by the CBI and NEDO on supplier development will, I am sure, prove very helpful.

(g) There is now a great deal of advice available and it is important that small businesses are aware of what advice is available. Both DE and DTI are putting a lot of effort into publicising these services, not only at national level but also at the level of local networks, helping put businessmen and women in touch with the right person to help them with their particular problem.

(h) Only a small proportion of those running businesses have received training in the skills required. Both owner/managers and their employees need to be persuaded to make use of all the training opportunities that are available to them. The CBI paper, in particular, homes in on this point. I would welcome further comments.

Conclusions (for Mr Fowler)

3.12 (a) Useful discussion. There is agreement on the importance of looking at market failures which lead to barriers to growth.

(b) Pleased that there is recognition of the role private sector can play in helping small firms develop. It is very often in the commercial interest of large firms to do all they can to develop suppliers.

(c) Recognise more work needs to be done to encourage owner-managers to learn about and to take advantage of all the help that is available. Above all, the practical usefulness of training, even for the busiest one-man band, is a message that still has not sunk in properly.

(d) Important that officials in both DE and DTI liaise regularly with CBI and NEDC so that our various complementary initiatives can be publicised to small firms in a coherent way.

SUPPLEMENTARY POINTS TO MAKE

FACTUAL

3.13 Business start-ups - over 1980-86 business starts exceeded stops by around 500 a week (on basis of VAT registrations).

3.14 Self-employment - risen every year since 1979. Total increase of nearly 1 million, or more than 50 per cent.

POSITIVE

3.15 Range of Government schemes

- eg, LGS, BES, MSC training programmes (LGE, TFE and MACE), support for Local Enterprise Agencies and tourism, DTI Enterprise Initiative consultancy assistance and discretionary regional grants.
- wide variety and mix of support to small and medium sized businesses.

3.16 Budget tax measures have further assisted small firms:-

- **Inheritance tax** threshold raised (from £90,000 to £110,000) and four tax rates replaced by single 40% rate;
- **Corporation tax** rate for small companies cut to 25%, in line with cut in basic rate **income tax**;
- Tax on pre-1982 **capital gains** abolished for all businesses;
- Ceiling on amount a company can raise via **BES** should help focus assistance on small firms;
- **capital gains retirement relief** increased;
- **VAT registration threshold** raised in line with inflation to maximum permitted under EC law.

3.17 <u>Deregulation</u>

- **Cash and Annual Accounting for VAT**, announced in 1987 Budget, now beginning to bring real benefits to small business.

- Many other measures to cut burdens for small firms (eg redundancy rebates for small firms, employee protection easements etc)

3.18 <u>Private Sector</u> encouragingly taking positive lead on several fronts:-

- development of **Unlisted Securities Market** and **Third Market** for firms experiencing rapid success and growth;

- **Venture Capital** invested has seen forty-fold increase between 1979 and 1985. In 1986 independent UK funds raised £239m (excluding specialist management buy-out funds). About 1/3 of companies receiving start-up investment were start-ups or in early stages of development. £622m raised first 9 months of 1987 alone (latest figure). Venture cap' in UK now almost half that in whole of EC; higher as % of GDP than in US.

- **Local Enterprise Agencies** represent involvement of business in local communities.

- **Clearing banks** launching initiatives to reach out to small businessmen (eg Barclays recent advertising campaign).

- **3is** continue to make substantial investment in small firms.

- **Regional BES funds** should be encouraged by Budget measures - some already healthily on the go (eg Wirral).

3.19 <u>Corporate venturing (NEDC paras 33-34)</u>: There can be advantages to both sides as corporate venturing - the small firm can gain finance, management input and prestige; the larger firm is able to participate in progress which might not fit into its corporate structure and it benefits from the small firm's innovative flair. The Corporate Venturing Register will help spread the message.

3.20 <u>Marketing (CBI paras 10-12)</u>: Pleased to note CBI's welcome for DTI's Marketing Initiative, which is designed to respond to the needs of the particular firm. The minimum consultancy period has been reduced from 8 to 5 days which is more suitable for small firms. DE has run seminars for small firms on the theme "Marketing your Business" and a regional series is to be launched this year.

3.21 <u>R + D (CBI paras 13-14)</u>: The Government schemes to which the CBI refer are new and to a certain extent experimental. When these schemes' initial progress has been monitored we will have a better idea of the optimum ways to help small firms and can then consider disseminating the ideas further.

3.22 <u>Technology Transfer (CBI paras 15-16)</u>: Government is taking action in this area but has to tread carefully as there are also private firms which undertake this "marriage broking" role. DE is discussing with those departments already involved in the field (eg MoD) ways in which it should be promoted within other Government Departments. Government is also acting to promote the transfer of technical skills and training to firms to make them more progressive in outlook.

DEFENSIVES

3.23 **Supplier/customer relationship (CBI paras 17-18)**: Government supports CBI approach. It has taken a number of initiatives to improve its own relationship with small suppliers eg "Tendering for Government Contracts" booklet. Purpose of improving supplier/customer relationships in this area is to help small firms to show that they can provide value for money.

3.24 **Central Government Purchasing - "perhaps more could be done by the Government's Central Purchasing Unit and its equivalents in other public sector agencies" (NEDO para 7)**
Government's policy is to give small business equal opportunities of access to contracting. The Central Unit on Purchasing's role is, of course, simply to assist and advise Government departments (not to place contracts itself).

3.25 **Local Investment Companies, LICs (CBI paras 31-33)**:

[Proposal: LICs would be intermediaries investing equity and/or loans in smaller businesses. There would be a "fiscal incentive for both corporate and individual investors". It appears that the incentive for individuals would be a relief along the lines of the Business Expansion Scheme (BES) - it is unclear whether the incentive for companies would take this form.

Comment (**Not** for use)
BES already exists to encourage equity investment in companies. £500,000 ceiling on amount a company can raise in any year is likely to increase the amount invested in smaller companies, in particular through BES funds. Meant to retarget BES on riskier investments and on companies which might otherwise have found difficulty in raising equity finance. The **CBI proposal** would reverse this because loans tend to be less risky than equity investment and correspondingly easier for businesses to obtain. Not only would this be likely to have a substantial deadweight cost (in respect of finance that could have been raised without a fiscal incentive) it would also tend to direct money away from riskier investment, thus frustrating retargetting of BES. A fiscal incentive to corporate investors could similarly have very substantial deadweight cost (would it include companies which currently invest in small business, eg banks and venture capital funds?). And the wider scope of this proposal (in comparison with the BES) would be likely to necessitate anti-avoidance provisions which were more elaborate than for BES]

<u>Line to take</u>: On the face of it, this proposal is inconsistent with the Governmnent's general policy. Our aim is to broaden the tax base so as to enable tax rates to be lower, thereby increasing incentives. Any special reliefs should be narrowly targetted. This year's changes to the BES are meant to improve its targetting and thereby increase its cost-effectiveness. It seems that your proposal would be less cost-effective in getting finance to business which would not otherwise have been able to raise it.

3.26 **<u>Training (CBI paras 26-30; NEDC memo paras 38.40)</u>**: Aware that there is a real problem in getting small firms involved in training. The entrepreneur may recognise the long-term benefits but the short term disadvantages (time away being money lost) take precedence. MSC have adapted their training provision to the needs of small businesses. There is need to identify effective methods of persuading small businesses to undertake training.

3.27 **<u>Liaison between DTI and DE (CBI para 40)</u>**: At both Ministerial and official level, before the publication of DTI's plans for the Enterprise Initiative liaison between DTI and DE ensured that the services offered by the two Departments to small firms would be complementary. DTI's new advisory service is essentially subsidised consultancy which is not new for DTI and is not an area in which DE is involved. There is a clear and sensible dividing line between the work of the SFS and the Enterprise Initiative. SFS counselling is aimed at businesses which either cannot afford or are not yet ready for consultancy. Practical arrangements have been worked out for collaboration between the Departments. The SFS staff will be trained to act as a gateway into DTI schemes if necessary, and the Enterprise Counsellors are briefed on how the SFS can assist small firms not suitable for Enterprise Initiative consultancy.

3.28 **<u>Information on small firms (TUC memo paras 3-4+42)</u>**: Improvements have been made in the availability of small firms statistics, and - at least as important - in our understanding of the way small firms operate. Despite complaint, no shortage of numbers in TUC paper. In making further improvements we must consider both the burdens that may thereby be imposed on small firms and value for money. Does CBI want more onerous statistical requirements placed on business?

3.29 **Contribution of small firms to the economy and employment (TUC memo para 39)**: Although the exact size of the small firms sector and its contribution to the economy are still a matter for debate, it is beyond question that there are a very large number of small firms which in aggregate make a significant contribution, particularly to job generation, and that we therefore cannot afford to ignore them. There is no question of giving small firms an unfair advantage over large ones, but we aim to assist them overcome problems created for them by failure of the market to operate efficiently.

3.30 **Effort should be concentrated on mature firms (TUC memo para 41)**: It is essential to have a balanced policy aimed at both startups and established firms. It is not the Government's job to 'pick winners', but to correct market failures.

3.31 **Finance for small firms (TUC memo paras 28-31 +44)**: Sources of finance have increased since the Wilson Committee report in 1979. Changes to the Loan Guarantee Scheme to facilitate loans under £15,000 have helped small firms in obtaining small loans (see para's 3.14 to 3.18 above for positive points).

3.32 **Loan Guarantee Scheme (TUC memo para 29)**: A premium exists to reflect true risk of borrowing, otherwise it would be seen as unfair competition. It also helps with administrative costs. It was reduced from 5% to 2½% in the 1986 Budget with a resultant increase on uptake. The scheme is intended to encourage loan finance when conventional lending has been exhausted. Consequently these loans do present a higher risk. Although new monitoring and appraisal requirements reduced take-up, they also reduced overall failure rates to approximately 30%. Since 1 February 103 loans of under £15,000 have been granted under new arrangements for small loans. To the end of the 1987/88 Financial Year, HMG assisted in almost 19,000 loans worth over £620m through LGS - just over half to new businesses.

3.33 <u>Business Expansion Scheme (TUC memo para 30 and CBI para 33)</u>

- BES is an important contributor to the provision of equity finance. Its purpose is to encourage outside investors to provide additional risk capital for unquoted companies. We have been aware that much of the funding has been going to larger projects. Hence the proposed £500,000 ceiling per company per year.

- The restrictions placed on closely connected persons who invest in their own companies from qualifying for BES relief were introduced because closely connected persons are likely to risk their capital anyway - hence large "deadweight" factor would otherwise be involved. Also there would be risk of abuse. Scheme very successful - in five years since 1983 over £750m raised by over 3,000 companies.

3.34 <u>Small firms policy in inner city areas (TUC memo para 43)</u>: The Action for Cities package announced on 7 March focuses the Government's small firms employment and training programmes on the inner cities. This includes special provision for ethnic minorities. Public sector funding in the area of support for small firms should be to stimulate equal or greater private sector spending. Ethnic minority businesses have been helped by the creation of five special Enterprise Agencies (with pump-priming Government funding) in inner city areas with high ethnic minority populations. Special provision is made for inner city businesses under DTI's Enterprise Initiative whereby 2/3 of the cost of the various forms of consultancy available are paid to firms in the 57 Urban Programme Authority areas. In these areas unemployment fell by 15.6% in 1987.

3.35 <u>Health and Safety - record of small firms (TUC memo para 25)</u>: The total number of fatal accidents to all employees and the self-employed during 1986/87 was the lowest on record. Nevertheless HSC/E is always striving to reduce the accident rate. Inspectors are to concentrate more upon pre-planned inspection and investigation and target the key areas of small firms and construction. In addition the Government is making a substantial increase in the provision to HSC which will enable it to increase the number of HSE inspectors by 60. There is no question of lower safety standards for small firms. HSE is improving a range of general published guidance aimed specifically at small firms (eg a booklet of essential information for small firms called 'Don't Wait Until the Inspector Calls').

3.36 **<u>Health and Safety - Written Safety Statements (TUC memo para 26)</u>:** I fully accept that health and safety legislation is of equal importance to all firms whatever their size. The proposal in the 1985 White Paper (proposing raising the threshold of the requirement on employees to prepare a written safety policy from five to twenty employees) was never intended to signal a lack of concern for the safety of employees in small firms. All employers would still need to have proper arrangements to ensure the health and safety of employees.

3.37 **<u>Deregulation (TUC memo paras 24 + 42)</u>:** The TUC do not fully appreciate the importance of the Government's deregulation policy for small firms. These firms lack the resources - particularly time - and the expertise to handle a vast amount of form-filling. I am sure small firms welcome the fact that since 1982 well over 2,000 separate forms have been abolished and a further 3,350 have been simplified.

3.38 **<u>Audit requirements (TUC para 27)</u>:** Audit requirement for small firms is a difficult issue which has been looked at from time to time. We are continuing to examine the arguments for and against abolition. During this process, officials have been in contact with a narrower range of consultees on technical issues. But any change would require primary legislation which would give all concerned a chance to make their views felt.

3.39 **<u>"New financial intermediary" proposal should be re-examined (TUC para' 31)</u>:** [TUC instigated paper from Committee on Finance for Industry (CFI) several years ago advocating National Investment Bank - consistent with Opposition policy. Avoided considering **need** for such a body; confined to **criteria** such as commercial considerations, realistic appraisal of projects, provision of long term finance etc].

No need for a nationally based body. Government should not be creating complex bureaucracy in attempt to pick winners, nor distorting market for finance by subsidized lending. Government concentrates instead on creating economic framework for growth and proper regulation of financial markets. Small firms with good prospects already have access to private sector finance through venture capital, banks etc.

3.40 **Worker co-operatives (TUC memo para 37)**: There is no justification for the statement that national policy is not favourable to co-operative development. There has been no cutback in funding for the Co-operative Development Agency which receives £240,000 for core-activities in 1988/9 (compared to £200,000 last year). Number of worker co-ops grown rapidly in recent years: 300 in 1979; about 1,400 by autumn of 1986.

3.41 **Decline in manufacturing net business formation rates (TUC table 1)** Important that manufacturing thrives and is profitable. But UK needs, at least as much, strong service sector which now contributes more than twice as much to output, and nearly three times as much to employment. Fall in manufacturing employment a long-established trend - peaked as far back as 1965; experience shared by all western countries; but "the trend in manufacturing employment for the moment is upward" and further increases in manufacturing jobs are expected" (CBI Industrial Trends Survey, January).

3.42 **Balance and coherence of Government schemes lacking - need "single access point" (NEDO memo' para 43)**
(See answer to 3.27)

3.43 **More generous Section 137 Assistance to Industry? (TUC memo para'36)**

The Government has already announced that it does not intend to raise the limit governing expenditure under Section 137 - broadly discretionary spending by local authorities for which they have no specific powers. The whole question of Section 137 and spending on economic development was addressed by the Widdicombe Enquiry, to which the Government expects to publish its response within the next few months. But bound to say that local authority economic assistance spending is not obviously good value for money, eg when authorities simply compete for the same business development at no overall gain to the United Kingdom.

3.44 **Uniform Business Rate (AKA National Non-Domestic Rate) bad for Business**

No, very beneficial for business:

- UBR will rise no faster than recorded change in RPI, so business will be protected from high and uncertain changes in rates;

- UBR will be the same everywhere in England (and separately in Wales), thus protecting business from very high rates bills in high spending areas;

- the Chancellor will have a power to uprate the UBR by less than the RPI each year, which would provide even more benefit for business in any year in which such a lower uprating could be afforded.

3.45 **Transition to new rates bills/concern over small business**

Environment Secretary has made the Government's intentions clear in the recent debate on the Local Government Finance Bill:

- There will be transitional arrangements to new rates bills, following both 1990 rating revaluation and move to UBR. These will take the form of an annual percentage limit on any increase in rates bills. Largest changes may be phased in over more than 5 years.

- Special schemes for **small businesses**, in the form of a lower annual percentage limit.

- Details to be announced later, when comprehensive information about gainers and losers from the revaluation becomes available.

- Much too soon to announce details now. Must use best possible information, and take account of the effect on gainers who will also see phasing-in to offset the loss of revenue from phasing-in losers. No question of extra Exchequer finance, at the expense of personal and business taxpayers at large.

3.46 **Demand of crucial importance to small firms' policy (TUC paper para 2ii)**

Growth during 1987 was above trend. Thus not surprising if some deceleration in 1988. But, despite this, whole economy still forecast to grow at 3 per cent in 1988 with growth in non-oil economy of 3½ per cent.

ANNEX

KEY CONCLUSIONS OF NEDC/TUC/CBI PAPERS

NEDC

- welcomes the growth of wealth and employment through the rise in the number of small firms and the measures which have helped this to happen;

- welcomes the DTI's new initiative for making advice and assistance available to small firms;

- notes that the growth of small firms makes the skills and training problems of the UK more difficult to solve and this aspect needs special attention from those concerned;

- welcomes moves towards partnership sourcing and encourages NEDC Sector Groups and other to facilitate this development;

- welcomes the operation of the NEDO Corporate Venturing Register.

CBI

- emphasises the importance of marketing - the DTI's Marketing Initiative is welcomed, but more emphasis is needed on market intelligence and selected schemes;

- points out the opportunities for technology transfer - need to avoid duplication and encourage best practice (a guide is to be produced);

- Partnership Sourcing is being actively pursued as well as support for NEDO's corporate venturing initiative;

- more training is needed for small firms on applying for finance and for financial providers and advisers;

- support for Local Investment Companies to act as intermediaries taking equity in and making long-term loans to small firms;

- provision of advice, counselling and consultancy should not be divorced from training;

- important that DE and DTI services for small firms do not overlap.

<u>**TUC**</u>

- the contribution of smaller firms to economy and employment growth is important but should not be exaggerated;

- the policy is overconcentrated on deregulation; not enough on question of finance or demand;

- the main focus of policy should be on more mature firms with some potential to expand;

- the regional and inner city dimension is important and a more active policy is needed involving the full range of local economic initiatives, particularly to promote ethnic-minority businesses;

- existing schemes to promote finance for small firms are unsatisfactorily - a new form of financial intermediary is needed.

ITEM 4 (BELOW THE LINE); NEDO PLAN AND BUDGET FOR 1988-89

Handling

4.1 There should be no discussion of this paper, which is below the line.

4.2 However, this year's NEDO plan and budget is the first since the Chancellor's 1 July announcement of fewer Council meetings and reduced numbers of Sector Groups. So it is possible that Sir John Cassels or the TUC might seek to say something to about the reduced level of operation. You should resist any such attempt. The remainder of this brief includes defensive points to make if discussion does ensue.

Objectives

4.3 (i) Take this item below the line and allow paper to be published without discussion.

(ii) If other parties insist on discussions, stress that budget entirely consistent with decisions already accepted by Council.

Views of the TUC/CBI

4.4 The CBI were content with the Chancellor's announcement. If the subject is raised, the CBI will say that the whole subject has already been discussed by G4 and they are quite happy.

4.5 The TUC were much less happy. They did not cause problems when the new pattern of Sector Group work was discussed in October. They may complain that difficulties in fixing meetings (now the Chair rotates) is making NEDC arrangements very difficult.

Defensive Points To Make

4.6 If you are tackled about the reduction in NEDO'S grant-in-aid, you might draw on the following points to make.

(i) Budget too small? Number of Council meetings has been reduced from 10/11 a year to 4. Number of Sector Groups roughly halved. Entirely consistent that NEDO grant-in-aid should be reduced. Grant-in-aid for 1988-89, excluding transitional costs, over 60 per cent of level planned before reorganisation, so Office should have no difficulty in coping with reduced workload.

(ii) Need to cover transitional costs? Grant-in-aid for 1988-89 includes £320,000 to cover transitional costs.

(iii) Staff cuts too heavy? Number of staff reduced from average 197 in 1987-88 to 124 in 1988-89. But all redundancies voluntary.

(iv) NEDO less able to deal with new demands? Welcome Sir John Cassels' view that "the new system will improve the Office's flexibility and efficiency...".

(v) Salaries/staff costs increasing faster than grant-in-aid? Public sector bodies have to contain staff costs. Agree with Sir John Cassels that this is "a spur to improve efficiency". Consistent too with Government policy on holding down inflation and restraining public expenditure.

(vi) Rotating Chair means difficult to arrange NEDC meetings? Always difficult to arrange meetings of 23 busy people. Mr Couchman (NEDC Secretary) and Steering Group do a splendid job.

IF PRESSED:

(vii) Private funding? Grant-in-aid consistent with tripartite Sector Groups continuing to receive public funding. If Private Sector bodies wish to take over work of any committees not being publicly funded, we would expect them to provide full financial and secretarial support privately. Interested to hear any serious offers [would envisage privately financed committees being organised separately from NEDO, but willing to consider any proposals on case by case basis].

RESTRICTED 25/4

CHANCELLOR OF THE EXCHEQUER'S OFFICE: MEETING

SUBJECT	ECGD: GENERAL PROVISION AGAINST SOVEREIGN DEFAULT
DATE AND TIME	MONDAY 25 APRIL 11.30AM
VENUE	Chancellor's Room, Treasury/~~No 11/Conference Room/House of Commons~~
PAPERS	12/2 CASE → CHEX
THOSE ATTENDING	CST EST SIR P. MIDDLETON SIR G. LITTLER SIR T. BURNS SIR A. WILSON MR LANKESTER MR BEASTALL MR MOUNTFIELD MR H. EVANS MR TURNBULL MR BOTTRILL MR INGLIS MR HALLIGAN Gill Noble instead CC MRS LOMAX MRS BUTLER MR J. TAYLOR

CHANCELLOR OF THE EXCHEQUER

Julie.

CST can't manage Monday morning's meeting on Sovereign debt. I think he needs to be at ~~the meeting~~ any discussion we have.

∴ postpone + reschedule, pl.

(Sorry!)

J.

SUBJECT: ECGD General Provision Against Sovereign Default.

LOCATION: HMT.

↓ pl confirm

CAST LIST.	PHONE NO.	DATE + TIME: Wed 20 April 10.00am. ✓	IF NO GIVE REASON	Friday 22 April 10.00am. ✓	IF NO GIVE REASON	Monday 25 April 11.30. ✓	IF NO GIVE REASON	✓	IF NO GIVE REASON.
CST	5088	✓		✓		✓			
FST.	5127	✓		✗	CUSTOMS VISIT	✓			
PEM	5158	✗	PERMISECS MEETING	✓		✓			
GL	5409	✗	TOKYO	✗	TOKYO	✓			
TB	5202	✓?	ALREADY HAS MEETING	✓		✓			
Sir A Wilson.	5176	✓?		✗	COPEC	✓			
Lankester	5256	✓		✗	HANNY	✓			
Beastall	5358	✓		✗	COPEC	✓			
Lomax	5397	✗		✗		✗	OFF FROM 9/4 → 22/5		
Mountfield	4886	✗	PARIS.	✗	COPEC.	✓			
✓ Evans.	5553	✓		✓		✓			
Turnbull	5516	✓		✗	COPEC	✓			
Bottrill	4884	✓		✓		✓			
Mrs Butler	5343	✗		✗		✗	11/4 → 3/5. AL		
Mr Inglis	5448	✓		✓		✓			
Mr Halligan.	4874	✓		✓		✓			

PAPERS: 12/2. Mrs Case → Chx.

CHANCELLORS MEETING

1. SUBJECT ECGD. General Provision Against Sovereign Default.

2. LOCATION. HMT.

CAST LIST	'PHONE NO'	DATE - TIME Tue 29/3 11.30	Wed 30 11.30	Thurs 31. 10.00	
CST.	5088	✓	✗	✓	
EST.	5127	✓ 12.45	✓	✓	
PEM	5158	✓	✗	✗	NOT HERE
GL	5409	✗ OFF	✗ LUNCH	✗ WANTS LEAVE	
TB	5202	✓	✗	✗	LEAVE
Sir A Wilson	5176	✗ OUT	✗	✓	
Lankester	5256	✓	✓	✓	
Beastall	5358	✓	✗ LEAVE	✗ LEAVE	
Lomax	5397	✓	✓	✗ MEETING	
Mountfield	4886	✗ DTI	✗ CO	✓	
Evans.	5553	✗	✓	✗	LEAVE
Turnbull.	5516	✓	✓	✗ LEAVE	
Bottrill.	4884	HAS NOT	ARRIVE YET		
Mrs Butler	5343	✓	✗ H.A	✓	
Mr Inglis	5448	✗	✗	✗	LEAVE
Mr Halligan	4874	HES NOT IN.			

PAPERS Mrs Case 12/2 → Chx.

MTG NOTICE SENT :

iae3.ip/docs/cst

CONFIDENTIAL

pmg

FROM: J MACAUSLAN
DATE: 25 April 1988

CHIEF SECRETARY

cc: Chancellor
Mr Monck
Mr Pickford
Mr Wynn Owen
Mr Kaler

NEDC 26 APRIL AND EMPLOYMENT TRAINING PROGRAMME

1. Mr Flanagan's note of 22 April enclosing briefing for the NEDC meeting mentioned that the TUC's Employment and Training Committee would meet today to consider whether or not to co-operate with the Employment Training Programme.

2. The Committee have decided to reach no view as yet, but to seek a meeting with the Secretary of State. They will probably seek endorsement of this approach at the full TUC General Council on Wednesday 27 April. The Secretary of State would agree to a meeting.

3. The main complaints against the programme from the unions have been that it is under-resourced; that the allowance of £10-12 over benefit is too low and that the rate for the job should be paid; that child care provision is inadequate; that the role of unions in monitoring schemes under the programme has been attenuated; and that the Government might withdraw benefit for those refusing places on the programme.

4. Given this afternoon's decision, any TUC attack on the programme tomorrow may be muted. I am going to a briefing meeting with Mr Fowler this afternoon, and will let you know if there is any more to report.

5. In the meantime, you will want to stress (at NEDC) that the resources available for the programme are enormous, amounting to almost £1.5 billion a year. The Government have provided for a programme of training for the unemployed of unprecedented scale and quality. It is now up to the TUC to participate.

JM

CHANCELLOR OF THE EXCHEQUER

Julie.

ECGD meeting.

I understand that Mr Bottrill, rather than Mr Mortimer, is Mrs Case's successor. So he should be invited to the meeting, etc. Sorry!

JS

ps2/36M

UNCLASSIFIED

RP

FROM: MISS M P WALLACE
DATE: 25 April 1988

PS/CHIEF SECRETARY

cc PS/Economic Secretary
Mr Monck
Mr MacAuslan
Miss O'Mara
Mr Flanagan

NEDC BRIEFING: EXCHANGE RATES

The Chancellor has seen Mr Flanagan's minute of 22 April. He has suggested one small amendment to the line on the exchange rate at point 2.11(v) - in point (a): delete "accept financial discipline implied by exchange rate and ...".

MPW

MOIRA WALLACE

91G.SCB.1784.26

FROM: H C GOODMAN

DATE: 25 April 1988

pmp

PS/CST

PS/EST

cc: PS/Chancellor (Ms Wallace)
Mr Peretz
Mr R I G Allen
Ms C Evans
Ms Simpson
Mr W-Owen
Mr Nelson

NEDC: EXCHANGE RATE POLICY

You may find it helpful to have the extract from the Chancellor's This Week Next Week interview yesterday concerning the exchange rate.

2. If this is raised you may like to quote the following points the Chancellor made:-

> "we are interested in the maximum possible exchange rate stability, within the context of sound anti-inflationary policies";

> "an unsustainable appreciation is damaging for business and industry".

3. Also attached is a letter from Mr John Banham complaining about the rise in sterling, together with a line to take.

4. Briefing on the TCSC Report published today is being submitted separately by Ms Evans.

HC Goodman.

H C GOODMAN

Daily Telegraph 19 April

Reference..

The CBI's addiction to a weak pound

SIR—Mr John Banham of the CBI has once again been complaining about what he calls the strength of sterling (report, April 14). He should remind his members that sterling is now worth barely 50 per cent of its 1970 value against a basket of currencies. Even against the ailing dollar, we have devalued by 25 per cent over 20 years.

Mr Nigel Lawson presided over a massive devaluation in 1985, and CBI members should have taken advantage of that temporary increase in export opportunities. It appears from recent balance of payments figures that they have done no such thing. Instead, they are asking for "a more competitive exchange rate", via lower interest rates. The CBI is really like a drug addict who asks for just one more shot in the arm before he goes straight.

It seems very odd that two countries, Japan and West Germany, who have kept strong currencies in spite of contrary advice from abroad, have standards of living vastly superior to ours and export performances which are the envy of the world.

The CBI should realise that devaluation increases inflation, leads to higher wage demands, increases raw material costs to industry, encourages slackness and inefficiency and perpetuates the use of old-fashioned manufacturing methods. The damage that it has done to our country is best illustrated by the fact that we are about 15th in the standard-of-living league table among the industrial nations of the world. Furthermore, post-war history should have taught us that a weak currency never cures balance of payment problems.

PETER HUNT
Chichester

Daily Telegraph 22 April

The price industry pays for strong £

SIR—It is sad that Mr Peter Hunt (letter, April 19) should have so badly misunderstood the CBI's concern about the recent rapid appreciation of sterling. I suspect his view reflects a widely held misconception.

We are not addicted to a depreciating currency. Quite the contrary. We expect the growing strength of the economy to be reflected by sterling and accept the discipline imposed on business costs by stability against a low inflation currency like the Deutschmark.

The CBI is certainly not complaining; 1987 was a remarkable year for British business. United Kingdom manufacturing output headed the growth league of the major economies. Britain's share of world manufactured exports rose; unemployment fell; investment increased strongly; and inflation remained low, reflecting major improvements in productivity. For many firms, increases in earnings were more than offset by increases in productivity.

But an appreciation of more than four per cent in the value of the pound since early March, encouraged — if not caused by — relatively high interest rates, is a rate of change with which few businesses can contend. Already the profits on export sales for most companies have been seriously reduced; for some they have been eliminated entirely. One of the nation's largest exporters loses £3 million in profits for every cent that the dollar depreciates against the pound. We must not forget that the United Kingdom is twice as dependent on foreign trade as Japan.

Productivity is the key factor in helping to reduce inflation further. But productivity requires investment — in people, plant, technology and products; and investment requires internally generated finance. A major increase in business investment is needed if we are to maintain the momentum of our economic recovery. This has to be funded largely from profits, which remain relatively low by international standards.

We have a lot of ground to make up. Our disturbingly large investment gap with West Germany is worsening at the rate of £10 per household per week.

So long as there is uncertainty about the future level of exchange rates and a continued squeeze on profit margins as a result of the recent rise in sterling, businesses will be hampered in making the necessary investment to improve their productivity and thus contribute to reduced inflation. It is for this reason that the CBI continues to support those Government policies that worked so well in 1987.

JOHN M. M. BANHAM
Director-General, CBI
London WC1

CODE 18-77

Line to Take

Main threat to competitiveness is if Government relaxed its anti-inflationary strategy. CBI's monthly council meeting on 13 April endorsed Government's commitment to low inflation.

WHITE: Are you expecting the Treasury and Civil Service Select Committee to be satisfied about it just, as you put it, bobbing about a bit, for that matter the Govenor of the Bank of England about inflation 'bobbing about a bit'.

LAWSON: Well, I haven't seen the report of the Treasury's/Civil Service Select Committee which I believe comes out tomorrow. I am sure it will be critical but that's their business - they're always critical. What I do notice is that they have always whenever I have appeared before them which I do frequently, and enjoy doing, they have always asked me why I keep interest rates as high as they are and I have always explained to them that is because we have to keep downward pressure on inflation.

WHITE: Internationally, Chancellor you have been placing great stress on the evolution on a new, more ordered system of internation economic relationships, and the system you called a managed floating exchange rate. Is there a contradiction between the perfect market Chancellor, the free market Chancellor and the Manager internationally.

LAWSON: No, I think that international co-operation between finance ministers is highly desirable and I think that is now recognised at meeting of the so-called 'Group of 7' - the seven finance ministers of the major nations of the world, ourselves the United States, Japan, France, Germany, Italy and Canada - there is absolute agreement on that and we are not a gang of wild socialists, that co-operation is desirable and there has been over the past few years much better internation co-operation.

WHITE: I am not suggesting that the Prime Minister thinks that you have become a wild socialist but in your speech to the IMF last September, you said you beleived in ' the maximum stability of exchange rates in managing any changes that might be necessary in an orderly way'. Do you think what happened just before budget week when the pound broke through the 3 Deuchmark barrier was an example of that?

LAWSON: Well it was not all that disorderly - it was quite orderly I think it was unfortunate that the thing was discussed as much as it was in public because these are very market sensitive matters and it isn't usually sensible for these matters to be discussed in public. But what I had in mind when I made that speech in Washington was the extraordinary gyrations we had seen in the dollar when between 1982 and 1985 the dollar had doubled and then of course between 1985 and 1987 it had halved again. Now that sort of movement is very bad for the American economy and very bad for the world economy and it bears no relation what ever to economic fundamentals which don't change like that.

WHITE: It wasn't just the press who addressed themselves to the matter of the exhange rate in public, it was the Prime Minister and First Lord of the Treasury herself. Did she devalue your office by speaking about the exchange rate in public as she did?

LAWSON: WEll I don't think she devalued my office but I do think that as I say one needs to be very careful about how one talks about these matters in public.

WHITE: Was she?

LAWSON: I think that that incident was unfortunate but that is all behind us.

WHITE: Did you think of resigning?

LAWSON: Oh no, I was just about to deliver what I considered to be a very important budget and I was certainly not going to resign.

8

WHITE: Then you must have been hopping mad.

LAWSON: Well as I say, that matter is now behind us.

WHITE: She said that you couldn't 'buck' the market. But that's .... you may not be a wild socialist but you believe that you can lead the market.

9

THIS WEEK/NEXT WEEK

24.4.88

LAWSON: Oh, inevitably the authorities, as they are called, Governments and central banks, do influence the market and can influence the market, you talk to anybody int he market and they know that, what is absolutely true is that if you try and buck economic fundamentals, then you are likely to come unstuck, but, of course, very often the market is not reflecting economic fundamentals at all, foreign exchange markets.

WHITE: What is the United KIngdom governments policy on internaitonal exchange rates now, are we in favour of manage floating, are we in favour of free floating,which we believe is the Prime MInsiter's desired objective, or are we just muddling through? .....

LAWSON: The managed ~~wrong~~ floating concept, which I sketched was 'something which we are not in at the present time, what I was in that speech concerned about was explaining the changes that are undoubtedly taking place in all the major countries of the world about how we co-operated and how we looked at the exchange rate, and how that evolution has happened and what further evolution I thought would be sensible. As for where we are now, we are certainly and the Prime MInsiter has said this as well as, as a matter of fact I have said it, we are certainly interested in the maximum possible exchange rate stability, within the context of sound anti-inflationary policy.

WHITE: Without you necessarily giving the figure now, because that would spoil it, is there an exchange rate target now Chancellor?

LAWSON: "As I said, "it is very unwise to talk about these market sensitive matters" but I certainly do not want to see the exchange rate appreciate further." I think that it would be, as I have said on the previous occasion, it would be unsustainable, and an unsustainable appreciation does nobody any good and is damaging for business and industry.

WHITE: So we are living in an era in which there are exchange rates targets,w hich the government is operating to, and which the Bank of England on your behalf is trying to operate in the market?

LAWSON: Well, obviously the exchange rate is very important, it's very important for business and industry, it's also very important in the judging what the state of the economy is at the present time, and judging what is necessary in terms of anti-inflationary policy.

WHITE: She believes, the Prime Minister believes, I suggest to you, Chancellor, and her advisers believe that your Exchange Rate Policy does nothing to actually reduce and may actually induce monetary expaansion and therefore inflation and the difference between you is more serious than you have been suggesting, it wasn't just a tiff before the Budget?

LAWSON: No, I don't think you are right at all, I think perhaps what you are referring to is intervention in the Foreign Exchange Market. Now, intervention in the Foreign Exchange Market, I am sorry, this is rather technical, but since you have raised the point, intervention in the Foreign Exchange Market, as I said, buying foreign currency, which is very useful in one respect in building up your foreign exchange reserves, but...intervention in that sense, can certainly induce inflationary forces into the economy, if it is not sterilized...if you don't..that is to say, if you don't fund it by borrowing from the public. But every single pound of intervention in 1987/88, was fully funded, fully sterilized, and therefore injected no inflationary policies into the economy at all.

WHITE: Can I ask you one question, aside from what sounded like those clinical...about your policy, may it be the case that you have exchanged in your policy, if it works as you say that it is working, the instability of exchange rates, the instability of interest rates instead, because you used interest rates in the market, to get the money going the right way, now if you do that, doesn't it mean that ordinary men and women who don't understand anything about the exchange markets or may not, find that the most important items in their families budget, their mortgage rates, their loan rates, go up and down unpredictably as they never did before and that's the price that they are paying, for your policy of so-called exhcnage rate stability?

LAWSON: No, if anything the reverse is the case, it is perfectly true to take the two parts of your question, it is perfectly true that in a free economy, in a free society, almost the only instrument of policy you have between budgets is the interest rate, so therefore, interest rates, if you are going to keep the economy on course, interest rates have to go up sometimes they have to go down, sometimes, that is inevitable, but if you are saying that it is worst if exchange rates are stable, that is not so at all, indeed, if exhcnage rates are highly volatile, then your are liekly to get more interest rate movements, rather than fewer.

WHITE: May I go back to your Budget last month, when you delivered that Budget to the HOuse, Chancellor, did you feel that it was it was the climax of your career, that after that it would all be anti-climax, that 1989 could never be as exciting as 1988?

LAWSON: Oh I would certainly think that the 1989 Budget couldn't be as exciting as the 1988 Budget, inevitably, but this was a Budget which was pre-eminently a BUdget which I had been working upto for a considerable length of time, it is now putting place the major reforms of a tax system that I wish to see, but that doesn't mean to say that the 1989 Budget won't be important.

WHITE: Are you thinking of new fields to conquer?

LAWSON: At the moment I am carrying on with my job.

WHITE: You used to be a politician who stayed rather aloof from politics, after the last election you were the first Chancellor to have the new intake of MPs around for tea and drinks at Number Eleven, you were an... and a careful politician, your speech to the Party Conference, where previously they were rated as rather dull, was nearly musical by these standards towards the end, do you feel yourself to be more of a politician now than you were, a strange question to ask a senior politician?

LAWSON: Well,, as you say, it is a strange question, I never...a politician, you can't survive in this world without being a politician.

WHITE: Do you feel that your....

LAWSON: .....in my job anyway.

WHITE: Do you feel that your experience as Chancellor has made you much more marketable as a politician than you were?

LAWSON: I don't know what you mean by marketable?

WHITE: Let me put it this way, let me take it job by job, would you like the foreign Office?

LAWSON: Geoffrey Howe is doing an excellent job as Foreign Secretary, so that doesn't arise. Now if you are trying to speculate, I'm not one of those people who is always thinking of what is the next step, what is the next job, what am I going to do next. I have always concentrated on doing whatever I happen to be doing, as well as I can.

WHITE: Nevertheless, it's a nice irony isn't it, that those years ago as a young man you were turned down by the Foreign Office and now you could actually run the place?

LAWSON: I don't think that that has any bearing on it at all.

WHITE: Just before the last Budget you said, I have no ambition to be Prime Minister, well, that might be the sort of thing that Presidents say when they say they are not intending to run for office, do you have a little more ambition now?

LAWSON: No that's true, I have no ambition to be Prime Minister.

WHITE: Do you think, nevertheless, in the Tory Party....what did I just hear you say...you have no ambition to be Prime Minister at all.

LAWSON: No ambition to be Prime Minister.

WHITE: Does that mean that you wouldn't want to be Prime Minister, that you wouldn't want the job if the opportunity arose?

LAWSON: No, I answered your question, I answered it so straightforwardly that you were taken aback. but in addition...on top of all that, all I can add is as I say I am not one of those people who spend their time, and never have been, even when I was editor of the Spectator, I wasn't thinking what am I going to do next, although I clearly wasn't going to spend the whole of my life being editor to the Spectator, I'm not one of those people who is always thinking, what am I going to do next, I concentrate on doing the job that I am doing, and I am fortunate to have a job which is of considerable interest and which is a great challenge and which is of some importance to this country.

WHITE: I like the picture that you paint of yourself that everything comes along as a delightful surprise to you, are you thinking of staying in politics, Mr. Lawson, can you go as far as that...

LAWSON: Well my previous answer answers that question as well.

WHITE: These things just occur, you have no control over these events, you might stay, you might leave?

LAWSON: Well, of course I shall not be going on as Chancellor of the Exchequer forever, I have already been Chancellor of the Exchequer for longer than most people who have held this office, but I haven't taken any decision at all as to when I will leave and, anyhow, it's also a matter for the Prime MInister.

WHITE: It is, can I ask you a more general question about the mood in the Tory Party now. You said, you know, there have been difficult times before, there maybe difficult times coming again, I wonder whether in the Tory Party now, the feeling may be ...that they can see beyond this Prime MInister being in the job, and that that has changed peoples estimation of what has taken place within the conservative Party? That they are thinking beyond her term?

LAWSON: Well my guess, I don't know whether they are or not, I rather doubt it, my guess is that she is going to go on as Prime Minister for a considerable time to come, but the difficulties, I don't think you can exaggerate the difficulties in the Conservative Party, they were far greater before. I can remember in our first term, when there was a major split on the whole of economic policy, which was right in the centre of our policy, indeed the terms wet and dry originally grew up in that context, that has completely disappeared, there is now agreement on the economic policy, there may be differences on detail, but there is an agreement on economic policy, there is agreement over the whole wide range of policies, there are certain doubts which have been expressed about particular aspects of policy, but those are matter which we will get by.

WHITE: And by comparison last month, was a mere tip of the teacup?

LAWSON: Well I think that it will seem very very much less in retrospect than it seemed at the time.

WHITE: Chancellor, thank you very much indeed. That's all from This week, Nexl Week for this week, we will be back next week at the same time, that's One O'Clock on BBC1. Meanwhile, from all of us ont he team, good bye.

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CONFIDENTIAL

Copied to NM

PMP

FROM: N MONCK

DATE: 25 April 1988

The CST (if he attends) & EST should so far as possible control themselves with [illegible] attitudes & with no [illegible] expressions.

2. While I see no great value in such sessions, I see no great harm in it either. NL

CHIEF SECRETARY

cc Chancellor
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr R I G Allen
Mr MacAuslan
Mr Wynn Owen

NEDC : EXCHANGE RATE POLICY

The CBI have just let us know that John Banham will be making a good deal of the exchange rate when he leads for the CBI on item 2 at NEDC tomorrow, the report of the cotton and allied textiles sector group. The TUC may well support him.

2. You or the Economic Secretary will no doubt make use of the points the Chancellor made over the weekend, which Ms Goodman has circulated today.

3. This note suggests a line if Mr Banham proposes that a paper should be prepared for NEDC on the lines of:

"the differing impact of exchange rate fluctuations on different sectors".

He proposed this at a meeting of the NEDC Group of Four at the end of March and Sir P Middleton, in the hope of neutralising it, said the Treasury would think further about it.

4. We think Ministers should resist any such proposal, why? though we cannot prevent individual sector groups reporting on exchange rate problems. Mr Allan is giving this message to Mr Fowler's office. Done I suggest you or the Economic Secretary should take the following line:

(a) the Chancellor's remarks over the weekend reflected the fact that sterling appreciation has a greater direct effect on the tradeable sector of the economy;

(b) this is well known and is fully taken into account when the authorities take macro-economic decisions and in particular decide how to respond to market pressures within the context of sound anti-inflationary policies;

(c) the CBI's report last year was a useful survey of industry's views about the importance of the exchange rate. But I do not see the value of an economic study which attempted to measure the differential effect of exchange rate changes on different sectors or sub-sectors. How would it help the Government to take decisions in difficult situations of the kind we have recently faced? I do not see what practical help it would give. For this reason as well as because of the inherent sensitivity of the subject, we see no advantage in a new study being prepared for NEDC along these lines. [IF PRESSED: It is of course open to sectoral groups to make whatever points they like when they report to the Council from time to time.]

N MONCK

NEDC

National Economic
Development Council

SERVING THE CUSTOMER

NEDC (88)13
26 April 1987

Memorandum by Mr S D Hollander CBE, Chairman of the Cotton and Allied Textiles Sector Group.

1 This paper reports how the Cotton and Allied Textiles Sector Group has worked on the objective of changing its industry's approach to its customers. It underlines how an industry in the main supplying intermediate products needs to focus just as much on serving the end customer as industries in more direct contact if it is to be competitive in the 1990s.

THE INDUSTRY

2 The industry served by the SG covers spinning of cotton and man-made fibre yarn, weaving of that yarn into fabric, and dyeing, printing and finishing that fabric. It employs around 60,000 people and has an output worth just over £2 billion. Since 1981, production has grown by 11 per cent in real terms, and most companies are now healthily profitable.

3 There is intense international competition in textiles. The UK industry was the first to suffer severe competition from the Far East, and virtually all basic products now come from that source: at the same time, there is severe competition from Continental countries in more up-market products. The result is that imports account for nearly 60% of the UK market. Just over 25% of UK production is exported. More detailed statistics are contained in Annex 1.

The challenge of diversity

4 The industry is diversified in terms of end uses. About 30 per cent of fabric is hemmed and packaged for retail sale as sheets, towels and curtains. Most of the rest goes to the clothing industry, but medical uses are important and sales to the engineering and construction industries are growing. About half the yarn produced is sold within the industry to weavers; the rest goes to the knitting industry. The industry is fragmented, and its structure is horizontal, not vertical (see Figure 1). Small companies account for about half the industry, but even the major firms like Courtaulds and Coats Viyella which own spinning, weaving and finishing operations treat them as separate profit centres.

5 The picture is complicated by the merchant converter, whose role is shown diagramatically in Figure 2, and who provides much of the creative input. Converters do not generally own manufacturing capacity in the shape of weavers, dyers and finishers. They buy grey (ie unfinished loomstate) cloth from weavers and pay a fee to finishers to dye and print it to designs which the converters have created, amended or recoloured.

6 Until the early 1950s, converters were the UK industry's principal exporters, and much of the manufacturing side of the textile business was purely production oriented, seeing its role as servicing converters. With the advent of cheap grey cloth from Asia, and subsequently the UK's entry into Europe making finished cloth from the EEC more readily available, converters gradually became importers more than exporters. The typical converter today will source grey cloth from low cost sources and finish it in the UK or elsewhere in the EEC. Despite this shift, even by the 1980s weavers and finishers remained very much locked into a structure which separated them from end users, who were jealously guarded by converters. It was difficult for these manufacturers to start supplying end users directly; not only would they incur considerable costs in establishing their own marketing operations - as well as having to acquire new attitudes and skills - but converters would threaten to cease to deal with weavers and finishers who attempted to do so.

7 The problem for the fabric manufacturer was thus distance from the final customer (usually the retailer), caused both by the horizontal structure and by the existence of converters. This is particularly important in a fashion-oriented industry, where responsiveness to colour and design trends is of paramount importance in serving the customer - yet where colour decisions may have to be made up to five manufacturing stages back up the supply chain.

THE SECTOR GROUP'S PROGRAMME

8 With this in mind, the SG set itself three linked themes:

- creating growth by helping the industry to respond to the final as well as the intermediate customer;

- dealing with the vulnerabilities in the textile supply pipeline;

- and finally, because to achieve the first two objectives would mean having the right people, attracting and developing the relevant talent.

The remainder of this paper deals with how the SG has tackled or is tackling each of these issues. In each case, the aim was to achieve practical action. The focus has been on remedying deficiencies in the supply pipeline through closer co-operation between customers and suppliers.

Responding to the market place

9 Because converters had taken most of the initiative for marketing, weavers and finishers had paid little attention to this vital area of business. While the other major EEC nations have a fairly even balance of trade with each other in textiles, the UK has a substantial deficit with them. The SG has therefore had to try to improve exports and to promote competitiveness with imports, while at the same time trying to help improve weavers' and finishers' marketing skills.

10 The industry has responded positively to two export initiatives. In September, a group of converters will be visiting Scandinavia on a trade mission (most of them do not currently export to Scandinavia, or indeed elsewhere); this exercise may later be extended to other potential markets. Thirty weavers and finishers are participating in an export market research

study of France, looking particularly for potential customers among converters; again, other Western European markets will subsequently be considered.

11 Collective action can pay dividends in terms of strengthening the position in the home market, and in January 1987 the EDC organised a "Better Converted in Britain" exhibition. This extension of the BMIB concept saw converters showing imported fabrics to weavers and finishers, while at the same time weavers and finishers showed converters the sorts of goods and services they were capable of producing. The event achieved some immediate re-sourcing to UK supply, but it should also lead to the establishment of the first showcase for home manufacturers: the first "British textiles: Lancashire to London" exhibition is planned for 1989, aimed especially at converters and retailers to demonstrate the growing confidence and market orientation of UK textile manufacturers.

12 Improvements in market share will not take place without proper attention to design and colour. Here the SG has run well-attended seminars to raise the industry's consciousness, most recently on "Computers and Creativity" with demonstrations of the latest in CAD equipment. The next project is a study of best practice in colour and design forecasting. The SG is also concerned about the industry's relationship with design education, and is helping to develop closer links between companies and colleges.

Dealing with vulnerabilities in the textile supply pipeline

13 In an industry with so many production stages, response times need to be cut down as far as possible to reduce vulnerability to the vagaries of fashion. There are now not two but six or more fashion seasons a year, and manufacturers need to be more flexible to improve market share. The main way to improve speed of response will be by improving relationships within the long textile pipeline, and there is evidence that relationships between converters and UK weavers and finishers are indeed getting better, partly as a result of the SG's efforts. In addition the SG is currently working with the Clothing SG to develop "best practice" demonstration projects covering each link in the chain, including retailers. These will also show the substantial benefit of stock reductions and less wastage.

Attracting and developing talent

14 The industry still has a "clogs and shawls" image - yet the reality is that each operative can be responsible for £½ million worth of machinery. Highly talented and adaptable people are needed to work within it and to manage it. The SG has just published a report on "Management Training and Development" which focuses on small firms' management training needs. It finds that while the larger companies in the industry like Courtaulds and Coats Viyella are committed to a minimum of five days management training annually (an aim proposed in the Handy Report), most small firms do very little, partly because few suitable courses exist. However, they are increasingly aware of training's importance because of growing difficulties in recruiting both experienced people and recent graduates, and in finding people of sufficiently high calibre internally to promote to senior levels. A summary of the report is attached as Annex 2.

15 In terms of developing management skills, the SG developed a self-help strategic planning kit to improve the way in which managers in small companies can shape their own destinies, introduced at well-attended seminars (the concept was subsequently exploited by three other EDCs). It has also developed with Manchester Business School and the MSC an eight week part-time course for directors of small and medium sized textile companies, covering company finance, marketing, quality management, motivation and management style, creativity, and strategic planning, which has met with a good response. The SG is currently talking to other training organisations about further courses on communications skills, financial management for non-accountants, organising exports, design appreciation and management for non-designers. The SG is also seeking to develop appraisal systems suited to small firms so that the top managers of the future can be identified and developed. The recent improvement in the performance of leading companies, coupled with image-building efforts by industry organisations, should lead to an up-grading of the image of the industry as a whole, which should in turn help to attract talent.

CONCLUSIONS AND IMPLICATIONS FOR THE COUNCIL

16 In a long supply pipeline like the textile industry's, all the latest technology will count for little without trust and understanding between customers and suppliers. The Council is invited to note that an important contribution towards improving industrial competitiveness, especially but not solely in the case of smaller companies, can be achieved by ensuring that the component elements of the supply chain work together more effectively. The SG has focused most of its efforts on these relationships, and is confident that it is making a positive contribution towards improving them.

National Economic Development Office
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FIGURE 1: THE COTTON AND ALLIED TEXTILES INDUSTRY'S HORIZONTAL STRUCTURE

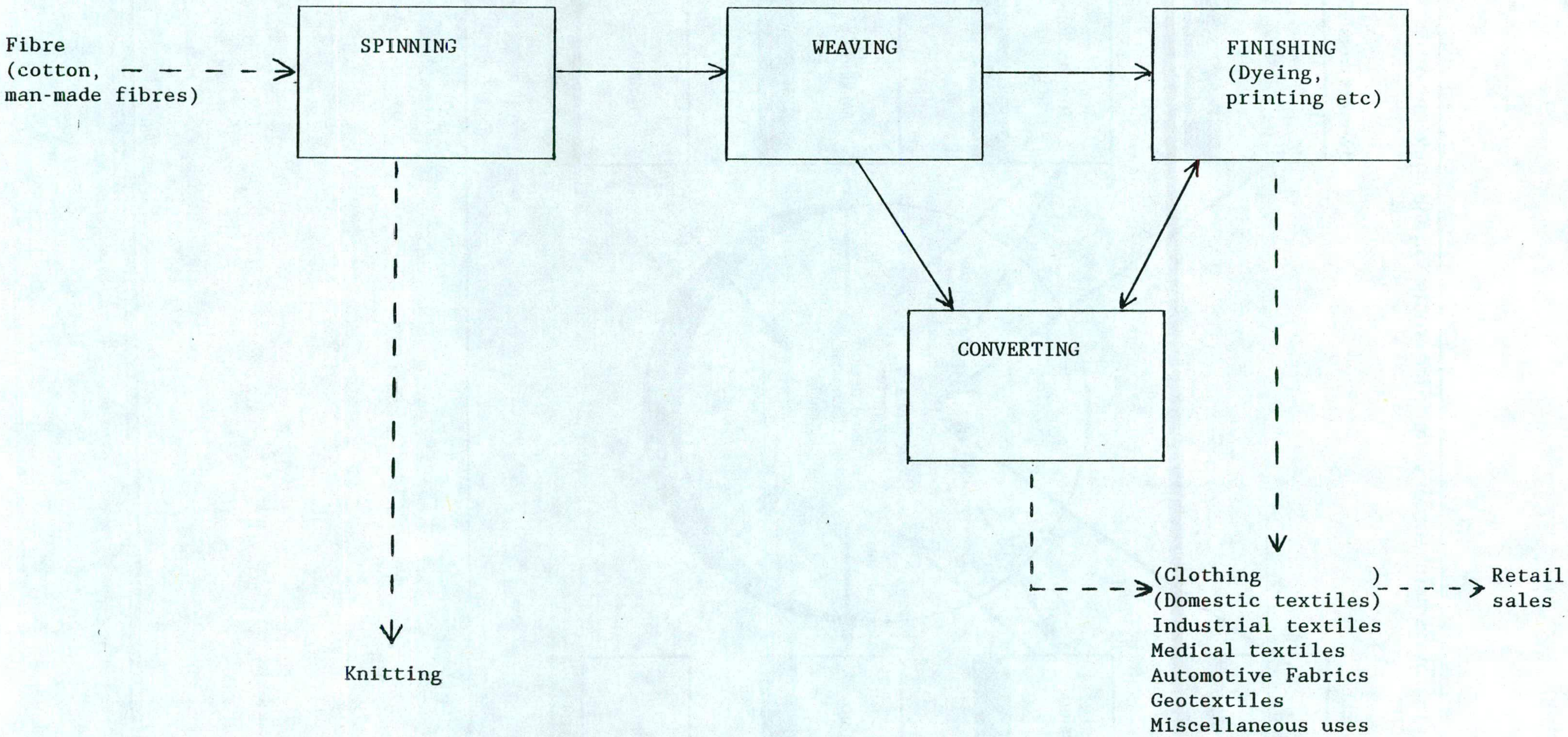
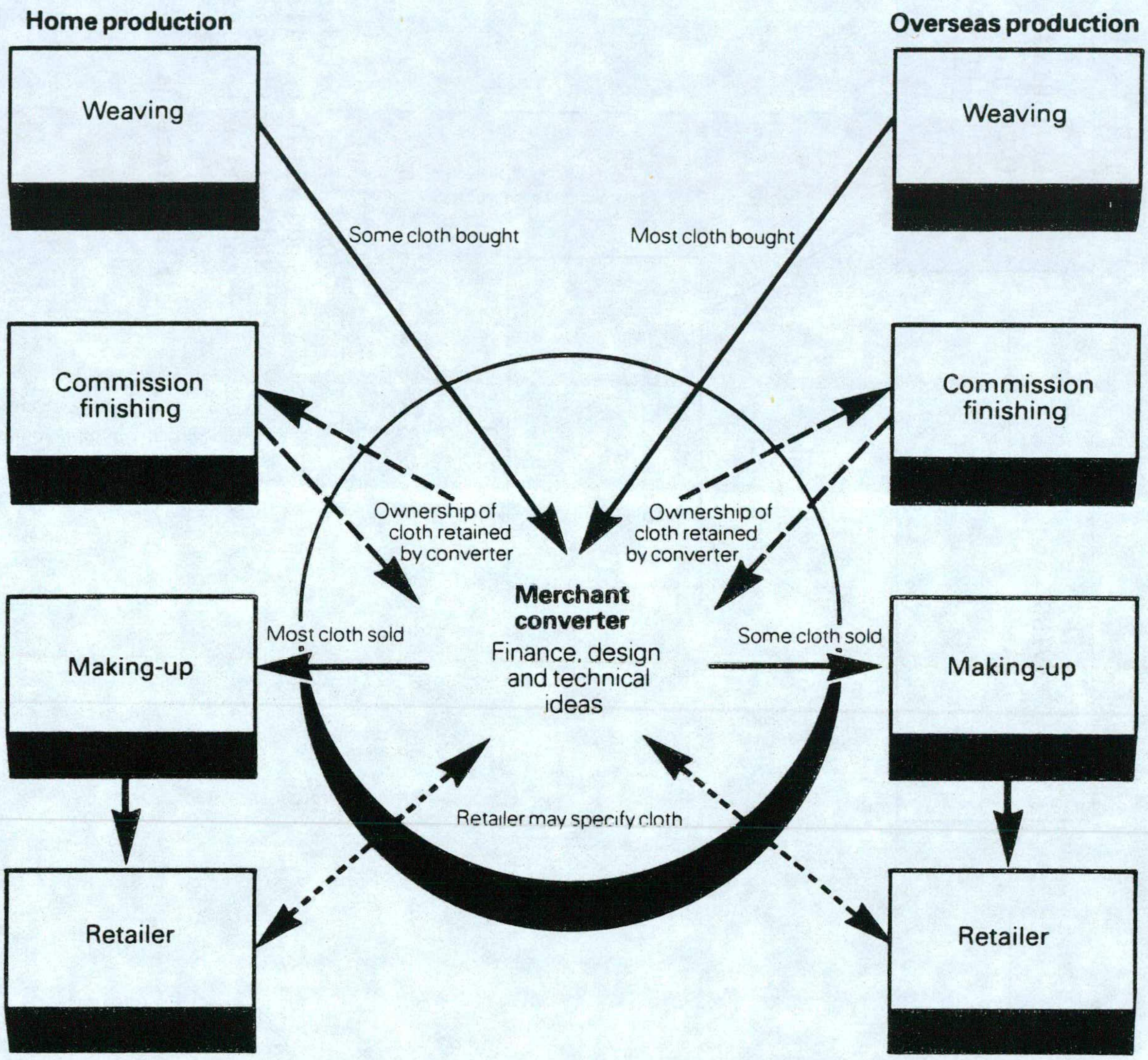


Figure 2 **The role of the merchant converter in the production and marketing of finished fabric**



COTTON AND ALLIED TEXTILES : KEY INDUSTRY STATISTICS

	1980	1981	1982	1983	1984	1985	1986	1987 Est.
Sales £m	1591	1411	1485	1560	1716	1875	1961	2030
Sales at constant prices £m	1591	1366	1387	1376	1430	1496	1525	1518
Exports £m	424	354	361	374	407	474	482	546
Imports £m	850	977	1058	1205	1506	1723	1760	1955
Export ratio %	26.6	25.1	24.3	24.0	26.7	25.5	24.6	26.9
Import penetration %	42.1	40.0	48.5	52.0	53.5	55.2	54.5	56.8
Employment '000s	101	81	71	67	66	64	62	60

MANAGEMENT DEVELOPMENT AND EDUCATION: SUMMARY OF THE REPORT

Image of the industry

* University students in textile and non-textile courses were asked to rate the industry in comparison with others. Textile students put it first, but non-textile students put it seventh out of a possible ten. Only the steel, shipbuilding and coal industries had worse images. However, the recent improvement in the industry's performance and image building efforts by industry bodies should bring about a change in perception in due course.

The importance of training

* Potential recruits attach high importance to training. Students put it second in their reasons for applying to particular companies, and existing employees put it fourth. Twenty four per cent of employees were dissatisfied or very dissatisfied with the training they had received in their present job.

* The large firms in the industry (who account for well over half of employment) are firmly committed to the goal that all managers should receive at least 40 hours' training annually, and the amount of management training they provide is rising steadily.

Small firms

* Most small firms do very little management training, but they are becoming increasingly aware of the importance of management training and development because they find difficulties in recruiting both experienced people and recent graduates, and in finding people of sufficiently high calibre internally to promote to senior management positions.

Recommendations

* There is therefore a need for courses specifically aimed at small firms, in particular to bring their managers up to date on recent management techniques, but also on more specific issues. There is also a need for many small companies to follow the lead of the industry majors by developing appraisal systems so that future top managers can be identified and developed.

* It is proposed to adapt existing courses to meet these needs; in some cases, financial support may be available from the MSC.

* Efforts will be made to help companies not in direct competition to learn from each other by arranging exchange visits.

this + one behind are spare - pl send to CST if they do not already have

NOT FOR PUBLICATION

National Economic
Development Council

NEDC 26 APRIL 1988

Note by the Secretary to the Council

Attached please find the annex to NEDC(88)12 - for Agenda Item 1.

Also enclosed in this despatch is the Memorandum from the TUC on Small Firms, Agenda Item 3, (NEDC(88)16.

Martin Couchman

THIS PAPER IS NOT
FOR PUBLICATION

Undertraining and Skill Shortages in the UK

I. Introduction

(1) The skills of the British workforce are a crucial factor in our economic performance. They permit us to compete with countries which have larger endowments of natural resources and, together with the stock of physical capital, they are the main factor which determines the level of real wages the economy can afford. This paper first restates the case for the importance of skills. It then goes on to argue that Britain has a skills problem when compared to our international competitors, and considers various economic explanations, in particular, market failures of different kinds. These explanations have implications for the conduct of training policy by government, employers, and the workforce.

(2) Studies of economic performance have established a clear link between international productivity differences and the relative skills of workforces. This can be seen both in broad sectors of industry and in plants carefully matched to remove the effects of different types of capital equipment. Modern machinery is used more effectively by skilled workers. Export performance is enhanced, too. The acquisition of skills is beneficial to individual workers as well as to the industries in which they work. Several pieces of research have indicated that education and training are likely to enhance an individual's income and occupational status considerably. For instance, a study of male employees' earnings calculated the rate of return to an extra year of education to be around 10%, and found that men with a Higher National Certificate qualification earned some 20% more than those with an Ordinary National Certificate qualification.[1] Significant returns accrue to vocational training in terms of pay and occupational status, even when it does not lead to formal qualifications.[2]

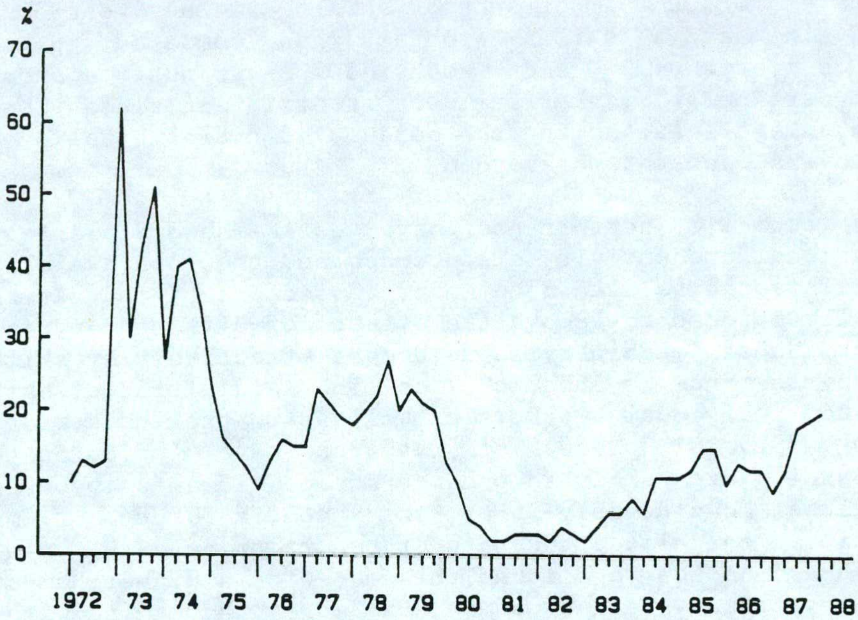
(3) The UK workforce has been becoming more skilled. The Population Censuses inform us that the management and professional and intermediate classes (Social Classes I and II) increased from 21% of the economically active population in 1971 to 25% in 1981, while the semi-skilled and unskilled (Social Classes IV and V) declined from 28% to 24%. In the industries covered by the Engineering Industry Training Board, the percentage of the total workforce who were professional engineers, scientists, technologists and technicians rose from 9.2% to 14% between 1978 and 1987, and managerial, administrative and professional staff rose from 9.5% to 13.4%. Meanwhile, the unskilled category "operators and other employees" fell from 46.9% to 40.9%. This improvement of the skill mix has not been accompanied by any substantial narrowing of differentials, thus suggesting that the improvement has been brought about by an increased demand for more highly trained workers throughout industry. There is every reason to suppose that this demand will continue to increase, and it is important to ensure that an adequate supply will be forthcoming.

II Does Britain Have Enough Skilled Workers?

(4) A sizeable minority of British firms now claim in response to the regular CBI Industrial TrendsSurvey that they expect their output to be constrained because they cannot hire sufficient skilled labour. Figure (1) shows how this perceived problem has been getting worse since the

beginning of 1983, although it has not reached the dimensions of 1973 and 1974. The skills problem is particularly acute in engineering and textiles, where it is a more serious constraint than a shortage of plant capacity. Over 1987 as a whole, the proportion of respondents in manufacturing that reported their output being constrained by shortages of skilled labour varied from 0.75% in the food, drink and tobacco sector to 26.25% in textiles and 38.25% in electrical and instrument engineering.

Fig. (1) Proportion of firms reporting that output is likely to be limited by insufficient skilled labour



Source: CBI Industrial Trends Survey

(5) This type of data gives only a partial picture of the extent of the skills problem. It does not give any indication of the stock of skills available in the working population or the extent to which jobs are filled by workers with inadequate skills because keeping vacancies open would be even more costly; nor does it reveal whether firms believe that the shortages they report would be ameliorated by an increase in the relative pay offered to skilled workers. In other words, the problem could be one of inflexible relative wages, not an inadequate supply of skilled workers. In replying to surveys, employers tend to exaggerate skill shortages when they are experiencing or anticipating them. Hence we need to investigate the stock of skills in Britain and the rate at which this stock is augmented by training. One criterion by which adequacy can be judged is the level of skills achieved by our international competitors.

(6) The NEDC/MSC Report, "Competence and Competition", established that there is a substantial gap separating the UK on the one hand and Germany, the US, and Japan on the other. The most clear-cut difference is the larger proportion of the British workforce which acquires no recognised qualification at all (see table (1)). This has been corroborated in studies of particular countries, such as those at the National Institute of Economic and Social Research, where efforts have been made to put the grading of qualifications on a comparable basis.

Some 60% of the German labour force have attained apprenticeships or similar intermediate-level qualifications, compared with only around 30% of Britain's. A comparison of Britain with Switzerland leads to a similar conclusion. The United States, France and Japan have tended to pursue more school and college-based vocational training than have Germany and Switzerland, but Britain suffers in a comparison with these countries, too. For instance, only a quarter of the American workforce have qualifications below intermediate level or none at all, compared to over half of the British workforce. In Japan, over 95% of pupils stay on in full-time schooling until the age of 18 (compared to 32% in England), and at least three times as many workers reach technician level (i.e. above apprenticeship level) as do so in England (after allowing for the different sizes of the workforce). Managers of Japanese-owned manufacturing plants in Britain find inadequate supplies of workers with intermediate training compared to the situation in Japan. France also has a comparative advantage at intermediate level and fewer completely unskilled workers. This comparative advantage is increasing; for instance, in mechanical and in electrical engineering work, France today trains between 2½ and 3 times as many qualified craftsmen and technicians per head of the workforce as does Britain. The fraction of the total workforce employed in engineering and metal-working who hold vocational qualifications is 50% higher in France than in Britain. According to the National Institute, over the decade 1975 to 1985, the numbers acquiring engineering qualifications in France increased by around 60% and in West Germany by 35%, while in the UK there was a fall of 30%.[3]

Table (1)

Workers with a recognised qualification as a proportion of the population

		Nature of minimum qualification
Germany (1980)	66% of labour force	Vocational qualifications
(US (1981)	78% of civilian labour force	High School Diploma
Japan (1982)	60% of population 21+	Lower secondary school diploma
GB (1981)	50% of working population	1 CSE pass

Source: Table 6.6, Competence and Competition (1984)

(Note that what constitutes a 'recognised qualification' differs from one country to another. No attempt is made here to put them on a comparable footing.)

(7) At the opposite end of the occupational hierarchy, the MSC/NEDC/BIM (1987) report, The Making of Managers (the "Handy Report"), established that the training of managers in this country leaves much to be desired, stating that, "there can be little doubt that, by comparison with the other countries in this study, Britain has neglected her managerial stock". It found that in West Germany, 63% of top managers have a degree; in one American survey of top corporate managers, 85% had a first degree and 51% a second degree. In Britain, surveys suggest a comparable figure of 24%. Obviously, this measures only one limited dimension of the training of managers. Other

dimensions considered by the Handy Report were no more favourable to Britain. For example, it concluded that it is quite possible that over half of the country's 3.3 million self-defined managers have never received any formal training or developmental help.

(8) There are some indications that training (broadly defined) has become more widespread over recent years. The Director General's paper presents some summary data from the Labour Force Survey, showing that the proportion of employees receiving some sort of training in the four weeks prior to the survey has increased by some 30% over the period 1984 to 1987. The Surveys also show that training rates are higher for those in employment, for men and, especially, for the young, than for those out of work, for women, and for the older worker respectively. The government's Youth Training Scheme, started in 1983, has helped. A recent survey of establishments participating in YTS concluded that the Scheme has increased both the quantity and the quality of training (although not necessarily in the most needed skills) despite a certain amount of displacement of older workers and financing of training which would have taken place anyway.[4] However, the authors highlighted the need to encourage an expansion of training in more advanced skills, at craft and technician level. YTS by itself cannot be an adequate substitute for such training, although it has the potential to contribute to its early stages. We turn now to a piece of evidence which suggests why this is important.

(9) Evidence about long-term training is available in manufacturing from the employment statistics provided by firms over a longer period of time than the data from the Labour Force Survey. Table (2) presents data from 1964 to 1987. A steep decline is obvious (and confirmed by samples from the New Earnings Survey; as far as full apprenticeships are concerned, the NES suggests the phenomenon is not restricted to manufacturing). The decline has not been reversed despite the stabilisation of manufacturing employment. This helps to explain the skill shortages, particularly in engineering, noted by the CBI. It should be noted that the 1986 and 1987 figures largely exclude the Youth Training Scheme, as few YTS trainees have a contract of employment. A generous adjustment, using MSC and Department of Employment data, would raise the 1986 figure for "all trainees" from 1.9% to around the 1983 figure of 2.7%. The decline in training in the traditional training industries is corroborated by data from the Engineering Industry Training Board. Small and medium-sized establishments in particular have cut back since the late 1970s and now have considerably fewer trainees as a proportion of employment than do large plants with over 1000 employees. Unfortunately, long-term evidence about the trends in the services sector (of growing importance) is sparse.

Table 2: Apprenticeship and other trainees in manufacturing industries as a percentage of all employees, GB

	Apprentices	Other Trainees	All Trainees
1964	3.0	1.8	4.8
1974	2.0	2.2	4.2
1979	2.2	1.6	3.9
1983	1.8	0.9	2.7
1986	1.2	0.7	1.9
1987	1.1	0.7	1.9

Source: Department of Employment

N.B. People on Youth Training Schemes who do not have a contract of employment are excluded.

III Why Does Britain Have a Skills Problem?

(10) Having suggested that Britain is probably at a comparative disadvantage in terms of the skills of its workforce, it is necessary to consider why this problem has arisen. If the relevant markets all worked perfectly, skill shortages could not arise, so their presence must be due to the failure of the markets for skilled labour to work as effectively as we would wish. There are various theoretical possibilities which must be confronted with the evidence.

(11) First, there could be a deficiency (compared to their international counterparts) in the demand for skills on the part of UK employers. Second, there could be an insufficient supply of skilled workers. In this case, the cause of the problem could be that not enough workers want to undertake training, given the incentives, or that not enough firms want to provide training opportunities, given the costs of doing so. These potential costs will be substantially higher if firms think they first have to make up for deficiencies in the education previously received by workers. In other words, two types of market failure could be involved. Firms may find themselves bearing the costs of training without being able to capture the benefits. Also, individuals may regard investment in their own training as a risky undertaking, and hence refuse opportunities. The empirical relevance of these potential explanations is considered below.

(12) If the supply of skilled workers is insufficient, but employers' demands for skilled workers are similar to those of their international competitors, one would expect the relative wages of skilled workers to be driven upwards. According to the best available comparative evidence on the structure of earnings in Europe, pay relativities compared to the unskilled for skilled and semi-skilled manual workers in manufacturing are very similar in the UK, West Germany and France (differentials tend to be smaller in Italy).[5] Given the substantial differences in the quantity of skilled labour, this evidence about the price of skilled labour suggests that British companies have a lower demand for skilled workers than their international counterparts. Faced with a less well-trained workforce, UK firms will then tend to choose less skill-intensive methods of production and less skill-intensive products. Unfortunately, these will often tend to have a lower market potential, and be less likely

to benefit from innovations.

(13) As well as having a lower demand for skilled workers, Britain's supply of skilled craftsmen is also weaker. Economists find it useful to distinguish between specific skills, which are only of use within the firm in which they are acquired, and general skills, which are equally applicable in other firms (in the real world, actual skills lie somewhere between these polar cases). There is a big disincentive to firms to invest in the training of their workforce in general skills, because other firms can hire the workers with transferable skills without paying anything towards the costs incurred in their training; this is the well-known phenomenon of "poaching". Possession of widely recognised vocational qualifications is an indication that many of a worker's skills are fairly easily tranferable. Employers' funding of training leading towards such qualifications is therefore likely on theoretical grounds to be less than the ideal amount because they are aware that many of the workers they train will be poached. Firms nonetheless spend a good deal on general training in practice.

(14) The importance of the disincentive to employers to finance workers' training depends upon the costs of training. Details of the costs of training in the economy as a whole, including the pay received by people while they are acquiring skills, is not readily available in this country, which is one of the reasons why the Manpower Services Commission is undertaking a major study of the funding of vocational education and training. A consultation document for the MSC estimates that public expenditure on vocational education and training (through central government, the MSC and local authorities) amounts to about £7 billion, employer spending to about £5 billion and armed forces expenditure to about £1.3 billion.[6] The total of £13.4 billion excludes direct and indirect contributions made by trainees and their families, and any subsidies received through the tax and benefit system.

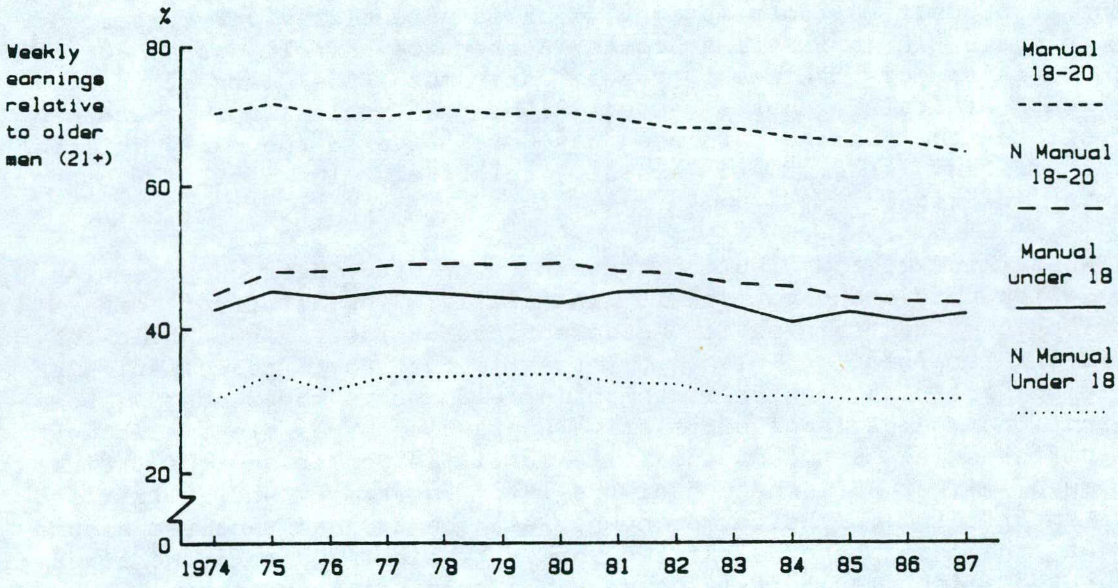
(15) The Labour Costs Survey, mounted every three years, examines vocational training costs (excluding instructors' pay and the wages and salaries of trainees who were not full-time employees) in British industries. In 1984, it estimated vocational training costs to be about 1.3% of total labour costs in manufacturing (varying between 3.1% in shipbuilding and 0.6% in the food, drink and tobacco sector), 2.6% in construction, 0.8% in distribution, and 0.7% in banking, insurance, and finance. Most industries showed a decline in this fraction between 1981 and 1984; manufacturing's fraction, for instance, fell from 1.8% to 1.3%. Some of this decline may be accounted for by increased MSC funding of trainees through YTS, but, if this is the case, it suggests that employers' supply of training is relatively inelastic. The decline may also reflect a shift away from traditional, relatively high-cost, apprenticeships.

(16) Craft-level training appears to be expensive to employers, although one problem that arises in trying to estimate the costs of training is that British employers tend to have poor accounting records for these costs (the same is true in the United States, where the inadequacy of firms' records of training costs has caused the cancellation of at least one official survey of training). Yet in West Germany, over 80% of the firms engaged in training in the early 1980s were able to provide a breakdown of training costs per trainee. This may reflect the relative importance attached to training by employers, and an improvement in British practice is very desirable. A recent study making use of information supplied by training personnel

calculated the net costs of a 3½ year engineering craft apprenticeship (without any YTS subsidy) to be nearly £9000 (at September 1984 prices).[7] This estimate attempted to allow for the value of the trainee's productive contribution, which is potentially very important to employers in offsetting costs. Apprentice payroll costs, 90% of which consist of trainees' wages, are much the largest single component of training costs (about 70% of the total). It is therefore appropriate to examine trainee pay, relative to the fully skilled rates, in any attempt to explain relatively low levels of craft training in Britain.

(17) What kind of contribution do workers make to their own training, from which they stand to benefit financially? The nature of workers' contributions to training is the acceptance of lower wages while they are being trained. This cuts the labour cost to companies of providing training, which is the major element in their costs. Some international comparisons of relative apprentice wages are available. The differential between the fully qualified worker and the trainee was much larger at the end of the 1970s in Germany and Switzerland than in Britain. In the former countries, the trainee received around 20% of the earnings of a skilled worker, while in Britain the figure is about 50% (for men). It is conceivable that the British trainee has higher productivity (for instance, in Germany - but not in Switzerland - all 15 to 18 year old employees have to be released for one day a week to attend vocational schools), but not that much higher. Data from the New Earnings Survey and the Labour Costs Survey indicate that the differential has tended to increase in Britain since the early 1970s. For instance, a male apprentice in 1970 received on average 52.4% of the average weekly gross earnings of all full-time men not engaged in vocational training, but in 1984 received just 46.4%. However, this is still well above the proportion in other countries in which on-the-job vocational training is very important. In general, the relative pay-rates of youth workers have declined somewhat (see figure (2)). Some of the reduction probably results from the shift of employment away from manufacturing, without any change in the differentials within manufacturing or within the services sector. However, to the extent that apprenticeship pay has been reduced by the transfer of preliminary training into YTS, the costs to employers will have been reduced. YTS trainee allowances appear to be less than half as much as apprenticeship rates for the under-18s, and of course the MSC helps to finance YTS programmes.

Fig (2) Earnings relativities for full-time young men



Source: N.E.S

(18) France and the US, where a much larger proportion of vocational education and training is carried out in the educational system, the question of getting incentives to employers right does not arise in the same way. However, it is relevant to note that people receiving vocational education do not receive pay; thus the trainee is expected to make a bigger contribution to costs. In the US there are often fees to be paid as well. Japan's system, mixing more extended formal education and on-the-job training (with the employees expected to acquire general skills in their own time) also puts more of the burden on the trainee.

(19) There is good reason to conclude that one reason why British employers generally do not invest in training as much as their international competitors is that it costs them more per person to provide training; they have to pay more to the workers being trained.

(20) The supply-side problem identified above can be exacerbated if there is an insufficient supply of willing and able would-be trainees. Individual workers may be discouraged from undertaking training in transferable skills because the returns on this "self-investment" are seen as uncertain. Workers' "human capital" cannot be diversified to spread risks in the same way as financial capital can, and technological change can render many specialised skills obsolete. If more of the burden of financing general training is placed on individuals, they may have difficulty in raising the money, given low current earning power and constraints on borrowing when the only "collateral" they have to offer is future earning power. In practice, this is probably not an acute problem at the moment. Returns to training are high, sometimes very high, for individuals, and many good quality training opportunities are rationed. This general conclusion is confirmed by a Department of Employment study of youth labour

markets in Chelmsford, Liverpool, and Walsall.[8] The authors concluded that:

> "The main obstacles were not on the supply side... In general, the young people that were interviewed were only too willing to upgrade their qualifications and skills, given the opportunity. Trainees' most frequent criticisms of the Youth Training Scheme were not objections to the principle of training but to schemes that had led nowhere"

The authors observed that, in many companies, a shortage of skilled labour was a long standing problem, yet the companies explicitly ruled out extra training effort as too risky and expensive, confirming the market failure arguments put forward above. Studies of the determinants of apprenticeship intake in the 1960s and 1970s (when there was more pressure on the youth labour market) indicate that factors affecting employers' demand[9] are more important than factors on the supply side (eg demographics).

(21) However, the supply of young people willing to take up proper training opportunities cannot be assumed to continue to be adequate in the future particularly if employers demand a higher educational standard of trainees. YTS has helped to increase the proportion of young people who actually receive some training (in January 1988, the total in training in Great Britain stood at 413,049). This will not be sufficient to maintain the overall rate of training in the economy at a time when the relative size of the youth cohort is expected to fall considerably, after 1983. Department of Employment labour force projections indicate that, over the next five years, the number of young people in the labour force will fall by around 13% (this is after allowing for a slight projected <u>increase</u> in activity rates). To maintain the level of youth employment over this period would require the virtual abolition of youth unemployment (the unemployment rate for 16-18 year olds in the United Kingdom in January 1988 was 12.9%). The 16-19 year old age group is predicted to decline by 22% between 1988 and 1995, while the number of 20-24 year olds will fall by 10%. In England, the number of young people leaving school during each academic year and available for employment is likely to continue to fall until 1992-93. This opens up the prospect that the demand for training will soon become inadequate, because of the fall in the number of young people, who have a high propensity to undertake training.

IV Some Conclusions

(22) The evidence suggests that Britain does have a skills shortage, and that this arises for two reasons. Firms do not fully appreciate the benefit to be derived from a more skilled labour force or are forced to specialise in less skill-intensive product lines, so the demand for skilled labour is not as great as it should be. The incentives to provide training of an appropriate type and quality are inadequate, so the supply of skilled labour is not as great as is desirable. In the future, because of demographic trends, this problem will be exacerbated by a fall in the proportion of the workforce who wish to undertake training in particular, initial and longer-term training, unless action is taken. The extension of YTS to two years so that young people do not enter the normal labour market until the age of 18 is a move in the right direction. Employers should be reassured about the government's long-term commitment to the Scheme and its upgrading. As some training content is always specific to the firm, employers must expect to bear a share of the costs, even if it is a lower share than was traditional in the old apprenticeship system.

(23) Britain should be concerned about increasing the proportion of its workforce with identifiable skills, particularly at intermediate level. Some of our competitors have done this by providing initial vocational training within the educational system, funded mainly from the public sector (e.g. USA, France). Some have done it by utilising employers (e.g. West Germany, Switzerland), although in all cases the educational foundation laid down initially is important. Under both alternatives, trainees tend to be expected to bear a larger fraction of the costs, through fees and foregone income, than they are in Britain. They are prepared to do so because of the opportunities thereby opened to them and because of positive attitudes towards training in society at large. The corollary of this sort of reduction in employers' costs of training must be to improve employment prospects of trainees and training standards (the work of the National Council for Vocational Qualifications is important in this respect, particularly in encouraging progression of trainees to higher and higher levels). Otherwise there is a danger of simply substituting cheaper youth workers for similar relatively unskilled adult workers, a danger not without historical precedent.

(24) The expected fall in the annual number of school leavers in future implies that any attempt to upgrade the quality of the workforce rapidly will entail more training of its existing members. This will be particularly true if the proportion of each youth cohort which continue in full-time further and higher education increases, itself a necessary development if higher-level skills are to be augmented. Efforts to target support for adult training on the long-term unemployed are likely to help more at the lower end of the skill range than at the intermediate level, because the long-term unemployed are significantly less well educated than the labour force at large. This is another area in which it would be helpful if continuous human resource development became a more important part of collective bargaining, with employers recognising the need to provide incentives to trained workers to stay with them. The supersession of the apprenticeship, with its association with youth, may actually be helpful in this respect.

(25) The problem of actual or potential "poaching" can be reduced by firms if they develop internal labour markets with clear career progression for workers who develop their skills, as is done for

instance in the larger firms in Japan, with their emphasis on on-the-job training. In this way employees and employers can share the benefits accruing from their joint investment in training. However, the spread of widely recognised standard qualifications should not be discouraged in order to achieve this goal, because this would impede labour mobility and attempts to improve the standard of training. Instead, firms should tailor their own training programmes to add value to such qualifications by relating them to the particularities of their own procedures and production systems. This is much easier for large firms, in which the overheads of training programmes can be spread more widely, and the need for newly qualified workers is more predictable. Small firms, which currently undertake considerably less training per head on average, need to be able to buy in training facilities and courses tailored to their needs. In many cases, large firms who are not direct competitors are potential suppliers of such services. An excellent example of such an arrangement in practice is that of Sheerness Steel Company, which has successfully set up the North Kent Technology Skills Centre and marketed its facilities to many other firms in the region who are willing to pay to make use of expertise developed in Sheerness Steel's own training programmes. Courses tend to be short and are tailored to firms' specific requirements.

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NOT FOR PUBLICATION

NEDC

National Economic
Development Council

RP

NEDC 26 APRIL 1988

Note by the Secretary to the Council

The following papers are circulated herewith:

ITEM 1 (SKILLS):

- Memorandum by the Secretary of State for Employment and the Chairman of the Manpower Services Commission (NEDC(88)9).

- Memorandum by the CBI (NEDC(88)11) - with two annexes (booklets) for Members and Principal Advisers only.

ITEM 2 (COTTON AND ALLIED TEXTILES SECTOR GROUP):

- Memorandum by Mr Stuart Hollander CBE (NEDC(88)13).

ITEM 3 (SMALL FIRMS):

- Memorandum by the Department of Employment (NEDC(88)14).

- Memorandum by the CBI (NEDC(88)15).

- Memorandum by the Director General (NEDC(88)17) with annex.

ITEM 4 - FOR NOTING ONLY - (NEDO PLAN AND BUDGET)

- Memorandum by the Director General (NEDC(88)18).

A note on NEDC lunches is also circulated herewith.

Other papers and the agenda will be circulated shortly.

MARTIN COUCHMAN

THIS PAPER IS NOT
FOR PUBLICATION

NEDC

National Economic
Development Council

SERVING THE CUSTOMER

NEDC (88)13
26 April 1987

Memorandum by Mr S D Hollander CBE, Chairman of the Cotton and Allied Textiles Sector Group.

1 This paper reports how the Cotton and Allied Textiles Sector Group has worked on the objective of changing its industry's approach to its customers. It underlines how an industry in the main supplying intermediate products needs to focus just as much on serving the end customer as industries in more direct contact if it is to be competitive in the 1990s.

THE INDUSTRY

2 The industry served by the SG covers spinning of cotton and man-made fibre yarn, weaving of that yarn into fabric, and dyeing, printing and finishing that fabric. It employs around 60,000 people and has an output worth just over £2 billion. Since 1981, production has grown by 11 per cent in real terms, and most companies are now healthily profitable.

3 There is intense international competition in textiles. The UK industry was the first to suffer severe competition from the Far East, and virtually all basic products now come from that source: at the same time, there is severe competition from Continental countries in more up-market products. The result is that imports account for nearly 60% of the UK market. Just over 25% of UK production is exported. More detailed statistics are contained in Annex 1.

The challenge of diversity

4 The industry is diversified in terms of end uses. About 30 per cent of fabric is hemmed and packaged for retail sale as sheets, towels and curtains. Most of the rest goes to the clothing industry, but medical uses are important and sales to the engineering and construction industries are growing. About half the yarn produced is sold within the industry to weavers; the rest goes to the knitting industry. The industry is fragmented, and its structure is horizontal, not vertical (see Figure 1). Small companies account for about half the industry, but even the major firms like Courtaulds and Coats Viyella which own spinning, weaving and finishing operations treat them as separate profit centres.

5 The picture is complicated by the merchant converter, whose role is shown diagramatically in Figure 2, and who provides much of the creative input. Converters do not generally own manufacturing capacity in the shape of weavers, dyers and finishers. They buy grey (ie unfinished loomstate) cloth from weavers and pay a fee to finishers to dye and print it to designs which the converters have created, amended or recoloured.

6 Until the early 1950s, converters were the UK industry's principal exporters, and much of the manufacturing side of the textile business was purely production oriented, seeing its role as servicing converters. With the advent of cheap grey cloth from Asia, and subsequently the UK's entry into Europe making finished cloth from the EEC more readily available, converters gradually became importers more than exporters. The typical converter today will source grey cloth from low cost sources and finish it in the UK or elsewhere in the EEC. Despite this shift, even by the 1980s weavers and finishers remained very much locked into a structure which separated them from end users, who were jealously guarded by converters. It was difficult for these manufacturers to start supplying end users directly; not only would they incur considerable costs in establishing their own marketing operations - as well as having to acquire new attitudes and skills - but converters would threaten to cease to deal with weavers and finishers who attempted to do so.

7 The problem for the fabric manufacturer was thus distance from the final customer (usually the retailer), caused both by the horizontal structure and by the existence of converters. This is particularly important in a fashion-oriented industry, where responsiveness to colour and design trends is of paramount importance in serving the customer - yet where colour decisions may have to be made up to five manufacturing stages back up the supply chain.

THE SECTOR GROUP'S PROGRAMME

8 With this in mind, the SG set itself three linked themes:

- creating growth by helping the industry to respond to the final as well as the intermediate customer;

- dealing with the vulnerabilities in the textile supply pipeline;

- and finally, because to achieve the first two objectives would mean having the right people, attracting and developing the relevant talent.

The remainder of this paper deals with how the SG has tackled or is tackling each of these issues. In each case, the aim was to achieve practical action. The focus has been on remedying deficiencies in the supply pipeline through closer co-operation between customers and suppliers.

Responding to the market place

9 Because converters had taken most of the initiative for marketing, weavers and finishers had paid little attention to this vital area of business. While the other major EEC nations have a fairly even balance of trade with each other in textiles, the UK has a substantial deficit with them. The SG has therefore had to try to improve exports and to promote competitiveness with imports, while at the same time trying to help improve weavers' and finishers' marketing skills.

10 The industry has responded positively to two export initiatives. In September, a group of converters will be visiting Scandinavia on a trade mission (most of them do not currently export to Scandinavia, or indeed elsewhere); this exercise may later be extended to other potential markets. Thirty weavers and finishers are participating in an export market research

study of France, looking particularly for potential customers among converters; again, other Western European markets will subsequently be considered.

11 Collective action can pay dividends in terms of strengthening the position in the home market, and in January 1987 the EDC organised a "Better Converted in Britain" exhibition. This extension of the BMIB concept saw converters showing imported fabrics to weavers and finishers, while at the same time weavers and finishers showed converters the sorts of goods and services they were capable of producing. The event achieved some immediate re-sourcing to UK supply, but it should also lead to the establishment of the first showcase for home manufacturers: the first "British textiles: Lancashire to London" exhibition is planned for 1989, aimed especially at converters and retailers to demonstrate the growing confidence and market orientation of UK textile manufacturers.

12 Improvements in market share will not take place without proper attention to design and colour. Here the SG has run well-attended seminars to raise the industry's consciousness, most recently on "Computers and Creativity" with demonstrations of the latest in CAD equipment. The next project is a study of best practice in colour and design forecasting. The SG is also concerned about the industry's relationship with design education, and is helping to develop closer links between companies and colleges.

Dealing with vulnerabilities in the textile supply pipeline

13 In an industry with so many production stages, response times need to be cut down as far as possible to reduce vulnerability to the vagaries of fashion. There are now not two but six or more fashion seasons a year, and manufacturers need to be more flexible to improve market share. The main way to improve speed of response will be by improving relationships within the long textile pipeline, and there is evidence that relationships between converters and UK weavers and finishers are indeed getting better, partly as a result of the SG's efforts. In addition the SG is currently working with the Clothing SG to develop "best practice" demonstration projects covering each link in the chain, including retailers. These will also show the substantial benefit of stock reductions and less wastage.

Attracting and developing talent

14 The industry still has a "clogs and shawls" image - yet the reality is that each operative can be responsible for £½ million worth of machinery. Highly talented and adaptable people are needed to work within it and to manage it. The SG has just published a report on "Management Training and Development" which focuses on small firms' management training needs. It finds that while the larger companies in the industry like Courtaulds and Coats Viyella are committed to a minimum of five days management training annually (an aim proposed in the Handy Report), most small firms do very little, partly because few suitable courses exist. However, they are increasingly aware of training's importance because of growing difficulties in recruiting both experienced people and recent graduates, and in finding people of sufficiently high calibre internally to promote to senior levels. A summary of the report is attached as Annex 2.

15 In terms of developing management skills, the SG developed a self-help strategic planning kit to improve the way in which managers in small companies can shape their own destinies, introduced at well-attended seminars (the concept was subsequently exploited by three other EDCs). It has also developed with Manchester Business School and the MSC an eight week part-time course for directors of small and medium sized textile companies, covering company finance, marketing, quality management, motivation and management style, creativity, and strategic planning, which has met with a good response. The SG is currently talking to other training organisations about further courses on communications skills, financial management for non-accountants, organising exports, design appreciation and management for non-designers. The SG is also seeking to develop appraisal systems suited to small firms so that the top managers of the future can be identified and developed. The recent improvement in the performance of leading companies, coupled with image-building efforts by industry organisations, should lead to an up-grading of the image of the industry as a whole, which should in turn help to attract talent.

CONCLUSIONS AND IMPLICATIONS FOR THE COUNCIL

16 In a long supply pipeline like the textile industry's, all the latest technology will count for little without trust and understanding between customers and suppliers. The Council is invited to note that an important contribution towards improving industrial competitiveness, especially but not solely in the case of smaller companies, can be achieved by ensuring that the component elements of the supply chain work together more effectively. The SG has focused most of its efforts on these relationships, and is confident that it is making a positive contribution towards improving them.

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FIGURE 1: THE COTTON AND ALLIED TEXTILES INDUSTRY'S HORIZONTAL STRUCTURE

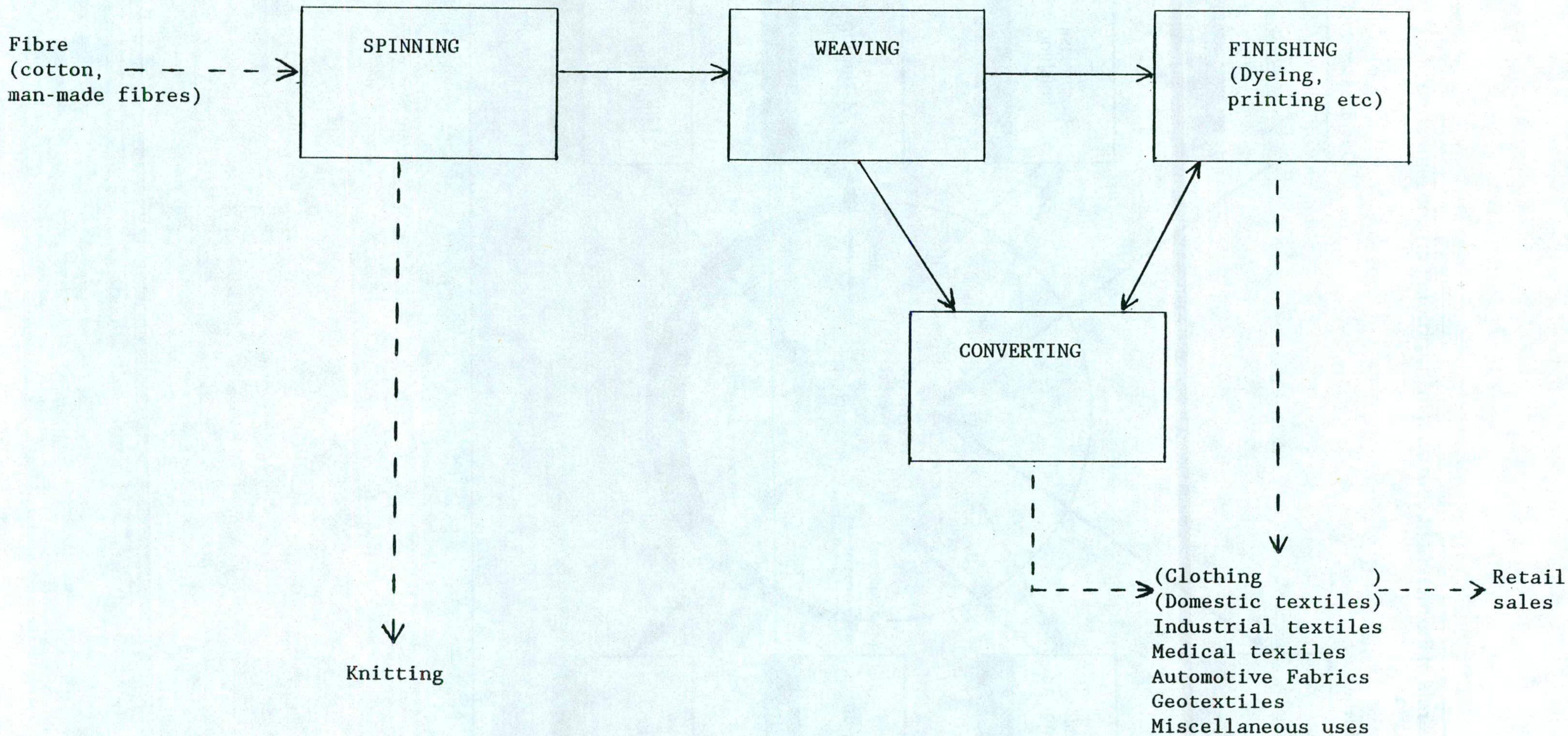
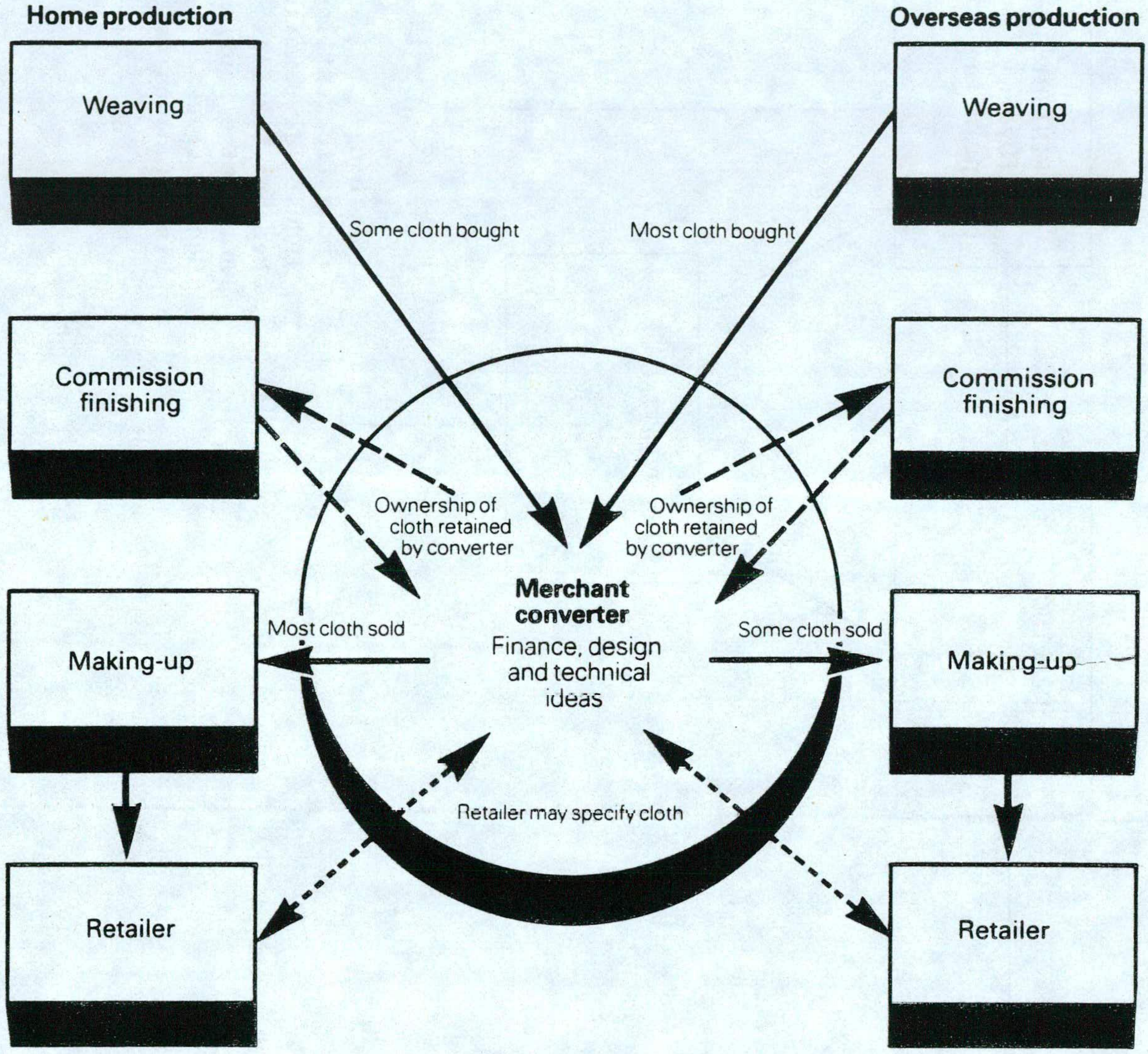


Figure 2 **The role of the merchant converter in the production and marketing of finished fabric**



ANNEX 1

COTTON AND ALLIED TEXTILES : KEY INDUSTRY STATISTICS

	1980	1981	1982	1983	1984	1985	1986	1987 Est.
Sales £m	1591	1411	1485	1560	1716	1875	1961	2030
Sales at constant prices £m	1591	1366	1387	1376	1430	1496	1525	1518
Exports £m	424	354	361	374	407	474	482	546
Imports £m	850	977	1058	1205	1506	1723	1760	1955
Export ratio %	26.6	25.1	24.3	24.0	26.7	25.5	24.6	26.9
Import penetration %	42.1	40.0	48.5	52.0	53.5	55.2	54.5	56.8
Employment '000s	101	81	71	67	66	64	62	60

MANAGEMENT DEVELOPMENT AND EDUCATION: SUMMARY OF THE REPORT

Image of the industry

* University students in textile and non-textile courses were asked to rate the industry in comparison with others. Textile students put it first, but non-textile students put it seventh out of a possible ten. Only the steel, shipbuilding and coal industries had worse images. However, the recent improvement in the industry's performance and image building efforts by industry bodies should bring about a change in perception in due course.

The importance of training

* Potential recruits attach high importance to training. Students put it second in their reasons for applying to particular companies, and existing employees put it fourth. Twenty four per cent of employees were dissatisfied or very dissatisfied with the training they had received in their present job.

* The large firms in the industry (who account for well over half of employment) are firmly committed to the goal that all managers should receive at least 40 hours' training annually, and the amount of management training they provide is rising steadily.

Small firms

* Most small firms do very little management training, but they are becoming increasingly aware of the importance of management training and development because they find difficulties in recruiting both experienced people and recent graduates, and in finding people of sufficiently high calibre internally to promote to senior management positions.

Recommendations

* There is therefore a need for courses specifically aimed at small firms, in particular to bring their managers up to date on recent management techniques, but also on more specific issues. There is also a need for many small companies to follow the lead of the industry majors by developing appraisal systems so that future top managers can be identified and developed.

* It is proposed to adapt existing courses to meet these needs; in some cases, financial support may be available from the MSC.

* Efforts will be made to help companies not in direct competition to learn from each other by arranging exchange visits.

National Economic
Development Council

NEDC 26 APRIL 1988

Note by the Secretary to the Council

Attached please find the annex to NEDC(88)12 - for Agenda Item 1.

Also enclosed in this despatch is the Memorandum from the TUC on Small Firms, Agenda Item 3, (NEDC(88)16.

Martin Couchman

Undertraining and Skill Shortages in the UK

I. Introduction

(1) The skills of the British workforce are a crucial factor in our economic performance. They permit us to compete with countries which have larger endowments of natural resources and, together with the stock of physical capital, they are the main factor which determines the level of real wages the economy can afford. This paper first restates the case for the importance of skills. It then goes on to argue that Britain has a skills problem when compared to our international competitors, and considers various economic explanations, in particular, market failures of different kinds. These explanations have implications for the conduct of training policy by government, employers, and the workforce.

(2) Studies of economic performance have established a clear link between international productivity differences and the relative skills of workforces. This can be seen both in broad sectors of industry and in plants carefully matched to remove the effects of different types of capital equipment. Modern machinery is used more effectively by skilled workers. Export performance is enhanced, too. The acquisition of skills is beneficial to individual workers as well as to the industries in which they work. Several pieces of research have indicated that education and training are likely to enhance an individual's income and occupational status considerably. For instance, a study of male employees' earnings calculated the rate of return to an extra year of education to be around 10%, and found that men with a Higher National Certificate qualification earned some 20% more than those with an Ordinary National Certificate qualification.[1] Significant returns accrue to vocational training in terms of pay and occupational status, even when it does not lead to formal qualifications.[2]

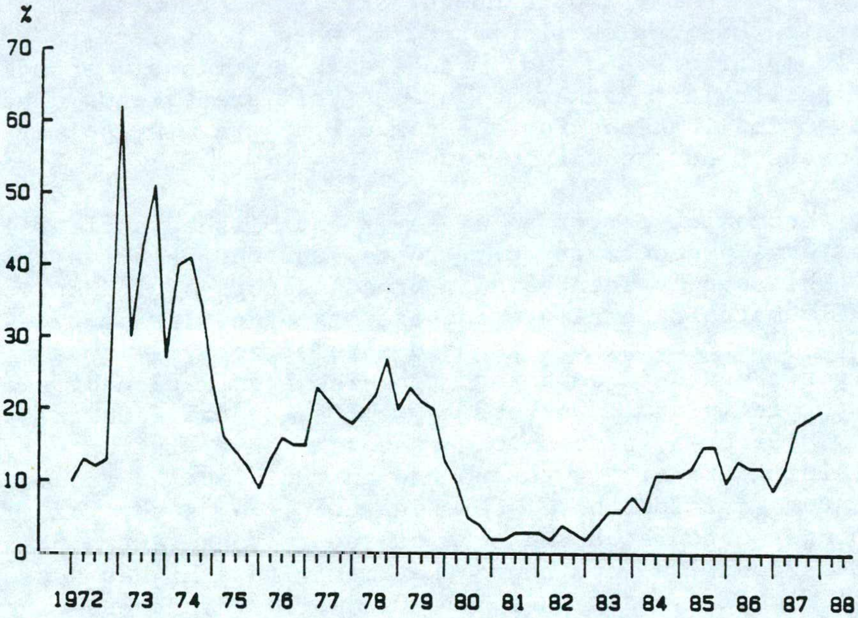
(3) The UK workforce has been becoming more skilled. The Population Censuses inform us that the management and professional and intermediate classes (Social Classes I and II) increased from 21% of the economically active population in 1971 to 25% in 1981, while the semi-skilled and unskilled (Social Classes IV and V) declined from 28% to 24%. In the industries covered by the Engineering Industry Training Board, the percentage of the total workforce who were professional engineers, scientists, technologists and technicians rose from 9.2% to 14% between 1978 and 1987, and managerial, administrative and professional staff rose from 9.5% to 13.4%. Meanwhile, the unskilled category "operators and other employees" fell from 46.9% to 40.9%. This improvement of the skill mix has not been accompanied by any substantial narrowing of differentials, thus suggesting that the improvement has been brought about by an increased demand for more highly trained workers throughout industry. There is every reason to suppose that this demand will continue to increase, and it is important to ensure that an adequate supply will be forthcoming.

II Does Britain Have Enough Skilled Workers?

(4) A sizeable minority of British firms now claim in response to the regular CBI Industrial TrendsSurvey that they expect their output to be constrained because they cannot hire sufficient skilled labour. Figure (1) shows how this perceived problem has been getting worse since the

beginning of 1983, although it has not reached the dimensions of 1973 and 1974. The skills problem is particularly acute in engineering and textiles, where it is a more serious constraint than a shortage of plant capacity. Over 1987 as a whole, the proportion of respondents in manufacturing that reported their output being constrained by shortages of skilled labour varied from 0.75% in the food, drink and tobacco sector to 26.25% in textiles and 38.25% in electrical and instrument engineering.

Fig. (1) Proportion of firms reporting that output is likely to be limited by insufficient skilled labour



Source: CBI Industrial Trends Survey

(5) This type of data gives only a partial picture of the extent of the skills problem. It does not give any indication of the stock of skills available in the working population or the extent to which jobs are filled by workers with inadequate skills because keeping vacancies open would be even more costly; nor does it reveal whether firms believe that the shortages they report would be ameliorated by an increase in the relative pay offered to skilled workers. In other words, the problem could be one of inflexible relative wages, not an inadequate supply of skilled workers. In replying to surveys, employers tend to exaggerate skill shortages when they are experiencing or anticipating them. Hence we need to investigate the stock of skills in Britain and the rate at which this stock is augmented by training. One criterion by which adequacy can be judged is the level of skills achieved by our international competitors.

(6) The NEDC/MSC Report, "Competence and Competition", established that there is a substantial gap separating the UK on the one hand and Germany, the US, and Japan on the other. The most clear-cut difference is the larger proportion of the British workforce which acquires no recognised qualification at all (see table (1)). This has been corroborated in studies of particular countries, such as those at the National Institute of Economic and Social Research, where efforts have been made to put the grading of qualifications on a comparable basis.

Some 60% of the German labour force have attained apprenticeships or similar intermediate-level qualifications, compared with only around 30% of Britain's. A comparison of Britain with Switzerland leads to a similar conclusion. The United States, France and Japan have tended to pursue more school and college-based vocational training than have Germany and Switzerland, but Britain suffers in a comparison with these countries, too. For instance, only a quarter of the American workforce have qualifications below intermediate level or none at all, compared to over half of the British workforce. In Japan, over 95% of pupils stay on in full-time schooling until the age of 18 (compared to 32% in England), and at least three times as many workers reach technician level (i.e. above apprenticeship level) as do so in England (after allowing for the different sizes of the workforce). Managers of Japanese-owned manufacturing plants in Britain find inadequate supplies of workers with intermediate training compared to the situation in Japan. France also has a comparative advantage at intermediate level and fewer completely unskilled workers. This comparative advantage is increasing; for instance, in mechanical and in electrical engineering work, France today trains between 2½ and 3 times as many qualified craftsmen and technicians per head of the workforce as does Britain. The fraction of the total workforce employed in engineering and metal-working who hold vocational qualifications is 50% higher in France than in Britain. According to the National Institute, over the decade 1975 to 1985, the numbers acquiring engineering qualifications in France increased by around 60% and in West Germany by 35%, while in the UK there was a fall of 30%.[3]

Table (1)

Workers with a recognised qualification as a proportion of the population

		Nature of minimum qualification
Germany (1980)	66% of labour force	Vocational qualifications
(US (1981)	78% of civilian labour force	High School Diploma
Japan (1982)	60% of population 21+	Lower secondary school diploma
GB (1981)	50% of working population	1 CSE pass

Source: Table 6.6, Competence and Competition (1984)

(Note that what constitutes a 'recognised qualification' differs from one country to another. No attempt is made here to put them on a comparable footing.)

(7) At the opposite end of the occupational hierarchy, the MSC/NEDC/BIM (1987) report, The Making of Managers (the "Handy Report"), established that the training of managers in this country leaves much to be desired, stating that, "there can be little doubt that, by comparison with the other countries in this study, Britain has neglected her managerial stock". It found that in West Germany, 63% of top managers have a degree; in one American survey of top corporate managers, 85% had a first degree and 51% a second degree. In Britain, surveys suggest a comparable figure of 24%. Obviously, this measures only one limited dimension of the training of managers. Other

dimensions considered by the Handy Report were no more favourable to Britain. For example, it concluded that it is quite possible that over half of the country's 3.3 million self-defined managers have never received any formal training or developmental help.

(8) There are some indications that training (broadly defined) has become more widespread over recent years. The Director General's paper presents some summary data from the Labour Force Survey, showing that the proportion of employees receiving some sort of training in the four weeks prior to the survey has increased by some 30% over the period 1984 to 1987. The Surveys also show that training rates are higher for those in employment, for men and, especially, for the young, than for those out of work, for women, and for the older worker respectively. The government's Youth Training Scheme, started in 1983, has helped. A recent survey of establishments participating in YTS concluded that the Scheme has increased both the quantity and the quality of training (although not necessarily in the most needed skills) despite a certain amount of displacement of older workers and financing of training which would have taken place anyway.[4] However, the authors highlighted the need to encourage an expansion of training in more advanced skills, at craft and technician level. YTS by itself cannot be an adequate substitute for such training, although it has the potential to contribute to its early stages. We turn now to a piece of evidence which suggests why this is important.

(9) Evidence about long-term training is available in manufacturing from the employment statistics provided by firms over a longer period of time than the data from the Labour Force Survey. Table (2) presents data from 1964 to 1987. A steep decline is obvious (and confirmed by samples from the New Earnings Survey; as far as full apprenticeships are concerned, the NES suggests the phenomenon is not restricted to manufacturing). The decline has not been reversed despite the stabilisation of manufacturing employment. This helps to explain the skill shortages, particularly in engineering, noted by the CBI. It should be noted that the 1986 and 1987 figures largely exclude the Youth Training Scheme, as few YTS trainees have a contract of employment. A generous adjustment, using MSC and Department of Employment data, would raise the 1986 figure for "all trainees" from 1.9% to around the 1983 figure of 2.7%. The decline in training in the traditional training industries is corroborated by data from the Engineering Industry Training Board. Small and medium-sized establishments in particular have cut back since the late 1970s and now have considerably fewer trainees as a proportion of employment than do large plants with over 1000 employees. Unfortunately, long-term evidence about the trends in the services sector (of growing importance) is sparse.

Table 2: Apprenticeship and other trainees in manufacturing industries as a percentage of all employees, GB

	Apprentices	Other Trainees	All Trainees
1964	3.0	1.8	4.8
1974	2.0	2.2	4.2
1979	2.2	1.6	3.9
1983	1.8	0.9	2.7
1986	1.2	0.7	1.9
1987	1.1	0.7	1.9

Source: Department of Employment

N.B. People on Youth Training Schemes who do not have a contract of employment are excluded.

III Why Does Britain Have a Skills Problem?

(10) Having suggested that Britain is probably at a comparative disadvantage in terms of the skills of its workforce, it is necessary to consider why this problem has arisen. If the relevant markets all worked perfectly, skill shortages could not arise, so their presence must be due to the failure of the markets for skilled labour to work as effectively as we would wish. There are various theoretical possibilities which must be confronted with the evidence.

(11) First, there could be a deficiency (compared to their international counterparts) in the demand for skills on the part of UK employers. Second, there could be an insufficient supply of skilled workers. In this case, the cause of the problem could be that not enough workers want to undertake training, given the incentives, or that not enough firms want to provide training opportunities, given the costs of doing so. These potential costs will be substantially higher if firms think they first have to make up for deficiencies in the education previously received by workers. In other words, two types of market failure could be involved. Firms may find themselves bearing the costs of training without being able to capture the benefits. Also, individuals may regard investment in their own training as a risky undertaking, and hence refuse opportunities. The empirical relevance of these potential explanations is considered below.

(12) If the supply of skilled workers is insufficient, but employers' demands for skilled workers are similar to those of their international competitors, one would expect the relative wages of skilled workers to be driven upwards. According to the best available comparative evidence on the structure of earnings in Europe, pay relativities compared to the unskilled for skilled and semi-skilled manual workers in manufacturing are very similar in the UK, West Germany and France (differentials tend to be smaller in Italy).[5] Given the substantial differences in the quantity of skilled labour, this evidence about the price of skilled labour suggests that British companies have a lower demand for skilled workers than their international counterparts. Faced with a less well-trained workforce, UK firms will then tend to choose less skill-intensive methods of production and less skill-intensive products. Unfortunately, these will often tend to have a lower market potential, and be less likely

to benefit from innovations.

(13) As well as having a lower demand for skilled workers, Britain's supply of skilled craftsmen is also weaker. Economists find it useful to distinguish between specific skills, which are only of use within the firm in which they are acquired, and general skills, which are equally applicable in other firms (in the real world, actual skills lie somewhere between these polar cases). There is a big disincentive to firms to invest in the training of their workforce in general skills, because other firms can hire the workers with transferable skills without paying anything towards the costs incurred in their training; this is the well-known phenomenon of "poaching". Possession of widely recognised vocational qualifications is an indication that many of a worker's skills are fairly easily tranferable. Employers' funding of training leading towards such qualifications is therefore likely on theoretical grounds to be less than the ideal amount because they are aware that many of the workers they train will be poached. Firms nonetheless spend a good deal on general training in practice.

(14) The importance of the disincentive to employers to finance workers' training depends upon the costs of training. Details of the costs of training in the economy as a whole, including the pay received by people while they are acquiring skills, is not readily available in this country, which is one of the reasons why the Manpower Services Commission is undertaking a major study of the funding of vocational education and training. A consultation document for the MSC estimates that public expenditure on vocational education and training (through central government, the MSC and local authorities) amounts to about £7 billion, employer spending to about £5 billion and armed forces expenditure to about £1.3 billion.[6] The total of £13.4 billion excludes direct and indirect contributions made by trainees and their families, and any subsidies received through the tax and benefit system.

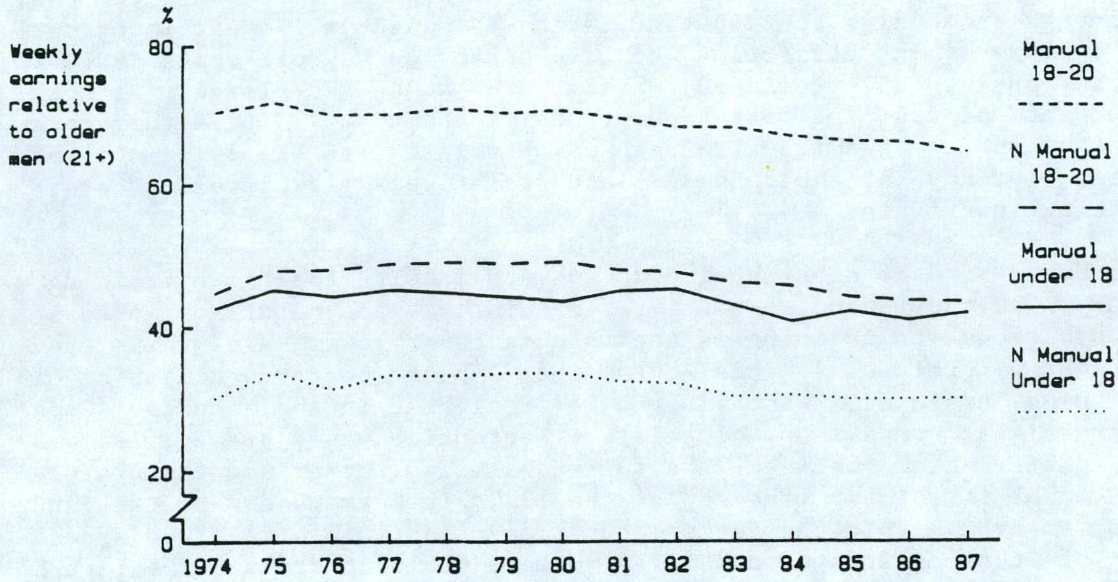
(15) The Labour Costs Survey, mounted every three years, examines vocational training costs (excluding instructors' pay and the wages and salaries of trainees who were not full-time employees) in British industries. In 1984, it estimated vocational training costs to be about 1.3% of total labour costs in manufacturing (varying between 3.1% in shipbuilding and 0.6% in the food, drink and tobacco sector), 2.6% in construction, 0.8% in distribution, and 0.7% in banking, insurance, and finance. Most industries showed a decline in this fraction between 1981 and 1984; manufacturing's fraction, for instance, fell from 1.8% to 1.3%. Some of this decline may be accounted for by increased MSC funding of trainees through YTS, but, if this is the case, it suggests that employers' supply of training is relatively inelastic. The decline may also reflect a shift away from traditional, relatively high-cost, apprenticeships.

(16) Craft-level training appears to be expensive to employers, although one problem that arises in trying to estimate the costs of training is that British employers tend to have poor accounting records for these costs (the same is true in the United States, where the inadequacy of firms' records of training costs has caused the cancellation of at least one official survey of training). Yet in West Germany, over 80% of the firms engaged in training in the early 1980s were able to provide a breakdown of training costs per trainee. This may reflect the relative importance attached to training by employers, and an improvement in British practice is very desirable. A recent study making use of information supplied by training personnel

calculated the net costs of a 3½ year engineering craft apprenticeship (without any YTS subsidy) to be nearly £9000 (at September 1984 prices).[7] This estimate attempted to allow for the value of the trainee's productive contribution, which is potentially very important to employers in offsetting costs. Apprentice payroll costs, 90% of which consist of trainees' wages, are much the largest single component of training costs (about 70% of the total). It is therefore appropriate to examine trainee pay, relative to the fully skilled rates, in any attempt to explain relatively low levels of craft training in Britain.

(17) What kind of contribution do workers make to their own training, from which they stand to benefit financially? The nature of workers' contributions to training is the acceptance of lower wages while they are being trained. This cuts the labour cost to companies of providing training, which is the major element in their costs. Some international comparisons of relative apprentice wages are available. The differential between the fully qualified worker and the trainee was much larger at the end of the 1970s in Germany and Switzerland than in Britain. In the former countries, the trainee received around 20% of the earnings of a skilled worker, while in Britain the figure is about 50% (for men). It is conceivable that the British trainee has higher productivity (for instance, in Germany - but not in Switzerland - all 15 to 18 year old employees have to be released for one day a week to attend vocational schools), but not that much higher. Data from the New Earnings Survey and the Labour Costs Survey indicate that the differential has tended to increase in Britain since the early 1970s. For instance, a male apprentice in 1970 received on average 52.4% of the average weekly gross earnings of all full-time men not engaged in vocational training, but in 1984 received just 46.4%. However, this is still well above the proportion in other countries in which on-the-job vocational training is very important. In general, the relative pay-rates of youth workers have declined somewhat (see figure (2)). Some of the reduction probably results from the shift of employment away from manufacturing, without any change in the differentials within manufacturing or within the services sector. However, to the extent that apprenticeship pay has been reduced by the transfer of preliminary training into YTS, the costs to employers will have been reduced. YTS trainee allowances appear to be less than half as much as apprenticeship rates for the under-18s, and of course the MSC helps to finance YTS programmes.

Fig (2) Earnings relativities for full-time young men



Source: N.E.S

(18) France and the US, where a much larger proportion of vocational education and training is carried out in the educational system, the question of getting incentives to employers right does not arise in the same way. However, it is relevant to note that people receiving vocational education do not receive pay; thus the trainee is expected to make a bigger contribution to costs. In the US there are often fees to be paid as well. Japan's system, mixing more extended formal education and on-the-job training (with the employees expected to acquire general skills in their own time) also puts more of the burden on the trainee.

(19) There is good reason to conclude that one reason why British employers generally do not invest in training as much as their international competitors is that it costs them more per person to provide training; they have to pay more to the workers being trained.

(20) The supply-side problem identified above can be exacerbated if there is an insufficient supply of willing and able would-be trainees. Individual workers may be discouraged from undertaking training in transferable skills because the returns on this "self-investment" are seen as uncertain. Workers' "human capital" cannot be diversified to spread risks in the same way as financial capital can, and technological change can render many specialised skills obsolete. If more of the burden of financing general training is placed on individuals, they may have difficulty in raising the money, given low current earning power and constraints on borrowing when the only "collateral" they have to offer is future earning power. In practice, this is probably not an acute problem at the moment. Returns to training are high, sometimes very high, for individuals, and many good quality training opportunities are rationed. This general conclusion is confirmed by a Department of Employment study of youth labour

markets in Chelmsford, Liverpool, and Walsall.[8] The authors concluded that:

> "The main obstacles were not on the supply side... In general, the young people that were interviewed were only too willing to upgrade their qualifications and skills, given the opportunity. Trainees' most frequent criticisms of the Youth Training Scheme were not objections to the principle of training but to schemes that had led nowhere"

The authors observed that, in many companies, a shortage of skilled labour was a long standing problem, yet the companies explicitly ruled out extra training effort as too risky and expensive, confirming the market failure arguments put forward above. Studies of the determinants of apprenticeship intake in the 1960s and 1970s (when there was more pressure on the youth labour market) indicate that factors affecting employers' demand are more important than factors on the supply side (eg demographics).[9]

(21) However, the supply of young people willing to take up proper training opportunities cannot be assumed to continue to be adequate in the future particularly if employers demand a higher educational standard of trainees. YTS has helped to increase the proportion of young people who actually receive some training (in January 1988, the total in training in Great Britain stood at 413,049). This will not be sufficient to maintain the overall rate of training in the economy at a time when the relative size of the youth cohort is expected to fall considerably, after 1983. Department of Employment labour force projections indicate that, over the next five years, the number of young people in the labour force will fall by around 13% (this is after allowing for a slight projected <u>increase</u> in activity rates). To maintain the level of youth employment over this period would require the virtual abolition of youth unemployment (the unemployment rate for 16-18 year olds in the United Kingdom in January 1988 was 12.9%). The 16-19 year old age group is predicted to decline by 22% between 1988 and 1995, while the number of 20-24 year olds will fall by 10%. In England, the number of young people leaving school during each academic year and available for employment is likely to continue to fall until 1992-93. This opens up the prospect that the demand for training will soon become inadequate, because of the fall in the number of young people, who have a high propensity to undertake training.

IV Some Conclusions

(22) The evidence suggests that Britain does have a skills shortage, and that this arises for two reasons. Firms do not fully appreciate the benefit to be derived from a more skilled labour force or are forced to specialise in less skill-intensive product lines, so the demand for skilled labour is not as great as it should be. The incentives to provide training of an appropriate type and quality are inadequate, so the supply of skilled labour is not as great as is desirable. In the future, because of demographic trends, this problem will be exacerbated by a fall in the proportion of the workforce who wish to undertake training in particular, initial and longer-term training, unless action is taken. The extension of YTS to two years so that young people do not enter the normal labour market until the age of 18 is a move in the right direction. Employers should be reassured about the government's long-term commitment to the Scheme and its upgrading. As some training content is always specific to the firm, employers must expect to bear a share of the costs, even if it is a lower share than was traditional in the old apprenticeship system.

(23) Britain should be concerned about increasing the proportion of its workforce with identifiable skills, particularly at intermediate level. Some of our competitors have done this by providing initial vocational training within the educational system, funded mainly from the public sector (e.g. USA, France). Some have done it by utilising employers (e.g. West Germany, Switzerland), although in all cases the educational foundation laid down initially is important. Under both alternatives, trainees tend to be expected to bear a larger fraction of the costs, through fees and foregone income, than they are in Britain. They are prepared to do so because of the opportunities thereby opened to them and because of positive attitudes towards training in society at large. The corollary of this sort of reduction in employers' costs of training must be to improve employment prospects of trainees and training standards (the work of the National Council for Vocational Qualifications is important in this respect, particularly in encouraging progression of trainees to higher and higher levels). Otherwise there is a danger of simply substituting cheaper youth workers for similar relatively unskilled adult workers, a danger not without historical precedent.

(24) The expected fall in the annual number of school leavers in future implies that any attempt to upgrade the quality of the workforce rapidly will entail more training of its existing members. This will be particularly true if the proportion of each youth cohort which continue in full-time further and higher education increases, itself a necessary development if higher-level skills are to be augmented. Efforts to target support for adult training on the long-term unemployed are likely to help more at the lower end of the skill range than at the intermediate level, because the long-term unemployed are significantly less well educated than the labour force at large. This is another area in which it would be helpful if continuous human resource development became a more important part of collective bargaining, with employers recognising the need to provide incentives to trained workers to stay with them. The supersession of the apprenticeship, with its association with youth, may actually be helpful in this respect.

(25) The problem of actual or potential "poaching" can be reduced by firms if they develop internal labour markets with clear career progression for workers who develop their skills, as is done for

instance in the larger firms in Japan, with their emphasis on on-the-job training. In this way employees and employers can share the benefits accruing from their joint investment in training. However, the spread of widely recognised standard qualifications should not be discouraged in order to achieve this goal, because this would impede labour mobility and attempts to improve the standard of training. Instead, firms should tailor their own training programmes to add value to such qualifications by relating them to the particularities of their own procedures and production systems. This is much easier for large firms, in which the overheads of training programmes can be spread more widely, and the need for newly qualified workers is more predictable. Small firms, which currently undertake considerably less training per head on average, need to be able to buy in training facilities and courses tailored to their needs. In many cases, large firms who are not direct competitors are potential suppliers of such services. An excellent example of such an arrangement in practice is that of Sheerness Steel Company, which has successfully set up the North Kent Technology Skills Centre and marketed its facilities to many other firms in the region who are willing to pay to make use of expertise developed in Sheerness Steel's own training programmes. Courses tend to be short and are tailored to firms' specific requirements.

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NEDC

PRIVATE AND IN CONFIDENCE

National Economic Development Council

NEDC(88)
2nd Meeting

MINUTES of a meeting at the National Economic Development Office
Millbank Tower, Millbank, London SW1P 4QX
on Tuesday 26 April 1988 at 10.00 am.

10/5/88.

BF 17/5

Chairman:

The Rt Hon Norman Fowler MP
Secretary of State for Employment

Mr J M M Banham

Mr R Bickerstaffe

Sir John Cassels CB

Sir Robert Haslam

Mr D A G Monk

Sir David Nickson KBE DL

Mr T J O'Connor

The Rt Hon Nicholas Ridley MP
Secretary of State for the Environment

Sir Thomas Risk

Mr R Todd

Mrs R E Waterhouse CBE

Mr N Willis

The following were also present:

Mr P Lilley MP, Economic Secretary to the Treasury.

Mr John Cope, MP, Minister of State for Employment.

The Hon. Francis Maude MP, Parliamentary Under Secretary of State for Corporate Affairs.

Mr Robert Jackson MP, Parliamentary Under Secretary of State for Education and Science.

Mr S D Hollander CBE, Chairman of the Cotton and Allied Textiles Sector Group

Advisers:

HM Treasury

Mr N J Monck
Mr J MacAuslan
Mr S Flanagan
Mr S Pickford

Trades Union Congress

Mr W Callaghan
Mr D Lea OBE
Mr I Brinkley
Mr M Smith
Mr R Jackson (Item 1)

Department of Employment

Mr G Reid
Mr J Haslam
Mr R Dawe (Item 1)
Mr J Turner (Item 3)

Bank of England

Mr M E Hewitt

Department of Trade and Industry

Mr S Spivey
Mrs M Touchard (Item 2)

Nationalised Industries' Chairmen's Group

Mr P Mitchison

Department of Education & Science

Mr D Libby

Department of the Environment

Mr S Putman

Confederation of British Industry

Mr R H Price
Mr P S Ditton
Miss A McIntyre
Mr A J Webb (Item 1)
Mr A P Scott (Item 3)

National Economic Development Office

Mr W Eltis
Mr D Fraser
Mr C Leach
Ms L McKinney
Dr A Bowen (Item 1)
Mr J Stevens (Item 1)
Mr M Cannell (Item 2)
Mr I Brown (Item 2)
Dr D Mayes (Item 3)
Mr H Murphy (Item 3)

Secretariat: Mr M Couchman
Mr S Earl

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INTRODUCTION

THE SECRETARY OF STATE FOR EMPLOYMENT welcomed Mr Stuart Hollander, Chairman of the Cotton and Allied Textiles Sector Group. He noted that it was Sir David Nickson's last meeting; his contribution to the Council's work had been of the highest order.

Apologies had been received from: the Chancellor of the Exchequer, who was represented by the Economic Secretary to the Treasury; the Secretary of State for Trade and Industry, who was represented by the Parliamentary Under Secretary of State for Corporate Affairs; from the Secretary of State for Education and Science, who was represented by the Parliamentary Under Secretary of State; from the Secretary of State for Energy; from the Governor of the Bank of England; and from Sir Bryan Nicholson, Mr John Edmonds, Mr Clive Jenkins, Mr Bill Jordan and Dr J S McFarlane.

1 SKILLS

THE SECRETARY OF STATE FOR EMPLOYMENT, introducing NEDC(88)9, said that UK economy had responded well to the challenge of increasingly global markets with high growth and falling unemployment. Demographic, technological and occupational changes made it vital to give more attention to skills. There would, by 1995, be 1 million fewer 16-19 year olds while the rest of the labour force would remain stable. To fill this gap, the skills of the unemployed must be improved and scarce skills put to the best possible use. Technological changes must be fully exploited; trainers had to use the latest technology. The occupational mix would be affected; there was further scope for increasing manufacturing productivity and for more flexible working patterns and a growing demand for a wider range of management skills. However, there was evidence that employers were still reluctant to hire qualified but inexperienced people.

He continued that the work of the MSC, the Technical and Vocational Educational Initiative and Work Related Non Advanced Further Education would help to provide an initial skill base for 16-18 year olds. There was also much scope for developing local Compacts. The Government was backing the National Council for Vocational Qualifications and, once Employment Training was under way, would be spending £3 billion a year on skills. Employers must take full advantage of YTS by improving quality; they must develop new strategies for existing employees and more opportunities for the unemployed and for women returning to work. Employers and unions must recognise their responsibilities on pay and working practices and develop individuals' understanding that acquiring skills was vital.

SIR DAVID NICKSON, introducing NEDC(88)11, said that, although the UK's overall performance had improved, training was still an area of weakness, though it was important not to talk of crisis. The CBI's latest quarterly trends survey of chief executives showed a more encouraging view of skill shortages as a constraint than the MSC/CBI survey of personnel directors. Creating awareness on skills was as important as preparing for the Single European Market; it was a top priority for unions, employees, employers and Government, but the buck stopped with employers. The training industry was growing fast; technology, such as Open Learning, could be particularly useful for developing middle range skills. Competence based training was particularly important. Demographic changes gave an opportunity to develop the untapped asset of the unemployed, but companies would have to carry out more training and not poach too much. The demographic changes also made links with education important; the CBI's Cadbury Task Force was concentrating on this. The CBI attached great importance to YTS, as to the Prince's Youth Business Trust which provided a link to finance for some YTS trainees who did not get employment. The CBI's Local Employers' Networks were promising; few had yet got off the ground, but they did draw attention to the regional nature of skill shortages and the impact on pay; employers must train in advance, get information on local needs and develop local links with education. Mobility was becoming increasingly difficult because of growing house price disparities.

Responding to Sir David Nickson, the SECRETARY OF STATE FOR EMPLOYMENT said that he shared his view about the potential of Local Employers' Networks: there would be an early decision on continued funding.

MR TODD, introducing NEDC(88)10, said there were numerous weaknesses in training. Insufficient young people were provided with opportunities after leaving school. Demographic changes provided an opportunity, but the potential of YTS was still not being coherently developed. There were gaps in the training initiative for adults and skill shortages remained. The upgrading of training had to take place alongside the necessary application of new technologies. The UK lagged behind its competitors; two-thirds of the workforce had no recognised qualifications, compared with one-third in West Germany. Investment in vocational education and training was as vital as investment in new technology. The TUC were strong supporters of the MSC, which had a proven track record, and of the NCVQ, which had an innovative mandate. However, there also needed to be developments at local level and in the workplace. For too many women and black workers there was insufficient access to training opportunities; more effective action was also needed in the inner cities. There was need for a common commitment, including more support from Government.

THE PARLIAMENTARY UNDER SECRETARY OF STATE FOR EDUCATION AND SCIENCE said that the National Curriculum would make a major contribution to improving the level of skills relevant for the economy. The core subjects would provide major opportunities for drawing on the experience of TVEI. The PICKUP scheme had grown by 40 per cent in the past year and had by now involved some 750,000 people, 1 in 30 of the working population. There was still a skills gap for 16-18 year olds in comparison with West Germany, the USA and Japan, though the percentage receiving education and training in the UK had increased by one third since 1979. Between 1979 and 1990, the numbers in higher education would increase by 50,000, but given the demographic changes the need for more highly trained manpower and the need to recruit workers at lower skill levels could conflict.

THE DIRECTOR GENERAL, introducing NEDC(88)12, focussed on three problems: first, young people: the development of YTS was encouraging, but, because of the scarcity of young people, it would come under threat from employers who were unwilling to train. The temptation of high paid jobs with little training would become acute. Secondly, adults: 7 out of every 10 people in the workforce today would still be in it in AD 2000; new initiatives for the young would not affect their skills. Satisfactory approaches to their training had to be developed. The UK was a world leader in distance learning, but was not yet applying it on a wide enough scale. Thirdly, middle range skills, for example, foremen and technicians: apprenticeship, once a major source of technicians, had withered and we had to recreate good routes into these jobs. The West Germans, the French and the Japanese were good at this; UK training bodies needed to give the matter a great deal of thought and attention.

MRS WATERHOUSE said women would represent 83 per cent of labour force entrants to 1995; they needed not only retraining but also booster courses while off work and such facilities as creches. The papers emphasised the importance of skills for industry, but they were also important for individuals. If high wages were available for unskilled work, there was no motivation to obtain skills. In the USA people often paid for their own training, because they saw the benefits; what benefits were there in the UK? Distance learning could be used more, particularly in improving languages. The CBI paper referred to a shortage of information, but there was also insufficient evaluation of schemes. Retraining people in work could provide opportunities for the unemployed to re-enter the market. Responding, the SECRETARY OF STATE FOR EMPLOYMENT said that the value for individuals was the same in the UK as in the USA, but it was better perceived in the USA. However, over the past few years, industry had become more aware of the value of training.

MR BANHAM agreed; industry's annual spend on training could now be as high as £7 billion. NEDC(88)12 drew attention to the considerable changes in skill requirements without some of which firms (especially smaller businesses) would not survive. There was a need for more graduates in science and technology. Employers were concerned about the proportion of school leavers who lacked the most basic skills. More effort was needed to help women to remain in and to return to the workforce, particularly in nursing and teaching. Spending on training might need to be doubled; this would take a considerable proportion of industry's profits. The SECRETARY OF STATE FOR EMPLOYMENT responded that the Employment Training Programme would need to provide training not just in higher skills, but also to repair the omissions of the education system. Considerable sums were being spent by industry on training, but poaching suggested that the spread was uneven.

In further exchanges, MR TODD said that equal opportunities issues were paramount. A fragmented national curriculum might damage TVEI; the curriculum proposals should be changed to conform to TVEI. Finally, why could not all employers train young people up to YTS standards? The SECRETARY OF STATE FOR EMPLOYMENT said it was wrong to assume that young people entering jobs rather than YTS would not receive proper training; employers' recognition of its importance was relevant. MR BANHAM agreed; training had suffered along with other investment in the early 1980s - it now had to have higher priority. SIR ROBERT HASLAM agreed that middle range skills were a major problem; with the rapid change from labour to capital intensity, as in British Coal, it was essential that foremen were efficient and multi-skilled; many existing employees might not have the ability for this. MR WILLIS supported comments about paying special attention to women and to black workers. Overseas investors saw our good reputation in higher education as relevant to investment decisions; further education was a part of the skills base which must not be lost. Poaching suggested that market forces did not seem to be working well. Because all parties to the Council were concerned about the problems, there were opportunities for mutual action. The DIRECTOR GENERAL said it was incorrect that good training for young people was squeezed out in 1980; the UK had a bad tradition of insufficient training for young people and the one area which had been good - apprenticeship - had declined by 60 per cent. In West Germany non-training jobs for young people had disappeared as a result of a consensus developed over many years. There must be the greatest risk that school-leavers would increasingly be attracted into jobs with comparatively attractive pay, whether or not worthwhile training was provided with them, at the expense of YTS with its comparatively low allowances. MR O'CONNOR added that even in the North many unemployed young people were not suitable for apprenticeships and young people often left school without basic skills.

Responding to the discussion, the PARLIAMENTARY UNDER SECRETARY OF STATE FOR EDUCATION AND SCIENCE noted members' recognition of problems which the Education Reform Bill was designed to solve. He noted also Mr Todd's point on fragmentation of the curriculum. Universities tended not to see higher education as part of the skills base; a cultural change was needed. The Engineering Technology Programme had aimed to provide 30,000 more places, but progress had been depressing, with a lack of applicants and a high dropout rate, possibly due to a perception that engineering was not remunerative. MR BANHAM agreed about remuneration, but added that the percentage of science graduates going into industry was very low. Training was an investment which should be separately identified in company reports. Young people would soon be in a sellers' market in which employers would have to compete.

Concluding, the SECRETARY OF STATE FOR EMPLOYMENT said there was a much greater realisation of the importance of training than before. Growth in the economy and greater confidence in industry should encourage investment in training. There was wide agreement in the Council that the influence of demographic changes would be profound; they must be made more widely known. Employers and employees must realise the importance of acquiring modern skills to sustain both business and career success.

The COUNCIL:

(i) took note of the Secretary of State for Employment's summing up and papers NEDC(88)9, 10, 11, and 12.

2 SECTORAL REPORT: COTTON AND ALLIED TEXTILES SECTOR GROUP

The Chairman of the Cotton and Allied Textiles Sector Group, MR S D HOLLANDER CBE, illustrated NEDC(88)13 with slides. He drew attention to the Sector Group's work on the sector's approach to its customers. An industry which mainly supplied intermediate products needed to focus on serving the end customer, just as much as industries in more direct contact, if it were to be competitive into the 1990s. The Sector Group had three linked themes: creating growth by helping the industry respond to final as well as intermediate customers; dealing with weaknesses in the textile supply pipeline; and attracting into the industry and developing the relevant talents. The Sector Group had encouraged weavers and finishers to find overseas converters whom they might service, and was arranging trade missions and exhibitions; in partnership with the Clothing Sector Group and retailers it was encouraging close liaison throughout the supply chain; and it had developed training courses in conjunction with the Manchester Business School and other colleges.

MR BANHAM congratulated the Sector Group on its work and drew attention to the necessity of attracting the right people into the industry so that it could go forward aggressively. The figures in Annex 1 of NEDC(88)13 showed an unsatisfactory position: sales had remained static in a growing market and import penetration was increasing. Were profitability levels really adequate to meet investment on the scale required to compete with Italy, France and West Germany? To what extent had the industry's competitive position been weakened by rises in energy costs and the recent strength of sterling?

MR WILLIS also commended the report. He was encouraged by the way a traditional industry, once considered to be in irreparable decline, had responded to the challenge of the market place. However, one should not be complacent; the figures showed that the competition remained formidable. The industry must continue to grasp opportunities and at the same time develop the trust of its workforce by involving people at all levels in the decision making process. Training was important, as was the need to change the image of the industry. He agreed with Mr Banham about the difficulties caused by exchange rate risks; TUC estimates using the Treasury model suggested that as many as 100,000 jobs could be at risk if sterling continued to appreciate.

The PARLIAMENTARY UNDER SECRETARY OF STATE FOR CORPORATE AFFAIRS said the report was a penetrating assessment of a sector which could no longer be considered a sunset industry, although problems remained. There was no grand strategy to address these problems and it remained for individual companies to find solutions and to respond quickly to the demands of customers.

THE PARLIAMENTARY UNDER SECRETARY OF STATE FOR EDUCATION AND SCIENCE recognised that improved design skills were desirable; his Department was making efforts in conjunction with the DTI to focus on this. Students were being encouraged to shift from fine arts to design. He wondered whether the need for design skills to be imported was a serious problem and, if so, whether greater emphasis should be placed on strengthening design capability.

MRS WATERHOUSE also expressed concern about the underlying statistics. Press articles had suggested that competitor countries were installing new capacity at a much faster rate than the UK. In addition, our competitors continued to demonstrate their superior design skills even in UK locations. The Sector Group had an important job to do in improving the image of the industry.

SIR ROBERT HASLAM expressed admiration for the extent of the turnaround achieved by the industry. It had been restructured to such an extent as to be unrecognisable when compared to his past experience of it when at ICI Fibres.

MR BICKERSTAFFE commented on the emphasis now being placed on the importance of design; he was pleased that high unit costs were no longer held to be the main factor reducing UK competitiveness.

Responding to the discussion, MR HOLLANDER said that industry-wide statistics were not particularly indicative of the success achieved by the better companies; only the strong had survived the recession. This applied to small companies as well as large; he now heard fewer complaints about design being a weakness. The UK industry was still not as good as those of Italy and West Germany but it was catching up due to increased investment, greater specialisation and a better understanding of the market. Investment in the printing sector, on a per capita basis, was well ahead of Italy and West Germany. However, it was under threat from spiralling energy costs and exchange rates. Growth, especially in exports and investment, had coincided with a period of stable exchange rates; this was now at risk. Energy costs in firms which were capital intensive could be as important as labour costs. The strategy for fighting imports was to improve quick response to customers' demands which overseas competitors were too far away to match.

THE ECONOMIC SECRETARY TO THE TREASURY noted comments about exchange rates. These reinforced the Government's policy which was to maintain the maximum possible stability within the context of a sound anti-inflationary policy. One could not maintain stability against all exchange rates simultaneously, hence the importance given to international cooperation, as for example in the Louvre Accord. An unsustainable rise in sterling would be damaging and undesirable; equally exchange rate stability was a discipline and not an easy option. Sterling could not produce competitiveness; only industry could. Mr Hollander's comments on energy costs were surprising; across industry as a whole, electricity represented only 2 per cent of costs and the 8.8 per cent increase in prices in April was not out of line with wage rises. MR HOLLANDER responded that his remarks related to total energy costs and to highly capital intensive plants.

Concluding, the SECRETARY OF STATE FOR EMPLOYMENT thanked Mr Hollander for his paper and presentation. It was clearly important that the industry achieve the ability to react positively and quickly to increasingly volatile consumer demands.

The COUNCIL:

(ii) noted NEDC(88)13.

3 SMALL FIRMS

THE MINISTER OF STATE FOR EMPLOYMENT, introducing NEDC(88)14, said that the number of small firms had increased considerably in recent years. Overall, they made an important contribution to the economy, especially by stimulating employment and self-employment. They had flexibility, the ability to innovate even in traditional industries and a readiness to take risks. They provided choice to the customer and to the potential employee, and they were an important link in the supply chain of some industries. The Government's role was mainly to create a climate which would stimulate initiative and enterprise. Assistance was not aimed at giving small firms a special advantage, but at dealing with specific problems where the market did not operate efficiently. Small firms wanted less interference from Government. It remained Government policy to help new firms, but all papers had rightly emphasised the need to remove constraints on the growth of established firms. The solution to making small firms more aware of the of advice available to them lay in networking. Small firms had to be persuaded of the value of training; open learning had a role in this.

THE DIRECTOR GENERAL, introducing NEDC(88)17, said barriers to the growth of established firms had to be removed. Much could be done by arrangements such as partnership sourcing. The NEDO initiative on Corporate Venturing was one way of improving finance for growth. Small firms had two specific training problems: the need for proprietors to be multi-skilled; and the difficulty of training employees. The latter issue was even more serious where self-employed people doing skilled work was concerned, as in construction.

MR O'CONNOR, introducing NEDC(88)15, said that special treatment for small firms was not a substitute for an economic climate in which all firms could operate successfully. The CBI welcomed the DTI's Enterprise Initiative; any increased public support for small firms should be directed towards growing businesses, which had tended to be neglected in recent years with the emphasis on start-ups. However, the Enterprise Initiative might duplicate the efforts of the Department of Employment and it might be logical later for all schemes to come under one Department. Small firms must raise their level of expertise; it was difficult for an owner/manager to value training when the limited resources available were needed for capital equipment. There should be more imagination in promoting existing support schemes, for example by making training a condition of support. Public support was welcomed, but the private sector could also do much; the CBI would be highlighting its work on partnership sourcing. Local support organisations were very effective in channelling private sector support.

MR BICKERSTAFFE, introducing NEDC(88)16, said that small firms, though important, were not the answer to the UK's economic and industrial problems. They had weaknesses in training, financial management and the adoption of new technology from larger firms. The UK's skill base needed expanding, but the growth of small firms made this harder to achieve. Balance was needed also on deregulation; he was pleased to see that the papers from the Department of Employment and the CBI did not treat it as a major issue. Proper regulation could be a spur both to efficiency and to the discharging of real social obligations. Many regulations needed updating and small firms needed more help over compliance, but, overall, he doubted whether regulations were as important as the other burdens affecting small firms. There was a need to concentrate less on the very small firms and more on those larger businesses which had potential for growth. The policy debate had been hampered by a lack of statistics. The inner city and regional aspects were very important; the collaboration of local authorities, trade unions and employers should be acknowledged by Government. The needs of ethnic minorities and of cooperatives should not be overlooked. More needed to be done to provide long term development capital; local authority Enterprise Boards had shown what could be done. Both the CBI Local Investment Company Proposal and NEDO's Corporate Venturing Initiative should be welcomed.

THE PARLIAMENTARY UNDER SECRETARY OF STATE FOR CORPORATE AFFAIRS said that very small firms did not create prosperity when formed but helped to guarantee continuing economic growth in 5 or 10 years' time. It was therefore essential to have conditions conducive to start-ups. Regulation was not always critical as a "make or break" but its cumulation increased marginal costs. Regulations should therefore be kept to the minimum necessary and there was scope for simplifying them; the deregulation initiative would therefore continue. The Enterprise Initiative was directed towards helping the growing firms, giving them access to new skills.

SIR THOMAS RISK said that, compared with 15 years previously, there was no longer a feeling that the finance sector was failing entrepreneurs. In the 1970s, Finance For Industry (now 3i) was the only source of equity and loan packages, but now, because of the response of the banking sector, there was no shortage of such finance. Government initiatives had been helpful: with its premium back at 2½ per cent, the Loan Guarantee Scheme was going well; in his own bank, it was only used as a top-up. The Business Enterprise Scheme was helpful, and had not been used substantially for purposes of speculation. In Scotland, the mobilisation of sources of finance by the Scottish Development Agency and the Highlands and Islands Development Board had been successful and corporate venturing was going well. Any remaining criticism of lenders was probably due more to a lack of understanding of sources of finance than to a failure of the sources.

MRS WATERHOUSE said that, while small firms could provide personal service to the benefit of consumers, there were greater difficulties in obtaining recourse if things went wrong. What percentage of new firms were likely to survive five years? She agreed with Mr Bickerstaffe about deregulation; safety and planning controls should not be dispensed with for the sake of small businesses. Start-ups needed support; it was not easy being in business on one's own.

THE PARLIAMENTARY UNDER SECRETARY OF STATE FOR EDUCATION AND SCIENCE said that further and higher education institutions should not just be seen as a training resource, but as a source of business ideas. The Education Reform Bill provided real opportunities; there would be 2,000 places, representing a majority, on the Governing Bodies of polytechnics and other higher education institutions for people from business and the unions.

SIR DAVID NICKSON, responding to Mrs Waterhouse, said that one third of small firms would survive for 10 years. Smaller firms often acted as sub-contractors on export projects, hence they had an impact on the UK's international competitiveness. Whether in small firms or in large, it was not the rate of pay increase that was relevant, but unit labour costs. Other costs that affected small firms, such as rates and electricity prices, were very important, but overall the restraint of inflation was critical.

THE PARLIAMENTARY UNDER SECRETARY OF STATE FOR CORPORATE AFFAIRS said that a degree of failure among small firms was essential to show that the right risks were being taken; it was important not to be over cautious. On deregulation, no area should be sacrosanct, since improvements could always be made, especially on health and safety.

SIR ROBERT HASLAM said that one fifth of British Coal's suppliers sold them under £500,000 of goods or services a year. A booklet had been produced to help them with marketing. British Coal Enterprises had set up workshops which, by the end of 1988, would provide some 1,700 units and 5,000 jobs. Experience suggested that, within three years, one third of the businesses in the workshops would fail, while the rest would outgrow the facility.

Responding to the discussion, the MINISTER OF STATE FOR EMPLOYMENT said that it was inevitable that a number of Departments would be involved with small firms. The most important thing was to direct people to the right source of advice. It was a condition of the Enterprise Allowance Scheme that training was undergone; however, more could be done to encourage training. His Department was attempting to update the Bolton statistics; the work would be completed soon. He agreed with comments about the inner cities and the need for business opportunities for ethnic minorities. Core funding for the Cooperative Development Agency had been increased and between 1979 and 1986 the number of worker cooperatives had increased from 300 to 1,400. The banks had taken excellent initiatives on finance and he was pleased by the development of the venture capital market. Loan finance provision had improved. On the balance of support, he would not want all firms to be small; there needed to be a little more emphasis on growing businesses, but the Government would not wish to stop helping start-ups in any way. The Government should purchase more from small firms, not to provide artificial help, but because large organisations tended not to understand what small firms could provide. In further exchanges, MR BANHAM said it was important to avoid inconsistencies; total spending on venture capital was £400 million a year, but the increase in business rates from April 1988 was about twice that amount. THE MINISTER OF STATE FOR EMPLOYMENT responded that, in the first nine months of 1987, £622 million had been raised in the venture capital market.

The COUNCIL:

(iii) took note of the points made in discussion and of papers NEDC(88)14, 15, 16 and 17.

4 NEDO PLAN AND BUDGET FOR 1988/89

The Council noted NEDC(88)18.

5 RELEASE OF PAPERS

The Council agreed that the following papers might be released:

NEDC(88)9, 10, 11, 12, 13, 14, 15, 16, 17 and 18.

6 ANY OTHER BUSINESS

MR WILLIS said the TUC wished to register concern about Council meeting dates. It had once been possible to get dates for meetings fixed well ahead, but they had become increasingly ad hoc. With the change to four meetings a year and a rotating chairmanship, there were questions as to whether a particular Secretary of State was available to chair particular meetings. The new meeting date for October was particularly difficult. This was not just a problem for the TUC; ministerial attendance was increasingly below Secretary of State level. SIR DAVID NICKSON supported the comments made by Mr Willis. THE SECRETARY OF STATE FOR EMPLOYMENT said he had total sympathy; the Steering Group for Council Programmes should consider the matter further.

The COUNCIL:

(iv) invited the Steering Group on Council programmes to consider the setting of dates for Council meetings, especially that of the Autumn 1988 meeting.

National Economic Development Office
Millbank Tower, Millbank, London SW1P 4QX

10 May 1988

PRIVATE AND IN CONFIDENCE

PRIVATE AND IN CONFIDENCE

Flan/051

arr pps pl.

FROM: S J FLANAGAN
DATE: 11 May 1988

1. MR MACAUSLAN ✓ JM 11/5
2. CHANCELLOR - 2

cc Sir P Middleton
Mr Monck
Mr Burgner
Mr Tarkowski
Mr Wynn Owen o.r

NEDC MEMBERSHIP: SIR DAVID NICKSON, SIR TREVOR HOLDSWORTH, SIR BYRAN NICHOLSON

Sir David Nickson and Sir Trevor Holdsworth

Sir Trevor Holdsworth takes over from Sir David Nickson as President of the CBI on 12 May. Sir David wrote to you on 24 March asking that you invite Sir Trevor to become a member of NEDC at an appropriate time after the 26 April Council meeting. Now would seem to be the right moment.

2. **Annex A** is a draft letter to Sir David Nickson thanking him for his work on NEDC. Mr Fowler said on 26 April that Sir David's contribution "had been of the highest order". **Annex B** is a draft letter of invitation to Sir Trevor Holdsworth.

Sir Bryan Nicholson

3. Your letter of 18 March to Lord Young suggested that Sir Bryan Nicholson should be appointed to the Nationalised Industry seat made vacant by Lord Marshall. Sir Byran currently sits on the Council in a personal capacity. Mr Baker, Mr Ridley, Lord Young and Mr Fowler have all agreed, and I understand that Mr Parkinson's office will indicate his agreement to yours by telephone. The NICG have also indicated that they would support this line.

done/ MPW

4. **Annex C** is therefore a letter to Sir Bryan Nicholson inviting him to take over the vacant Nationalised Industry seat.

Steven Fla

S J FLANAGAN

CHANCELLOR OF THE EXCHEQUER

NL

Ch/

I think Andrew's separate draft for Sir D Nichson can adequately cover his NEDC interest. I've slightly amended the Holdsworth one to turn it into a follow-up to today's drink.

OK to send Holdsworth & Nicholson letters?

OK as amended

MPW 17/5

Flan/051

DRAFT LETTER FROM THE CHANCELLOR TO: **ANNEX A**

Sir David Nickson, CBE, DL
Scottish and Newcastle Breweries Plc
Abbey Brewery
Holyrood Road
EDINBURGH
EH8 8YS

Since I did not see you at your last meeting of the NEDC, I am writing to thank you for the exemplary contribution you have made to the work of the Council. I would aslo like to take this opportunity to congratulate you on your most successful term as CBI President, and to extend my best wishes for the future.

[N L]

Flan/051

DRAFT LETTER FROM THE CHANCELLOR TO: **ANNEX B**

Now that you have assumed the Presidency of the CBI,

Sir Trevor Holdsworth
President
Confederation of British Industry
Centre Point
103 New Oxford Street
LONDON WC1A 1DU

NEDC MEMBERSHIP

I was glad you were able to come round for a ~~drink~~ chat on Tuesday. One formality which [I should record / I didn't mention] is that,

~~[I would firstly like to offer you my congratulations on your appointment as President of the CBI.] On David Nickson's advice,~~ I ~~am writing~~ would like to invite you formally to serve as a member of the National Economic Development Council, in place of David Nickson.

2. As I am sure you know, the broad purpose of the Council is to provide a forum for discussing economic and industrial matters with particular emphasis on ways of improving the performance of individual industrial sectors. I very much hope that you will agree to become a member. The appointment would be for a two year period.

3. The Council meets at Millbank Tower once a quarter, and I would be very pleased if you could attend the next meeting on Wednesday 6 July at 10.00 am.

[N L]

pl type this & letter behind final M.

Flan/051

DRAFT LETTER FROM THE CHANCELLOR TO: **ANNEX C**

Sir Bryan Nicholson
Chairman
Post Office Headquarters
33 Grosvenor Place
LONDON
SW1X 1PX

NEDC MEMBERSHIP

You will recall that, in my letter of 1 October 1987, I asked you to stay on the NEDC for the time being, in a personal capacity. I would now like to put your membership on a more regular basis. You may be aware that one of the Nationalised Industry seats on the Council has fallen vacant. I should like to invite you to fill it, in your new role as Chairman of the Post Office.

2. If you agree, ~~we would take~~ your new two year term (would be taken) as beginning from the next NEDC meeting on 6 July.

[N L]

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Facsimile 01-240 1578

From
Sir David Nickson KBE DL
President

CBI

24th March 1988

The Rt. Hon. Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

Mr P Wynn Owen
CST, PMG, Sir P Middleton
Mr Anson
Mr Monck
Mr Burgner
Mr MacAuslan

Dear Nigel,

As you know I hand over the Presidency of the CBI to Sir Trevor Holdsworth on May 12th and therefore April 26th will be my last NEDC meeting.

I am sending a copy of this letter to Peter Middleton and hope that it would be possible for you to make a formal appointment for Sir Trevor Holdsworth to become a member of NEDC in my place at the appropriate time after April 26th.

Yours ever

David

HK-T-32

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF
Telephone Direct Line 01-213 5803
Switchboard 01-213 3000

Ms Moira Wallace
Private Secretary to the
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

11/4

CHEQUER
11 APR 1988
Mr Wynn Owen
CST PMG
Sir P Middleton
Mr Anson, Mr Monck
Mr Bugner
Mr MacAuslan

G 8 April 1988

Dear Moira

NEDC MEMBERSHIP

My Secretary of State has seen the Chancellor's letter of 18 March about the appointment of Sir Bryan Nicholson to NEDC. He is content with this proposal.

I am sending copies of this letter to the private secretaries to Nicholas Ridley, Kenneth Baker and Cecil Parkinson.

Sincerely,

Beverley

BEVERLEY EVANS
Private Secretary

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5422
Our ref DC2AJE
Your ref
Date 30 March 1988

30/3

CHEQUER
30 MAR 1988
Mr Wynn Owen
CST, PMG
Sir P Middleton
Mr Anson, Mr Monck
Mr Burgner
Mr MacAuslan.

Dear Nigel,

NEDC MEMBERSHIP

Thank you for your letter of 18 March. I am content with your proposal to invite Sir Bryan Nicholson to fill the seat left vacant by Walter Marshall.

I am copying this letter to Norman Fowler, Nicholas Ridley, Kenneth Baker and Cecil Parkinson.

Yours,
David

the Enterprise initiative

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

Circulate

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

CH/EXCHEQUER
31 MAR 1988
for info Mr Wynn Owen
CST, PMG
Sir P. Middleton, Mr Anson
Mr Monck, Mr Burgner,
Mr MacAuslan

30 March 1988

G

Dear Nigel

NEDO MEMBERSHIP

Thank you for copying me your letter to David Young of 18 March.

I am content with your proposal.

Yours ever
Nicholas

NICHOLAS RIDLEY

100% RECYCLED PAPER

28/3 A11

CH/EXCHEQUER

REC.	28 MAR 1988
ACTION	Mr P Wynn-Owen G
COPIES TO	CST, PMG.
	Sir P Middleton
	Mr Anson. Mr Monck
	Mr Burgner,

Mr MacAuslan

SECRETARY OF STATE FOR EDUCATION AND SCIENCE

ELIZABETH HOUSE
YORK ROAD
LONDON SE1 7PH
01-934 9000

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

28 March 1988

Dear Nigel

NEDC MEMBERSHIP

Thank you for copying to me your letter of 18 March to Lord Young about Sir Bryan Nicholson's NEDC membership.

I am writing to say that I am content with the action that you propose. Copies of this letter go to recipients of yours.

Yours

Kenneth

Nationalised Industries' Chairmen's Group

Chairman
Sir Robert Reid, CBE,

Hobart House
Grosvenor Place
London SW1X 7AE

01-235 2020

29th March, 1988

Sir Peter Middleton, K.C.B.,
Permanent Secretary,
H.M. Treasury,
Parliament Street,
London, SW1P 3AG.

Mr Flanagan
PS/Chancellor
PS/CST
PS/FST
PS/PMG
PS/EST
Mr Monck
Mr Moore
Mr Burgner
Mrs M. Brown
Mr M.L. Williams
Mr MacAuslan
Mr Holgate
Mr Tarkowski
Mr Wynn Owen
Mr A E White
Mr Cropper
Mr Call
Mr Tyrie

Dear Peter

N.E.D.C. MEMBERSHIP

Many thanks for your letter. N.I.C.G. will be very happy to support your recommendation to the Chancellor that Sir Bryan Nicholson takes the Nationalised Industries' seat vacated by Lord Marshall.

Yours ever

BR

BOB REID

73-29-3

F1/052

Rm

FROM: S J FLANAGAN
DATE: 13 May 1988

1. MR MacAUSLAN ✓ Ma 13/5
2. SIR P MIDDLETON

cc APS/Chancellor – 17/2
Mr Monck
Mr Burgner
Mr Wynn Owen o/r

NEDC MEMBERSHIP: ALEC MONK

Mr Alec Monk comes to the end of his first two-year term as a member of the NEDC at the end of this month. He is a member of the CBI team on the Council, and I therefore attach a draft letter for you to send to John Banham asking him what he wants to do with the seat.

Steven Flan

S J FLANAGAN

F1/052

DRAFT LETTER FROM SIR PETER MIDDLETON TO:

J M M Banham Esq
Director-General
Confederation of British Industry
Centre Point
103 New Oxford Street
LONDON WC1A 1DU

NEDC MEMBERSHIP

As you are aware, Alec Monk's first two-year term of membership of the NEDC expires at the end of this month. As is usual, I am formally writing to ask you to let me know the wishes of the CBI with regard to this seat. I will then submit your recommendation to the Chancellor.

[P E M]

H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-270 3000
Direct Dialling 01-270 4360

cc APS/Chancellor
Mr Monck
Mr Burgner
Mr MacAuslan
Mr Wynn Owen
Mr Flanagan

Sir Peter Middleton KCB
Permanent Secretary

J M M Banham Esq
Director General
Confederation of British Industry
Centre Point
103 New Oxford Street
LONDON
WC1A 1DU

16 May 1988

Dear John,

NEDC MEMBERSHIP

As you are aware, Alec Monk's first two-year term of membership of the NEDC expires at the end of this month. As is customary, I am writing formally to ask you to let me know the wishes of the CBI with regard to this seat. I will then submit your recommendation to the Chancellor.

Yours ever,

Peter

P E MIDDLETON

NH6/37M

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

Sir Trevor Holdsworth
President
Confederation of British Industry
Centre Point
103 New Oxford Street
LONDON WC1A 1DU

18 May 1988

Dear Trevor

NEDC MEMBERSHIP

Now that you have assumed the Presidency of the CBI, I am writing to invite you formally to serve as a member of the National Economic Development Council, in place of David Nickson.

As I am sure you know, the broad purpose of the Council is to provide a forum for discussing economic and industrial matters with particular emphasis on ways of improving the performance of individual industrial sectors. I very much hope that you will agree to become a member. The appointment would be for a two year period.

The Council meets at Millbank Tower once a quarter, and I would be very pleased if you could attend the next meeting on Wednesday 6 July at 10.00 am.

I greatly enjoyed our chat the other day.

Yours ever

Nigel

NIGEL LAWSON

NH6/38M

cc - Sir P Middleton
Mr Monck, Mr Burgner
Mr MacAuslan, Mr Wynn-Owen
Mr Tarkowski, Mr Flanagan

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

Sir Bryan Nicholson
Chairman
Post Office Headquarters
33 Grosvenor Place
LONDON SW1X 1PX

18 May 1988

Dear Bryan

You will recall that, in my letter of 1 October 1987, I asked you to stay on the NEDC for the time being, in a personal capacity. I would now like to put your membership on a more regular basis. You may be aware that one of the Nationalised Industry seats on the Council has fallen vacant. I should like to invite you to fill it, in your new role as Chairman of the Post Office.

If you agree, your new two year term would be taken as beginning from the next NEDC meeting on 6 July.

Yours
Nigel

NIGEL LAWSON

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Facsimile 01-240 1578

From
Sir Trevor Holdsworth
President

CBI

MP

23rd May 1988

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1P 3AG

Dear Nigel

NEDC MEMBERSHIP

Thank you for your letter of 18th May 1988 and invitation to serve as a member of NEDC in place of David Nickson, which I am happy to do.

I look forward to my first meeting on 6th July.

Yours sincerely

Trevor

Sir Trevor Holdsworth

PS It was helpful to talk with you on Tuesday and I would like to repeat it from time to time.
TH

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& Chief Executive
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MP

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

24th May 1988

Dear Nigel,

Thank you very much for your letter of 18 May.

I shall be delighted to accept your invitation to fill the vacant Nationalised Industry seat on NEDC, and look forward to making a positive contribution over the next two years.

Yours sincerely

Bryan