

PREM 19/1567

PART THREE.

MT

SECRET CMO.

CONFIDENTIAL FILING

Strategy for Industry and Employment
Chequers Seminar on Employment
and Follow-up action.

Attempts to reduce the burden of
regulation on the economy.

MANPOWER

Part 1: Feb 1983

Part 3: June 1984

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5.6.84							
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ENDS							

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●PART 3 ends:-

HMT to AT 27.2.85

PART 4 begins:-

AT to PM 5.3.85.

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

House of Commons HANSARD, 15 January 1985, columns 197 to 280: Unemployment

House of Commons HANSARD, 21 February 1985, columns 1234 to 1243: Skillcentres

Unemployment: Are wages to blame – Harry Neuburger.
Published by the Low Pay Unit, 9 Poland Street, London W1V 3DG

Signed J. Gray Date 26/2/2014

PREM Records Team



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Treasury Chambers, Parliament Street, SW1P 3AG
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C D Powell Esq
10 Downing Street
LONDON SW1

27 February 1985

Dear Charles,

Your letter of 15 February encloses a copy of a message to the Prime Minister from Signor Craxi about the conference on Technological Innovation to be held in Venice on 10 and 11 April.

2. The Treasury has a close interest in the issues identified in the paper attached to Signor Craxi's note to the Prime Minister. It is not clear at this stage whether the Treasury representation would be appropriate. But given the issues it is proposed to cover we would wish to be involved in the preparation of papers for the conference.

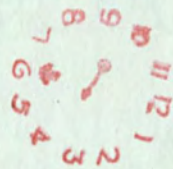
3. I am copying this to Colin Budd (FCO), Callum McCarthy (DTI) and David Normington (Dept. Employment).

Yours ever
Receael.

MRS R LOMAX
Principal Private Secretary

MANPOWER

Pt 3 Seminar.



28 FEB 1985

INTO INTRAPRENEURIAL BRITAIN

Optimists pretend that the Thatcher government could reduce unemployment by artificially increasing demand. They have not noticed that exchange markets last month were signalling that total British monetary demand was then too large already. Pessimists say that British unemployment must therefore remain high for a decade. They have not noticed that the world is at the beginning of the fastest period of market-driven economic development it has ever seen. Unfortunately, Britain is way-down-near-bottom among industrial countries with incentives to engage in this entrepreneurial revolution. The object of policy should be to move it back to way-up-near-top. Norman Macrae suggests 25 policy innovations, to businessmen and politicians

Twenty-five suggestions

This survey will offer 25 suggestions on how to increase entrepreneurialism and employment in Britain, at the fastest possible clappers. It will pick the wisest incentives now operating in the United States and Japan, and then recommend for Britain more drastic versions of each.

Most of the suggestions are nearly feasible even at the present stage of the informatics revolution. Since informatics capability is doubling every three years, all should be easy soon. Many will be called dotty, because they offend against at least 22 British illusions. We will number those illusions as we discard them, with some hectoring phrase as "key point to grasp".

Where the jobs will be

If you want to increase British employment and business activity, start with the broadly plausible estimates of where the latest 30m new jobs in the United States have been created. Around 60% of them have been in workplaces with fewer than 20 employees, and nearly all the rest (net) in workplaces not much bigger; employment in large factories is falling fast. Objection: this counts a new McDonald's fast-food restaurant as an under-20-employees workplace, and you should call that a big company's expansion, shouldn't you? Answer: no, you shouldn't. In the intrapreneurial revolution a lot of small-workplace ventures are going to be under the distributional (later franchising) umbrella of big companies, and key point one is to recognise that.

Key point two: around two thirds of new American jobs are in ventures that have not existed for more than five years, even although a third of the 600,000 American companies started each year fail, and so do a larger proportion of new

ventures started by big American firms.

Point three: it is good to be a country where a lot of new ventures fail, but do so very cheaply. Only by starting several hundred thousand small new ventures will a country get several thousands of those one-in-a-hundred that grow quickly big. In consequence:

● Suggestion one: small new firms should be freed from restrictions under employment protection laws, planning rules, "health and safety fascism". In the first year they should not even fill forms for income tax. But don't subsidise loans to them, because:

Point four: Britain's failing is not shortage of capital on offer, but lack of information about markets. A venturer in America is given a list of 100-200 potential customers, and kept on a shoestring and share options, working from his garage, until some of those 100-200 place sufficient orders for his prototype. By



contrast, a Briton with a gee-whiz technological idea can have money thrown at him like a pre-1982 Mexico, and with the same result—particularly if he is willing to go to some horrible part of the country, from which he cannot service a customer base.

Point five: any system of taxpayer subsidy or guarantee homes in on the went-

went stage of a go-go industry. For example, America's genetic engineering industry has grown from nought firms to 400, and is now on the way down to 20 again. This is good; it is how every innovative industry goes. Unfortunately, British governments throw money and guarantees just as the industry is declining from 400 firms to 20; it is then they first hear of it.

The Japanese also come in at this stage, but in order to eat went-went industries for pre-prepared breakfast. The Japanese have lists of the customers of manufacturing firms beginning to fail, calculations that "automated production of 50-mega-byte disk-drives would now cost only \$500 each, and will become profitable once overcapacity in the industry falls from 23 firms to three", and other figures which the British never conceive.

Telecommute your prototype

A lot of European misunderstandings would be removed if California's venture capital firms were renamed as "venturers' market searchers" which is what they are. The fastest-growing still-in-diapers Silicon Valley innoventure has grown in two years from four employees to 700. It was founded when four graduates showed a prototype to a venture capitalist who drew from his computerised "original-equipment-makers" list the names of 162 firms that might place bulk orders for the new machine if it worked. Less than \$1,000 was spent, mainly on an air ticket to show the prototype around, until three of those 162 potential customers responded with enthusiasm. The venture capitalist then took up his share options fast. A British innoventure can be financed into production before it knows whom to sell to; it just advertises vaguely in the trade press.

Key point six, and this is important: prototype launching will soon become much cheaper and more world-spread because of CAD/CAM (computer-aided design, computer-aided manufacturing) systems. Anybody who designs anything, from an airliner to a wedding cake, soon

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won't have to put a prototype into metal or pastry. With an electronic pen he will draw his design on a terminal, using the computer's power to reject whatever mathematically incompatible wiggles would cause the aircraft or cake to crash. The computer will digitise the drawing, store it in memory, and produce it on screen, confirming mathematically (or, for the cake, by picture) how fast and fuel-efficient (or, for the cake, how beautiful) it could be. Then the designer will press a button to show how robot machine tools should be programmed to produce the airliner or cake, thus calculating its cost. Then he will press another button to telecommute the design and cost price to a computerised list of people



who might buy an airliner or wedding cake. Within a terrifyingly short time, almost everything new will be designed, manufactured and sold like this.

At present Britain—although possibly still the rich country with the cleverest non-engineering graduates—is way down near bottom in designing, producing and (above all) selling things in this way. The object of the next two suggestions is to start moving Britain back to way up near top. The suggestions accord with key point three above: they are tiny, fiddly and will fail seven times out of 10, so go on sacking people from them at shoe-string level until they succeed.

Start a little database

● Suggestion number two. Mr Norman Tebbit's department of trade should fund, to the level of not more than 10 programmers, an intrapreneurial group within his ministry which will devise for Britain the equivalent of America's "original equipment makers" and other customer lists. The object is that the Briton who has invented a hoist could then press a button to find which 200 British or (better) 500 European or (best) 1,000 worldwide firms might be interested in buying it if told it existed. Each of these 10 programmers should be set a brutal timetable, on pain of otherwise being dismissed from the team. The incentive for not being dismissed should be the

following intrapreneurial opportunity:

● Suggestion three. Let each of those 10 programmers have a small intrapreneurial or "intra-capital" fund, for use at his (not the government's) discretion.

Intrapreneurial is a word invented by Mr Gifford Pinchot, who thinks researchers in a big firm should each have an intra-capital fund of perhaps \$50,000 to invest in ventures they guess would work. If they lose that \$50,000 of the firm's money, they are out of the intrapreneurial game. If they make \$1m, they keep perhaps \$100,000 for themselves, the other \$900,000 goes to the firm (in this case, to the ministry), but some of that \$900,000 swells your intra-fund for your next effort. At least in the early days, attach the entry number of each programmer to the part of the database he compiled. A new venturer could then key in: "I have started to contact the 300 customers suggested by your database for my prototype, and have already received these six quite favourable replies. Any hope of equity participation from your intra-capital, and of your playing my prototype through the database to see if you pick up some other prospects?"

Why so public?

Immediate objection: Why should such customer lists, which are compiled in America and Japan by the private sector, be delegated in Britain to the public sector? The inland revenue's, the vehicle registration's and the social security's long-drawn-out miscomputerisations have made Britain's bureaucracy the laughing stock of the computer world, because Whitehall will not understand key point seven: you must never computerise an existing (eg) tax collection system, you must always redesign a system so that in the computer age it can be operated with fewer people. Two answers:

First, and point eight. Such customer databases in the telecomputer age will be the equivalent of roads in the motor-car

age, except that more roads than databases could sensibly be toll-charged. The motorist entering a road knows in advance where it should lead, while a venturer entering a customer database does not.

Ideally, a British venturer in the 1990s will sit in his garage or public library telecommuting directly into the database of "his" department of industry (or, better, of his European commission at Brussels) to gather the several hundred names to whom he can telecommute his latest prototype. If he has to pay for access, he will probe only the market for his most likely idea, instead of for a hundred unlikely ones.

Second, and key point nine: informatics are an industry subject to economies of past accumulation. Later entrants gain from earlier ones. One company's staff now take two hours to write programmes which took three weeks a decade ago, because what they do now is an extension of what they have done.

After a short while, the database will spread well beyond the control of those 10 programmers, but it should then be possible to draw in incremental private additions to it, paid for in different ways:

● Suggestion four: Shopkeeping is a favourite small venture for people who have no idea where to start. Let them key into competing databases to find which shopping malls do not have sports goods shops, what is turnover in such shops in similar malls, local statistics (golf courses, age distribution, average local income?). Entry number of freelance compiler might wisely be bought by a bank.

● Suggestion five. If a firm is introducing a new product, and thus needs new components, it should be able to put (generally computer-aided) designs for each such component on a central database, and wait for the cheapest bidder who says he could make it. This would often be a low-wage co-operative, in order to spur the entrepreneurialism of the kids.

Tomorrow the world

How to get jobs for the poor and the young

In 1870 over 80% of working Americans were self-employed. Today, only 7% are, but seven times as many have told some opinion poll they would like to be. The new entrepreneurial age fits with America's culture, but not with Europe's elite.

In 1870 more than half of Britain's workforce consisted of domestic servants and farm labourers. The proportion in these two occupations is under 2% now. If forewarned of this, Victorian bourgeois would have wailed: "what conceivable

jobs will exist for the descendants of the majority of workers fit only to be housemaid or Hodge?". Actually, the housemaid's descendant became prime minister and Hodge's son split the atom. Mercedes in 1903 thought only the world's richest 1m families would ever buy motor-cars, since too few servants were trainable as chauffeurs. Computers are easier to drive than cars. Four-year-olds and drunks can experiment on them.

However, key point 10: the new age

will mean worldwide wage competition for jobs. If a Chinaman or Indian can do your job at half your efficiency, you won't long be able to hold that job at more than twice the average Chinese or Indian wage. For some building work in Saudi Arabia already, modules are manufactured in Brazil, then assembled in Riyadh by South Korean workers under American engineers. If Manchester will not allow that tomorrow, then Manchester's relative standards of housing and living will decline.

Key point 11: this does not mean that all "Henry Ford" industries such as car-making will pass to poorer countries. This was a mistaken panic of the pre-micro-processor 1970s. Soon we will be able to put microprocessors in most machines.

The educated countries will be better at devising the chipboard of 1988 which will make redundant the chipboard of three years before. Japan's robot-manned assembly lines will therefore beat South Korea's during the next generation after all. But, key point 12, the manufacture of components—including, eg, chipboard assembly—will go to the cheapest bidder. Quality control of component manufacture is going to prove progressively easier. In thousands of small Indian and Chinese workshops in the 1990s, Japanese-designed but on-the-spot-assembled chipboards will be pressed down into a mould attached to a computer. The computer will signal any fault.

The fine Italian way

Therefore, point 13, many people in rich countries will have to be willing to take some jobs initially at very low wages in small component-making workshops, but with the satisfaction that there are not going to be such things as dead-end occupations. (Note that there are also not going to be many such things as settled careers; graduates who used to rise to group vice-president or permanent secretary will instead run small businesses inside or outside entrepreneurial companies or government departments.) The worker in a sweated small component-workshop will also know he can become a small workshop entrepreneur tomorrow. The fashion-conscious Italian textile and leather industries already work that way. The big firms like Gucci buy from tiny five-man workshops which are virtually co-operatives. The same thing is now happening in California.

The Americans reckon each job in a Silicon Valley innoventure creates five or six low-tech jobs making components, which have to be subcontracted to the cheapest small workshops if the Japanese are not to capture the innoventure's whole field. Until 1982 it was assumed most of the light metal bending and

chipboard assembly would be subcontracted to Taiwan. Instead it is being done on piecework in tiny workshops in California by Hispanic immigrants. Many of these are illegals, with no statutory minimum wages or social security, so in a modern country readers of the Guardian will decently assume they should starve. Actually, many now own their workshops, and have become entrepreneurial.

When innoventures sprout in Britain there will be difficulty in getting the new components needed because so much of small west Midlands engineering has gone bust, and was too trade-unionised anyway. Where are Britain's equivalent of non-social-security Hispanics? Key point 14: they are just about to be created, and then sent in the wrong directions.

Misguiding youth

Lord Young, the minister for jobs, is distressed that 16- and 17-year-young unemployed draw unconditional benefit, while their brothers still at school do not. "Living off the state", he says, "is not an ideal start in life for a youngster". So he may be preparing to say they cannot have unconditional benefit, but must take training places or a community service job in the social services, education or health care. Can you see the two things very wrong with that?

Key point 15: in 1962-82, over 32m Americans enrolled in federal job-training programmes; among them, unemployment went sharply up, and labour-force participation went sharply down. In Britain, the last unwilling year at school is already the peak year for juvenile delinquency and alienation. A multiplication of bogus training places would make an endlessly prolonged uselessness in adolescence a graver social problem still.

Key point 16: three of the least efficient industries in Britain are the state-run social services, education and health care. To conscript British youngsters straight out of comprehensive school into their trade-unionised inefficiency would give them the worst start. Entrepreneurialism would give them the best one.

● Suggestion six: 16- and 17-year-olds should not draw unemployment benefit, but there should be facilities for them to go on piecework into small component-database-oriented workshops (responding to suggestion five above; if they could not undercut other bids, then the piece-wage they were demanding would be too high).

● Suggestion seven: an incentive should be held out for small groups (perhaps averaging around six or seven teenagers each) in these workshops to float themselves off into fairly independent co-operatives or partnerships.

Key point 17: most new products are

easily transportable. Last year's worldwide production of semiconductors could have been carried in 10 Boeing 747s, and information is weightless. The big job switch is from the two fifths of America's workforce who are hands-on production workers (those who pilot aircraft or lorries, stand on assembly lines or serve in shops) to the nearly three fifths who are already information workers: people who move bits of information around like bankers, secretaries, teachers, researchers, most salesmen and software writers. Training of 17-year-olds needs to be concentrated in this second group where jobs expand. So:

● Suggestion eight: unemployed youngsters could also be paid for updating the parts of the open-access databases where intrapreneurial activity was not sufficiently fast. Examples might include providing Britain with the Japanese-type lists of when assembly-line production in a slimmed-down went-went industry might become profitable, and when the computerology in any machines with more than a worldwide \$40m-a-year of sales is very old (say, three years); details of distributors' margins in different products in different countries, plus the more obvious



tricks of the export trade (never employ a sole distributor in Japan, even though he will take your salesman round the Ginza and say it is an insult to local custom to hire anybody else); how to beat cross-border testing and certification requirements in the EEC; and a detailed split into components, products and services requirements in the 15-20% of the EEC's gdp which goes in government contracts (often now restricted to domestic companies, but Europe is soon bound to be shamed out of that).

● Suggestion nine: switch from student grants (which breed welfare-state, trade-unionised, bloody-mindedness in your brightest young) to loans (which have provided America with waiters and entrepreneurs for 60 years).

Two objections. First, will not the whole idea of databases be devalued if untrained youngsters are putting some nonsenses into them? Answer: no, an entrepreneur misled by a false entry will merely be telecommuting a prototype to a

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customer who does not want it (and much less than in junk mail). Second, won't these suggestions clumsily increase government expenditure? Answer: no, they have been based on key point three—that a dynamic country will start lots of small ventures which, if they fail, will fail very

cheaply. If they start succeeding, much of the other expenditure at the departments of trade, industry, employment and energy (over £10 billion in 1984-85) could end. The memos their civil servants at present write to each other are virtually content-free.

The post-managerial economy

How to make your business prosper

The first two articles sought a British marketing infrastructure suitable for the informatics age. Next, we need an enterprise system that will produce things people want. Base it on intelligent share options and intrapreneurialism.

Key point 18: some share options for staff can be a fraud on ordinary shareholders, so seek the other sort. A successful American company, whose shares stood at \$60, offered "contingent B shares" to its staff at \$12 each. If the firm hit its target of a 35% annual increase in earnings per share for five years, the ordinary share's end-1989 market price should be about \$270. If targets were hit, each B share would be convertible into an ordinary share, thus multiplying its value 22½ times. One middle-grade executive, who bought \$50,000 worth, stood to become a millionaire. However, if the company stagnated, and the shares stood still, each B share would be convertible into only one tenth of an ordinary share. Each \$12 from the staff would then have bought a bit of the shareholders' company at twice its market price.

● Suggestion 10: the chancellor should offer super-added tax incentives for contingent B shares of this sort. The initial definitions should be narrow, so as to inform a surprised British industry that such things can exist. They should, however, embrace small intrapreneurial group incentives as at Baker International in America. Participants in a new departmental venture there get fictitious shares in it, convertible to Baker stock at a lush price if the venture's profit outpaces the corporation's.

A huge advantage is that sensible workers would then want to belong only to share-option-seeking trade unions. Would the public sector be left as a restrictive-practice ghetto? No, because:

● Suggestion 11: each group of a dozen public servants should be asked "what do you think you are meant to be doing? Can we together set targets, intra-capital schemes, payments by results, share-option equivalents so you are rewarded when targets are exceeded?". Whenever the answer is "eh?", the odds are that these dozen's jobs should not exist.

Key point 19, and perhaps the most important in this survey: the world has now entered a post-managerial society, where businesses can no longer be run by energetic bureaucrats, but must become confederations of entrepreneurs.

Action list for entrepreneurs

When most workers in rich countries are brainworkers, it is ridiculous to sit in managerial hierarchies arranging how a worker below one can best work with his imagination. In consequence, today's successful big corporation has no matrix



organisation, and tomorrow's will have no headquarters building. "We have nil group vice-presidents", says one excellent American company president, "we once had a guy who wanted to be, so we sacked him. We do have five group heads, loosely defined by product; but nobody much wants to be a group head either. Under these five group heads, everybody, down to the janitor, wants to run his own business." Suggestions 12 to 16 discuss how to edge your business into the post-managerial age.

● Suggestion 12: when the janitor has his bright idea—perhaps a new system of alarms attached to telephones—he should try to sell it first to the part of the salesforce that sells to telephone companies. When they reject it, he can submit it to any subdepartment in the group. Some companies have rules for each subdepart-

ment that "at least 25% of your sales should be in products that did not exist five years ago". Another president talks of "my bully pulpit 14 times a year, when each department head reports what's new from four weeks ago, and what relatively new thing has been killed. He's embarrassed unless there are some things in both categories".

● Suggestion 13: a key test in successful companies is therefore "the cost of irreversibility of decisions". If a product is disappointing at one stage, kill it before it proceeds to any expensive next stage, without recriminations and with a drinks party for those involved. Remember that your few very successful products are also likely to have a short life, plan for this, and keep the groups employed on each very small. "We try daily to obsolete ourselves", says one president. "Sub-contract everything," says another, "then you won't have to sack your own people when today's wonder product folds."

● Suggestion 14: ensure that your distribution team sticks to its usual last, and introduce a new distribution method if some new product plainly does not fit with it. One of the excellent companies discussed above sells its tens of thousands of products entirely to other companies; it once had a market leader in a consumer product, but "sold it to its originator" because distribution costs were too high. In 1980-81's most brilliant new product introduction—IBM's personal computer—it is no secret that the one internal clash was between the new venture team (which rightly decided to sell through computer retail stores) and IBM's normal salesmen (who were used to getting nice commissions for bulk sales). That introduction typified the best modern practice. A task force of eight or nine people in July, 1980; a rough prototype from them by September, when they got funding to the level of 12 engineers to start development; a fixed date that sales of a zero-defect model had to start within a year; about 150 people employed on the project during development year, but split into smaller teams with specific jobs. IBM is nowadays intrapreneurial.

● Suggestion 15: check your company's performance against five of the eight characteristics found by Tom Peters and Bob Waterman to be common to their 43 excellent companies in "In search of excellence", and check it especially against the 14 of those 43 companies whose latest results (see Business Week of last November 5th) disappointed. The five relevant Peters-Waterman characteristics are: (a) simple form, lean headquarters staff, few administrative layers; (b) bias for action (do something—anything—rather than send ideas through committees); (c) entrepreneurship (split

the corporation into lots of small skunk groups; (d) stick to the knitting (stay with the businesses and distribution channels the company knows); (e) stay close to the customer (which I call much the same as d).

Most of the 14 new limpers offended against (d) and (e). Hewlett-Packard, Texas Instruments and Digital—companies of engineers previously selling to engineers—tried to sell to consumers. Delta did not notice that airlines had been deregulated, and Atari that customers had switched from video games to home computers. Avon and Tupperware failed to spot that housewives had left home to pursue business careers. Levi Strauss thought its rather maltreated retailers would always want its superior jeans. Fluor departed from its knitting to pay \$2.3 billion for St Joe Minerals, just before metal prices collapsed. Chesebrough-Pond's diversified from cosmetics to buy Prince tennis rackets, buying went-went. Disney without Walt failed to notice that Americans had stopped having innocent children. Revlon without Charlie was re-organised from the top down by a new boss from Geneen's ITT. Caterpillar (admittedly recession-hit) and Eastman Kodak cannot easily be called small-group-entrepreneurial now.

● Suggestion 18: since many new products and soon far more services will spring from the application of science, note the two types of researcher. First, the sniffers. These sniff out an idea, get a list of people who might buy its applications, then put noses down on their trail. Second, the basic researchers: professors who discover interesting truths, but have no idea of their practical market value. Modern Britain is strong in these, with more Nobel prizewinners per uncommercial chucklehead than any other country.

In 1949 the British government's nuclear research laboratory at Harwell discovered that the molecular structures of various polymers subjected to high-energy radiation underwent a fundamental chemical change, and therefore retained an elastic memory of their previous shape; but it did not see why any businessmen should be interested in this arcane fact.

In a Californian garage, Raychem's two founders were. With an initial investment of \$15,000, they built a business with a turnover of well above \$700m a year in thousands of Harwell-related products. A telephone linesman in the snows of North Dakota heats some plastic put on a frayed wire, and it cuddles itself into welding shape. Under a broken North Sea oil pipeline, a diver heats some polymer previously shaped to grip that pipe's circumference. Raychem has graduated from sniffer to hound-dog, because

it now spends over \$70m a year itself on research, all very market-gear. "Compile a long list of firms that might conceivably make some use of each particular function you have examined today", runs the wall exhortation in the research laboratory of another hound-dog, "and put it on the database before you leave."

These suggestions 12-16 have been addressed to British private industry. Suggestion 16 obviously prompts a suggestion to the government as well. The worst way of establishing sniffers in Britain is for government to have a near-monopoly in

the financing of universities (see suggestion 21) or the fruits of other public-sector research. The best mechanism might be something like:

● Suggestion 17: let research discoveries from all government laboratories be put on a database. Open access to the world, but with any foreigners who buy the technology being required (a) to allow share options in it to some associated individual holders of intra-capital; (b) to explain how they became interested, while British entrepreneurs did not. Then publicise, publicise.

The governors depart

How to end public-sector imperialism

The Attlee government's nationalisations in 1945-51 imposed top-down monopoly management in some narrowly defined things, shortly before the new age required bottom-up competitive intrapreneurialism in lots of diffuse things. If Mr Attlee had been returned after 1951, he wanted to nationalise chemicals, but three quarters of the things now made by chemical companies did not exist then. If that nationalisation had gone through, Britain would now have a state monopoly making the dying quarter of chemical products, fighting a left-wing monopoly trade union.

The consequences of the remaining nationalisations are bad. Professor David Birch has identified 16 especially innovative industries in the United States, measured by how fast the best firms in each have grown. Seven of the 16 are not surprising (computers, etc). Three may be surprising (dried fruit, department stores, bicycles), but they show America has bred one million millionaires partly by making once-dying industries entrepreneurial. The other six have been robbed of entrepreneurialism in Britain by nationalisations (coal, railways, steel, universities, health care, airlines). Suggestions 18 to 22 look at remedies.

● Suggestion 18: note that the United States has a rumbustiously competitive coal industry, with 3,000 companies operating 6,500 mines, entrepreneurial

faceworkers eager to lease sometimes two-man pits, only 40% of its workers trade unionised, therefore drawing wages four times higher than British miners, yet able to land coal at Cardiff docks at prices which (if there was free trade in coal) would make 40% of British miners redundant. When a coal company in America closes an uneconomic but unexhausted seam, there is not a national crisis. Small entrepreneurial teams of miners see one more cheap seam to lease.

● Suggestion 19: since much of the land over which railways run was bought in the nineteenth century, many of British Rail's acres ought to be redevelopable at several-hundredfold existing-use worth. BR would be wise to give its workers share participations in the land at the stations or lines where they work. On Japan's private railways (though not its nationalised extravaganza), suburban stations can be rail-loaded supermarkets in which commuters can use rail season tickets as discount-attracting charge cards, on their way to daily auctioned car parking space.

● Suggestion 20: the Swedish School for Intrapreneurs stalked the steel mills. One employee diverted waste heat into a computer-controlled eel pond, whose mass-multiplying products go south with the bulk steel at (this is steel sites' main remaining advantage) almost nil marginal transport cost.

● Suggestion 21: note that the most dynamic British university today is the one that enjoyed a 40% cut in its taxpayers' grant three years ago. Salford University reacted by getting a vice-chancellor who has doubled the non-tax proportion of its total income, selling major and minor research consultancy, a screening service for heart disease, offering diplomatic studies for Middle Eastern students. "We're very close to the point", said one angry Salford academic, "where



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we're generating so much money from outside sources that we're no longer a university in the accepted sense". Key point 20: words like "university in the accepted sense" can be Britain's obituary.

● Suggestion 22: instead of mismanaging Britain's hospitals by committees of senior doctors (who have doubled hospital staff during 35 years while the number of hospital beds has gone down), a committee has sadly recommended that the service should be dragged kicking and screaming into the dead Henry Ford age (through inserting top managers to boss doctors about, which cannot be done when the bossed are more educated than the bossing, so the reform means yesterday's administrators are to be re-employed at higher pay). Meanwhile, in America hospitals become innovative with share options tied to efficiency.

● Suggestion 23: the Thatcher government has been right to increase the efficacy of audit commissions for local government expenditure, but wrong to allow no blind notice to be taken of what they say. The latest report on the £1 billion a year spent on vehicle fleet management in local government found that the worst local authorities used nine times more mechanical sweeping vehicles than the best ones per mile of road swept, while maintaining vehicles three times more expensively. The government is screwing its courage to say all maintenance of council vehicles, all refuse collection, street cleaning and upkeep of parks must go for tender; the councils' workforces will rightly get the contracts only if they submit the lowest bid. But, of course, all conceivable functions—in central government ahead of local government—should go to the cheapest bidder. Together with suggestion 14, this could provide the savings in government expenditure without which there will not be full employment in Britain.

Needed: a £30 billion-a-year cut

Key point 21: most new jobs will become available initially at well below the average annual adult wage, but a lot even of higher-wage jobs today yield a lower post-tax standard of existence than do social security's means-tested supplementary benefits. When the Tory cabinet wanted to cut upper-middle-class students' grants, Ms Hermione Parker calculated in *The Times* that a family with father's £12,000-a-year income (like some family doctors), and with three teenage children (one at university) while on an average middle-class mortgage, would get a weekly net post-tax spending power only £24 higher than a similar family would get on social security's supplementary benefits for doing no work at all.

Doctor will gallantly earn his net extra £24 a week by attending his patients at midnight, but why does a waiter? Key point 22: more than all of the 250,000 net new jobs created in Britain last fiscal year were taken up by 380,000 (mainly non-benefit-drawing) part-time women, and British waiters come from abroad.

America is backslashing as Mr Charles Murray's "Losing ground" details what has happened since Lyndon Johnson's Great Society started in 1966-67. Until then the gap between the proportion of white and black males with jobs was negligible, and illegitimate births in the ghettos were one third of their 55% now. The Great Society's many special programmes for the wildly disadvantaged made some of the soberly disadvantaged, who had previously adhered to the old rules (a low-status job is better than none; marry your girlfriend if she becomes pregnant), feel like suckers. Much of Christian America wants to eliminate federal welfare benefits for the working-



age poor. In Britain there will, within 15 years, be a worse backlash against its wider welfare state, but there is still just time to propose a better solution than utter heartlessness to the problem of "over 100% surtax on low-wage job-seekers".

Some part-answers are worthy (higher tax thresholds, allow those on supplementary benefits to earn more), but the real solution is:

● Suggestion 24: go to a negative income tax scheme. Every Briton of working age would get a minimum income from the state of slightly below present supplementary benefit level. When you went to work you would not lose any of that benefit, you would just pay perhaps 30% income tax even on your first earnings. You would get 70p for each pound you earned, versus losing more than a pound if in the unemployment trap now. This would instantly generate low-wage part-time jobs for the unemployed. Any such scheme that did not cut the incomes of the

poorest 10% would require cuts in other government expenditure of more than a net £20 billion a year, or perhaps 14% of the £150 billion that annual government expenditure will otherwise reach circa 1990. Intrapreneurialisations would save much more than this 14%.

The last unmentionable

The final unmentionable reason for high British unemployment is that between 1976 and 1982 labour costs per unit of output rose six times faster in Britain than in West Germany. There are desirable part-solutions (abolish employers' national insurance contributions for workers with below-average wages), but radical reform requires an honest look at why unemployment soared in the 1930s.

In the century to 1914, there were many recessions but unemployment rarely rose above 4-5%. In each recession, wages fell, so demand for labour rose, so people re-attained jobs. That was true even of the 1921 recession when output fell 15% in a year, but unemployment started falling again in 1922 because real wages turned right round from a 11% rise in 1921 to a 6% fall in 1922. Test question: how much larger was the 1929-32 recession than the 1921 one? Answer: it was much smaller—a fall in output of only 5% in 1929-32 versus 15% in 1921 alone, but unemployment soared to an unprecedented 22% because real wages rose in those three recessionary years by over 10%. Lionel Robbins gave the then orthodox explanation: "In the prewar period British trade unions were responsible for the maintenance of their unemployed. If the volume of unemployment rose above a certain point they knew it was time to reconsider their policy... Now... they have been relieved of this responsibility by the system of unemployment insurance... which secures the rigidity of wages."

The row over proposals to cut unemployment pay led to the break-up of the 1931 Labour government, and real wages started falling after 1932. Immediately, output and employment started recovering strongly. In 1932-37 both rose by 23%, or at an annual rate of around 4%.

If suggestion 24 was implemented, purists would say that unemployment insurance should then pass wholly to the commercial insurance market, but that would be cruel in the declining trades. So: ● Suggestion 25: the state should (rather minimally) subsidise some new unemployment insurance schemes run by trade unions. The unions could then choose whether to hold down wages or reduce promised benefits when their schemes were in trouble because their members' unemployment was going too high.

We had better stop at that.



JR

10 DOWNING STREET

From the Private Secretary

15 February 1985

I enclose a copy of a message to the Prime Minister from Signor Craxi about the Conference on technological innovation and the creation of jobs to be held in Venice on 10 and 11 April, together with supporting documents.

I am copying this letter and enclosure to Callum McCarthy (Department of Trade and Industry), Rachel Lomax (HM Treasury) and David Normington (Department of Employment).

(C. D. POWELL)

C.R. Budd, Esq.,
Foreign and Commonwealth Office.

JK

Economic Department

*Italian Embassy,
14, Three Kings Yard,
London, W.1.*

280

13th February, 1985

Dear Charles,

In the absence of ~~the~~ Ambassador Cagiati, at present on leave, I take pleasure in sending you, herewith enclosed, the text of a message addressed to the Prime Minister by Signor Bettino Craxi, together with a rough translation of the same.

Yours ever

Ferdinando Zezza
Ferdinando Zezza

First Counsellor (Economic)

Charles Powell, Esq.
Private Secretary to the Prime Minister
(Overseas Affairs)
10, Downing Street
LONDON SW1



10 DOWNING STREET

From the Private Secretary

4 February 1985

The Prime Minister has asked me to thank you very much for your letter of 25 January, and for sending her a copy of "Employment Trends in Britain and the USA". She was most interested to see this.

(David Barclay)

G.R. Steele, Esq.

✓

Mr Turnbull

University of Lancaster

R 31/1

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Lancaster LA1 4YX
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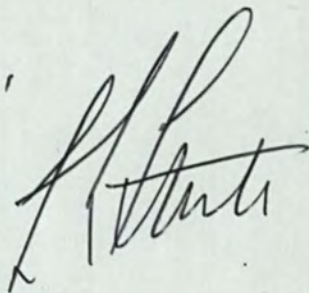
Prime Minister,

25th January 1985

Dear Prime Minister,

I watched your ITV interview last night. Burnett questioned you on the decline in output of manufacturing industry. I think you might have been better briefed, and so I enclose a copy of "Employment Trends in Britain and the USA" in which it is argued that real wage flexibility in the USA (as against the U.K.) has enhanced its competitive edge in world markets.

Yours respectfully,



B. R. STEELE

(Lecturer in Economics)

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EMPLOYMENT TRENDS IN BRITAIN & THE USA

Introduction

The question is as old as the hills and at least as enduring. Ever since the benefits of the division of labour led to the production of goods for exchange, rather than for self-sufficiency, people have been concerned about their security of employment. Essentially, they have worried about the possibility of falling demand for the particular "product" they supply or the possibility of that product being produced without them, (the latter fear usually being associated with anxieties about technological developments).

Unfortunately, it has hardly, if ever, been possible to forecast in any specific detail where the next generation's jobs will come from. Two hundred years ago, the majority of people were employed on the land; neither they nor their employers could have envisaged a situation in which the majority would be employed in industrial occupations. Equally, few would have forecast in the mid-nineteenth century that, by the second half of the twentieth century, the major share of employment in the "industrial" world would be in "services". Even now, it comes as something of a surprise to find that almost two-

thirds of total employment is in that sector. The market has transmitted altered demands and, together with the pattern of cost structures throughout the world, has determined how people should be employed.

Industrial change is therefore a central aspect of an efficiently functioning economy. In a world of advancing technology and continually changing patterns of demand, the quicker the response the better. The problem is that frequent change to their working lives is, understandably, not welcomed by the majority of people, and worse still, if responding to the demands of the market involves a period of unemployment or a reduction in remuneration, it is doubly unwelcome.

Employment Trends in Britain

However, even though the British economy does not have the reputation of being a rapidly changing economy, at least compared with other industrial nations, the record shows that over time it certainly does change (see table 1).

Just before the Second World War, 52% of employment in Great Britain was in industrial production and 43% in "services". Even by the late

Table 1 Employment in Great Britain (1939-83)

(thousands)	1939	1949	1959	1969	1979	1983
Manufacturing	6,815(38%)	8,229(38%)	9,169(39%)	8,181(37%)	7,053(31%)	5,346(27%)
Construction	1,310	1,438	1,509	1,415	1,252	965
Mining + Quarrying	873	875	823	434	347	311
Gas, Elect. & Water	242	334	374	397	338	323
INDUSTRIAL PRODUCTION	9,240(52%)	10,946(50%)	11,875(51%)	10,427(47%)	8,990(40%)	6,945(34%)
National & Local Govt.	1,385	1,392	1,307	1,432	1,564	1,495
Distribution	2,887	2,553	3,000	2,652	2,813	2,640
Other Services	3,458	5,674	6,074	7,159	8,863	8,761
TOTAL "SERVICES"	7,730(43%)	9,619(44%)	10,381(45%)	11,243(51%)	13,240(59%)	12,896(64%)
Agriculture, Forestry & Fishing	950(5.3%)	1,176(5.4%)	999(4.3%)	479(2.2%)	358(1.6%)	339(1.7%)
EMPLOYEES IN EMPLOYMENT	17,920	21,741	23,255	22,148	22,588	20,180

Sources: Annual Abstract of Statistics; Dept. of Employment Gazette.

fifties, this pattern had not changed much — 51% and 45% respectively — partly because this period coincided with a temporary increase in the United Kingdom's share of world manufactured trade. However, "industrial" employment began falling quite sharply in the sixties — both in absolute numbers and as a proportion of total employment. The reasons for this contraction — which is still going on — were twofold: first, principally because of technological change, manufacturing productivity is relatively easy to raise — it increased by 57% between 1962 and 1973 — and second, Britain's share of world manufacturing production was reduced by the impact of foreign competition (from the newly industrialised countries as well as the developed economies).

In contrast to the record in manufacturing, employment in services grew quite quickly in the sixties and seventies, accounting for 51% of employment by 1969 and 59% by 1979. In total, the service sector generated almost 3 million new jobs between 1959 and 1979. These increases in service employment were almost counterbalanced by the disappearance of jobs in the "industrial" and agricultural sectors. With the working population increasing by 1.7 million over this period, the other significant development was the rise in unemployment from about 400,000 in the

late fifties to just over a million in the late seventies.

In the eighties, the increase in public sector employment has been put into reverse as a matter of policy, the decline in manufacturing has accelerated and, for the first time since the Second World War, employment in other services has fallen. The net result has been another substantial increase in the United Kingdom's unemployment (from 1.2 million in 1979 to 3 million in 1983).

Table 2

Manufacturing Employment Comparisons (1974 and 1983)

(thousands)	Employment		Output	
	1974	1983	% change	% change
Food, Drink & Tobacco	740	611	-17%	+2.5%
Chemical & Allied	471	363	-23%	+1.0%
Metal Manufacture	507	259	-49%	-33%
Metal Goods	577	365	-37%	-39%
Engineering & Allied*	2129	1678	-21%	-16%
Motor Vehicles	509	307	-40%	-28%
Other transport equipment	244	195	-20%	-4.5%
Textiles, Clothing & Footwear etc.	992	567	-43%	-30%
Paper, Printing & Publishing	582	473	-19%	-17%
Other Manufacturing	923	718	-22%	n.a.

Sources: D.E. Gazette; Monthly Digest of Statistics; ton 1968 S.I.C. basis; *including shipbuilding.

Manufacturing

Between 1974 and 1983, manufacturing employment declined at almost twice the rate at which output fell (30% compared with 16%). The fastest falls in employment over the period were in metal manufacture; textiles, clothing and footwear; and motor vehicles — industries which are not in decline everywhere. The textile industries have been drawn to the cheap labour countries, and the motor and metal industries to the highest productivity countries.

Services

Employment in the service sector increased by about 1/2% per annum between 1974 and 1983 but within that overall trend, there were wide differences. Employment in financial services has increased by one fifth — banking increasing by 24% and insurance by 9%. Also within this category, employment in "other business services" has increased by 23%; the important identifiable sub-sectors within this category are "activities auxiliary to banking and insurance" (about 90,000); hiring of equipment etc. (about 90,000); estate agents (about 70,000) and computer services (about 60,000). Obviously, a proportion of those employed in some of these "services" are indirectly involved in the production of goods — e.g. the computer programmers who write the software for industrial robots.

In terms of sheer numbers, the "professional and scientific" services are dominated by medical/dental services (which are growing rapidly) and education (which, largely because of demographic factors, is not), but the fastest growing areas are the law and accountancy (+34%).

Elsewhere in the service sector, wholesale and retail distribution account for 2.6 million jobs and hotels/catering for almost a million, but the fastest growing sectors are in "recreation, sport and entertainment" (+37%), which includes the potentially important radio, films and t.v. sub-sector. The "other miscellaneous" services (+26%) include the social services (almost half a million).

As table 3 shows, the largest proportionate declines in demand have been in transport (where increasingly, we drive ourselves rather than pay others to do it) and laundries/cleaning (the

Table 3

Service Employment Comparisons (1974 and 1983)*

(thousands)	1974	1983	Changes 1974-83 (000)	(%)
Transport	1049	886	-163	-16%
Communications	434	419	-15	-3%
Wholesale Distribution	829	829	n.c.	n.c.
Retailing	1878	1810	-68	+4%
Financial Services	1101	1326	+225	+20%
of which:				
Banking & Finance	409	509	+100	+24%
Insurance	262	287	+25	+9%
Other Business Services	430	530	+100	+23%
Professional & Scientific Services	3284	3668	+384	+12%
of which:				
Medical & Dental Services	1130	1398	+265	+23%
Education	1693	1740	+47	+3%
Legal/Accountancy Services	187	250	+63	+34%
Research/Development	106	110	+4	+4%
Other	168	170	+2	+1%
Hotels & Catering	795	923	+128	+16%
Garages & Motor Repair	426	466	+40	+9%
Recreation, Sport & Entertainment	277	380	+103	+37%
Hairdressing	89	86	-3	-3%
Laundries & Dry Cleaning	86	60	-26	-30%
Other Miscellaneous Services	421	546	+125	+30%
Public Administration	1551	1540	-56	-4%
TOTAL SERVICES	12,220	12,895	+675	+5.5%

*estimated on 1968 S.I.C. basis

Sources: D.E. Gazette; Census of Employment.

market for which has fallen as the incidence of washing machines, vacuum cleaners etc has increased).

After falling between 1973 and 1979, the number self-employed — most of whom are in services of one kind or another — has since increased from about 1.9 million to 2.3 million in 1983. However, the total employed labour force still fell between 1979 and 1983 and more importantly, the rate of unemployment was on a consistently rising trend.

Just Part of a World Problem?

Why has the British economy failed to generate sufficient jobs to prevent this substantial increase in unemployment? The general recession of 1980-81 and Britain's loss of international competitiveness over a range of long-established industries provide a partial explanation, and its critics maintain that the Government has pursued too restrictive an economic policy. However, the primary question is whether or not Britain's experience has been different from that of other similar countries.

In all the developed economies, "industrial" employment has been falling in proportionate terms over the last ten years or so but there are marked differences between certain countries: industrial employment still accounts for 42% of total employment in West Germany but only 28% in the USA (see table 4). The proportion employed in this sector is very similar in the United Kingdom, France, Italy and Japan.

All the OECD countries have experienced sharply increased levels of unemployment since the first "oil shock" of 1973/4, but it has increased much more than the "average" in the United Kingdom and West Germany and much less in the USA, Japan and Italy.

The differing levels of unemployment have clearly been a reflection of individual countries' flexibility and their overall economic success or lack of it; generally, those countries that have achieved the best rates of economic growth have been able to contain the rise in unemployment better.

Lessons From America?

During the last ten years, West Germany and Japan have gained market share in manufactured goods at the expense of the USA and the United Kingdom. Apparently reflecting this, the United Kingdom's employment situation has deteriorated more or less consistently whereas in the USA, the total number of jobs has increased substantially (not least, during the last two years even though the dollar has been so strong). Clearly, this is not simply a question of greater "competitiveness" vis-à-vis other countries, it is also a matter of labour being competitive with capital and with the option of simply leaving potential workers idle.

Table 4

OECD Employment in the Major Sectors* in 1974 and 1983

		UK (%)	USA (%)	W Germany (%)	France (%)	Italy (%)	Japan (%)
Agriculture	1974	2.8	4.1	7.3	11.6	16.6	12.9
	1983	2.7	3.5	5.6	8.3	12.4	9.3
Industrial Production	1974	42.3	31.0	47.3	39.2	44.1	37.0
	1983	33.6	28.0	42.0	34.2	36.0	34.8
Services	1974	54.9	64.9	45.4	49.2	39.3	50.1
	1983	63.7	68.5	52.4	57.6	51.6	56.0

* OECD definitions of sectors.

Source: OECD "Labour Force Statistics".

The important wage rate is the market clearing rate — i.e. the rate at which all workers willing to work could actually find employment — and that rate will be different in different areas, industries and times. It is the flexibility of the US labour market, where real wages go down as well as up, according to prevailing conditions, that has allowed America to have rising employment even when its international "competitiveness" has declined. The various "de-regulation" measures, the lower proportion of the workforce in trade unions and the relatively small public sector have probably all been relevant in this context.

Certainly, the USA seems to have coped much better than Britain with the problem of generating employment, even though its civilian labour force has increased by 23% since 1974, whereas that of the United Kingdom has grown by only 4.5%. While US private sector employment has increased by 18.5% (11.8 million jobs), United Kingdom employment has fallen by 9% (nearly 2 million jobs). Manufacturing employment has fallen in both countries, but to a very much greater extent in this country — 29% compared with — 3.6%. In the non-manufacturing sector, Britain has generated only 265,000 new jobs (+1.8%) to fill the gap left by manufacturing whilst the USA has generated more than 12.5 million new jobs (+28.6%) in that sector. The result has been a quadrupling of our unemployment rate whilst that of the USA has not even doubled.

Although it would have been impossible to forecast exactly where the US jobs 'boom' would occur, the key to this divergence probably lies in the differing rates of real wage growth. Between

1976 and 1983, US private sector earnings rose by 64% and prices by almost 75% — producing a “real” decrease of 6%. In Britain, earnings rose by 128% over this period and prices by almost 113% — giving an increase in “real” earnings of 7%. Not only did this outcome result in a much higher level of United Kingdom inflation — contributing significantly to loss of market share at home and abroad — but it greatly encouraged the use of capital equipment in substitution for labour wherever possible (in contrast to the way the balance was shifting in the USA). This incentive to utilise capital rather than labour was increased further in the United Kingdom by the various investment allowances/grants available.

The contrast with the USA is clear enough in the manufacturing sector — an increase in “real” wages of 9.3% in this country, compared with a 2.8 per cent *fall* in the USA over the period 1976-83. In simple terms, in the USA, the so-called “inevitable” decline in manufacturing employment has been lessened by the acceptance of marginally falling real pay, whereas in the United Kingdom, it has been accelerated by significantly higher real wages and investment incentives.

In the non-manufacturing sector, the same influences can be seen at work but the contrast

between the United Kingdom and the USA is even more significant. Over the period 1976-83, real earnings in non-manufacturing fell by 6.7% in the USA whilst in Britain, they rose by 6.4%. Although cause and effect can be only inferred from this data, it does suggest that the demand for more labour in the non-manufacturing sector in the USA and the absence of it in this country, were in some close way related to the divergent movements in the rates of increase of real wages. Because productivity growth is usually — by its very nature — much slower in the labour-intensive “services” than in manufacturing, it could be said that the USA has consistently “mopped up” the labour unable to find employment in the manufacturing industries by utilising it in other sectors — at lower levels of productivity and at lower levels of pay. This interpretation seems to be confirmed by the relatively low pay in the US service sectors: in distribution (where employment has increased by 2.8 million in the last seven years), average hourly earnings are only 73% of those in manufacturing; in financial services (where employment has increased by 28%) and other service industries (where employment has increased by 35%), the ratio is 82%. In the USA, employment has grown rapidly in all

Table 5

Employment & Earnings in US and GB Industries 1976-1983*

	US Employment** (millions)		% change† in Real Earnings	GB Employment (millions)		% change† in Real Earnings
	1976	1983		1974	1983	
Manufacturing	19.0	18.6	- 2.8	7.1	5.3	+ 9.3
Non-manufacturing	45.5	55.5	- 6.7	14.9	15.0	+ 6.4
of which:						
Construction	3.6	3.9	-11.7	1.3	1.0	+ 8.6
Mining	0.8	1.0	+ 0.2	0.3	0.3	+14.0
Transport & Communications	4.5	5.0	- 4.1	1.5	1.3	+ 9.5
Distribution/retail	17.7	20.5	- 6.5	2.7	2.6	+ 7.5
Financial Services	4.3	5.5	- 4.8	1.1	1.3	+19.5
Other Services	14.6	19.7	- 4.8	7.4	7.6	+ 5.6
TOTAL	64.5	74.1	- 6.0	22.0	20.2	+ 7.1

*longest period for which compatible series are available

**figures for USA — private sector non-agricultural employment

†change in nominal earnings deflated by consumer price index.

Sources: US Dept. of Commerce “Survey of Current Business” IMF “International Financial Statistics”
D.E. Gazette; Consensus of Employment.

these sectors (particularly in the last eighteen months).

Of these sectors, only employment in financial services has grown almost as fast in Britain as in the USA in recent years whilst employment in distribution has fallen marginally (despite a very large increase in retail spending) and that in "other services" has fallen by 3%. Expressed as a proportion of wages in UK manufacturing, average male wages in financial services are 96%, in distribution 82%, and in other services 86%.

Regulated minimum wages apply to about two-thirds of Britain's employment, with statutory wages council rates applying to another 15%. The effect of these regulations is to deny the least skilled — especially the young — the chance to work at all because the value of their contribution to potential employers is less than their cost, as dictated by the minimum wage rates. At the lower end of the labour market, Britain's social security benefits also set an effective 'floor' to wage levels. Although the results are not so dramatic, the effects of similar "rigidities" in the rest of the labour market are essentially the same.

Conclusions

No confident answer can be given to the question posed in the title of this article but certain pointers stand out. First, the new jobs are unlikely to come in manufacturing; a reduction in manufacturing employment is being experienced in every developed economy. As people become better off, they spend proportionately less of their increased incomes on goods and proportionately more on "services". The downward trend in manufacturing employment must therefore be expected to continue, especially since the impact of semi-conductors — in particular in the form of industrial "robots" — will render labour progressively less necessary for industrial production. Second, the rate at which service employment expands to "fill the gap" depends on the price demanded by labour to work in these sectors. If that price is high, the cost of the "product" to the potential purchaser may be too great; in addition, it may make better sense to use capital equipment rather than labour to supply it. If labour markets are flexible — in particular with regard to pay being more in line with labour's value to the

Table 6

Service Employment in the USA: Detailed Analysis (000)*

	1974	(%)	1982	(%)	% Change 1974-82
Hotels etc.	919	(5.9)	1158	(5.7)	+26%
Business Services	2112	(13.6)	3304	(16.2)	+56%
Personal Services	862	(5.5)	934	(4.6)	+ 8%
Autorepair etc.	666	(4.3)	881	(4.3)	+32%
Motion Pictures	203	(1.3)	214	(1.0)	+ 5%
Amusement etc.	589	(3.8)	812	(4.0)	+38%
Health Services	3867	(24.9)	5814	(28.5)	+50%
Legal Services	316	(2.1)	567	(2.8)	+78%
Education	1159	(7.5)	1317	(6.5)	+14%
Social Services	2193	(14.1)	2702	(13.2)	+23%
Misc. Prof. Services	758	(4.9)	1082	(5.3)	+43%
Private Households	1903	(12.2)	1635	(8.0)	-14%
TOTAL	15,550	(100)	20,420	(100)	+31%

* Full-time and part-time employees.

Source: US Dept. of Commerce "Nat. Income/Product Accounts".

"production process" — there is no need for "de-industrialisation" or labour-saving technology to lead to permanent high levels of unemployment, (as the US experience seems to have demonstrated). Living standards will of course remain very much dependent on manufacturing success and efficiency, since if we are to continue to indulge our relatively high propensity to import manufactured goods, we must have something to export, but the level of unemployment will be determined more by the effectiveness with which we marry the undoubted demand for services — both those traded internationally and those that are not — with a willingness to accept realistic levels of pay for supplying them.

u MASTER
OPS



*Il Presidente
del Consiglio dei Ministri*

Roma, 18 Gennaio 1985

**PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T8AB/85**

Eccellenza,

mi riferisco all'invito formalmente esteso al Suo Paese a partecipare alla Conferenza che si terrà il 10 e 11 aprile p.v. a Venezia sul tema "Innovazione tecnologica e creazione di nuovi posti di lavoro".

Sono lieto di comunicarLe che le risposte sin qui ricevute sono state largamente favorevoli all'iniziativa che concerne un tema di alta priorità nell'attenzione delle nostre Società e delle istanze internazionali di collaborazione multilaterale.

Come Le avevo preannunciato ho fatto predisporre una nota di riflessione che suggerisce traccie utili per lo svolgimento del dibattito e che sottopongo alla Sua attenzione.

Una partecipazione attiva del Suo Paese alla Conferenza accrescerà il contributo che dai suoi lavori potremo trarre per quelle azioni necessarie a conciliare sempre meglio l'esigenza dell'innovazione e dell'ammodernamento tecnologico con la promozione dell'occupazione del progresso sociale, anche nell'interesse della stabilità delle relazioni economiche e politiche internazionali.

Con i migliori saluti.

S.E. Margaret Thatcher
Primo Ministro del
Regno Unito di
Gran Bretagna e Irlanda del Nord
L O N D R A

B. Cury

From: Signor Bettino Craxi President of the Italian Council of Ministers

To: The Rt. Hon. Margaret Thatcher, MP.

Date: Rome, 18th January, 1985.

ROUGH TRANSLATION

I refer to the invitation formally extended to your Government to take part in the Conference on the subject "technological innovation and the creation of jobs" which will be held in Venice on the 10th and 11th April next.

I am glad to inform you that the answers so far received have been largely in favour of this initiative which deals with a subject of the highest relevance both for our countries and for the international institutions involved in multilateral cooperation.

As anticipated, I am enclosing for your consideration the text of a document which should represent a useful basis for the debates.

Your Government's active participation to the Conference will undoubtedly contribute to the conclusions that from its discussions we will be able to draw with the aim of reconciling the objectives of technological innovation and modernization with the promotion of new jobs and social progress, also in the interest of stable political and economic international relations.

With my warmest regards.

Bettino Craxi



Presidenza del Consiglio dei Ministri

DEPARTMENT OF ECONOMIC AND SOCIAL AFFAIRS

Ref.: International Conference on Technology and Employment
(Venice, April 10-11, 1985).

1. BACKGROUND

At the London Summit Meeting the 7th and 8th of June 1984, the Italian Government extended an invitation, which was accepted, to a Conference on the subject of technological innovation and employment to be held in the spring of 1985.

Such an undertaking is in line with the conclusions of the Versailles Summit (June 1982) and with the reports on "Technology, Growth and Employment", submitted in Williamsburg and London by the Working Group of high-level representatives of the seven governments and ^{the} European Community.

"As unemployment in our countries remains high, stated the declaration of the Seven in London, "we emphasize the need for sustained growth and creation of new jobs. We must make sure that the industrial economies adapt and develop in response to demand and to technological change. We must encourage active job training policies and removal of rigidities in the labour market, and bring about the conditions in which more jobs will be created on a lasting basis, especially for the young. We need to foster and expand the international trading system and liberalize capital markets".



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All unemployment is wasteful. As extensively illustrated by the OECD activity, it has human, social and economic consequences which imply "costs" that no government should ignore. When unemployment is concentrated among youth and is of long-term, as in the current context, these consequences are even more serious: those to whom access to the mainstream of society is denied might well become permanently estranged from it.

Actually, technological innovation, output and employment growth are not independent. The interrelationship between technological change and employment growth was discussed in Paris at a OECD conference of Labour Ministers held in February 1984 on the subject of "Employment Growth in the Context of Structural Change".

Also in February 1984, the EEC Commission submitted a paper to the Council of Ministers containing a number of proposals for a Community strategy which - in parallel to initiatives in the field of innovation, research and development - provides a positive answer to the threats and challenges posed by the technological change to social structures and to the way of living.



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While it is true that technological change constitutes one of the principal and necessary impulses for economic and social change, it is also true that any change entails social costs which must be kept in balance with economic gains. Indeed, the success of the main scientific and technological innovations is often directly related to a positive attitude by public opinion.

This is the sense of the plea made by President Mitterrand at the Versailles Summit: "Technological innovation, cannot spread in a context of unemployment which creates a climate of pessimism, generates rejection and destroys confidence in social and economic advance. This is why the struggle against unemployment is an absolute priority for us".

Furthermore, the economic and social events of the last decade provide sufficient evidence that technological change is mostly resisted in those countries which are unable to control the transition from declining economic activities to new productive developments. Elsewhere, the consequences are exactly the opposite.



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2. TECHNOLOGICAL CHANGE AND THE DYNAMICS OF EMPLOYMENT IN THE
DECADE 1985-1995.

Western economies reacted to the 1973 and 1979 oil shocks in different ways: policies often diverged or conflicted, thereby leading to disparate and contradictory results.

Common to all countries, however, was an acceleration of technological change that affected the economy and its mechanisms, which eventually influenced social values and structures.

As a result, a major political problem confronting our governments in the present transition process is how to reconcile the objectives of full employment with acceleration and, perhaps, with intensification of the modernization of productive structures and social relations systems.

This latter process, however, seems to produce cumulative, and thus accelerating, effects which are quite often unprecedented and difficult to predict: e.g. new technologies (mainly microelectronics and information) show effects, especially as to their dimension and nature, which suggest a substantially different impact as compared to past innovations - though past innovations may have been just as revolutionary.



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This can be attributed, among other reasons, to differences
in:

patterns of diffusion;

the ways in which the structure of productive systems is
influenced and modified;

the impact produced on labour markets and employment;

the interrelationships and integration of factors (on
economic, socio-cultural and institutional grounds).

Other important factors suggesting substantial influences
on labour markets are:

A. New technologies are based on the labour-saving principle
as well as reduced consumption of raw materials and energy. Nevertheless,
with respect to many other past innovations, they also imply capital
savings (in terms of equipment, installations, and labour required for
the production of capital goods). These characteristics could well act
to reduce the compensatory effects of the technological multiplying
factor.

B. New technologies require a shift of emphasis in investments
from fixed capital to "human capital". However, a number of possible
obstacles might hamper the supply of "new skills" and cause a qualitative
imbalance between the demand and the supply of "new skills", with the



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consequences of slowing down the pace at which new professions replace old ones.

C. Not only the diffusion of innovation spreads faster than in the past throughout the production system, but time lags are observed here in the processes of job destruction and creation. The time lags, were they to become important, could result in imbalances, of growing size, in labour markets which may weaken the "virtuous circle" between innovation, growth, and employment. Another possibility is that these negative effects, if not countered through suitable policies, could start a "vicious circle" and provoke resistance arising from social costs that society can only bear if adequate policies exist or are adopted to protect individuals and families from them.

D. Another factor that should be considered is the possibility that, unlike the past, the diffusion of the new technologies may occur under conditions of higher protectionism and poor co-operation between nations. In this context, companies would face tougher competition in expanding their market shares or hold onto their respective positions. Decentralization of production at the international level becomes in this instance increasingly profitable.



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"Cumulative" advantages, for countries which produce innovations and possess new technologies, also become more important. This raises the following issue: given the existing gaps between the countries, including the employment effects of new technology, which possibilities exist that gaps widen as a result of longer delays and higher social costs in weaker countries?

If it is undeniable that new technologies can lead to significant improvements ⁱⁿ the ways of living and, especially in the working conditions, no automatic mechanism or universal guarantee can be devised to accrue benefits according to patterns that are the same in the different countries.

Differences between countries can depend on:

- a) differing point of departure, e.g. in productive capacity and levels of know-how; and, in particular
- b) different cultural and institutional conditions which can affect the responsiveness and consistency of public policies.

Hence, the importance to grasp how in the long term the various forces of change - i.e. the policy of industrial enterprises, the reaction of social partners and public policies - interact and "melt" to produce what will appear as the transition pattern.



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For each society, the net balance between the costs and benefits of new technologies will to a great extent depend on the capacity to manage and influence the transition to the new structures, i.e. the timing of the various waves of technological innovation, including changes in processes and production methods, modifications of public and private behaviour and of the institutional contexts.

It can be expected that the availability of the "new skills" mentioned above will play a central role. In particular, this applies to the capacity to renew institutions and devise a set of consistent policies which can favour rather than hinder technological and social change.

Possible changes in public policies seem to include deregulation and, in particular, the replacement of rigid rules with more composite and flexible ones, both at the national and international level. Nevertheless, the ways such changes will occur are yet to be determined.

If new technologies require profound changes in the attitude of both business and labour, they also call for new stances by public bodies as well as new policies to smooth transitional hindrances and new forms of international co-operation.



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Nobody, however, seems to have doubts that an essential requirement for a successful transition is a greater degree of flexibility. This will help to muster the changes which are underway, while preventing undesired constraints and regulations from hampering this process and bring it to a total paralysis.

Nonetheless, there still exists the risk of erroneous decisions.

As a consequence, the social burden of transition may increase especially in connection with decisions which have a nation-wide application.

3. MAJOR ISSUES FOR DISCUSSION AT THE VENICE CONFERENCE

To conclude, the main issues for the 1985-1995 decade can be formulated as follows:

how can our societies sustain and guide the modernization process and expect successful results without meeting explosive and unbearable problems such as increasing structural unemployment?

to what extent can individual countries successfully sustain the "transition" without the fruitful support of co-operation measures for promoting development and employment?



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To what extent the lack of co-operation and uncoordinated policies can widen gaps and increase tensions between industrialized and developing countries?

The Italian Government is hopeful that the Conference of Venice will provide a forum where views and experiences can be offered and discussed ^{and} answers found to the afore mentioned questions. The Conference will be attended by participants from Western countries, OECD,EEC,ILO, and Trade Unions and employers' associations, represented by TUAC and BIAC.

The programme, as well as other organizational aspects are being finalized by the Italian Government in contact with the afore mentioned participants.

The Conference should deal with the following main issues:

- (i) The effects of technological change on employment and on the creation of new jobs.
- (ii) Policies to foster and guide technological innovations, and related issues of international co-operation.
- (iii) Social measures which have been adopted or would seem suitable to attenuate the costs of transition, and their possible harmonization at the international level.



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- (iv) The formation of "human capital", innovation in schooling and educational curricula, vocational training, and other measure. facilitating the acquisition of new professional qualifications.

THE PROBLEM OF UNEMPLOYMENT

by Patrick Minford

(University of Liverpool)

Introduction

We have in Britain as in other parts of Western Europe unacceptably high levels of unemployment. Nor is there any realistic prospect under present policies that they will fall much from present levels. There are economists who argue that a major degree of 'reflation' - fiscal and monetary expansion, accompanied, some of them add, by import controls, could bring down unemployment.

This paper argues first that these economists are wholly wrong. Reflation only causes inflation and has a brief effect, if that, on unemployment. Import controls cause inefficiency and feather-bedding of protected industries, while simultaneously penalising other industries through associated rises in the exchange rate.

The paper is not merely negative however. There is a way to get unemployment down. This way involves eliminating obstacles to rising competitiveness. Only through raising competitiveness will new, viable jobs be created. The obstacles include union monopoly power, a rigid housing market, excessively high taxes and other penalties in the use of labour, and over generous social security benefits. To remove these obstacles will take a major effort of government will-power because of the vested interests built up to protect them over several decades with previous governments' connivance and encouragement.

The alternative is that society will have to live with high unemployment as it already has been doing to

an increasing degree for the last decade. Unemployment in the present welfare state is generously cushioned by the social security system and there are apparently opportunities for unrecorded part-time work in the shadow economy which further ameliorate the condition of unemployment. Unemployment is therefore unlikely to cause major social unrest. It will however represent a major waste of human resources. This waste must be minimised. Society clearly will wish to protect its less fortunate members. But it must find ways of doing so that do not encourage unemployment. This paper first examines the theory of unemployment, then reviews the relevant facts for the UK. Finally it suggests some specific measures for the government to adopt.

The theory of Unemployment

The economy is a system of markets in which supply and demand are balanced by relative prices. An excess supply of tea is eliminated by a fall in the tea price, and excess supply of labour is eliminated by a fall in the price of labour, wages. How then can unemployment persist in this system?

In just the same way as an excess supply of tea could persist - through intervention to prevent its relative price falling. For example if the Ceylon and Indian tea planters were to set a minimum price, then an excess supply at this

price would not be eliminated; instead they would have to buy it.

So too if the government sets a minimum wage, to be paid to people regardless of labour market conditions, then excess supply of labour at this minimum wage will not be eliminated; instead they would have to buy it. They may do this in a variety of ways: by preserving uneconomic jobs in nationalised industries, by hiring them into the public service, or by paying social security benefit. The uses to which this labour will be put will similarly vary; but in general it is not as productive as the wages paid for it, because if it were then the government would not have to buy it. Much of it will be registered as 'unemployed'; the rest of it will be 'underemployed'.

If government sets a minimum wage unions will react with perfect rationality - by using their monopoly power to mark up union wages over this minimum, which will tend to be the ruling price in the non-unionised sectors of the labour market. This union mark up - which in the U.K. appears to be of the order of 25% - reduces the demand for labour. So the excess supply of labour is further increased.

If the minimum wage is a national one, regardless of excess supply in each region, there may be one region whose products and labour are in high demand and where therefore excess demand is eliminated by a rise in wages, while in another region whose products are in low demand excess supply of labour cannot be eliminated because wages are

at the minimum level. There will therefore be unemployment black spots alongside areas of full employment.

This is where housing comes in. The more cheaply a family can leave their house and set up house elsewhere, the less overall unemployment. For the wages in the areas of full employment will tend to be higher than those in the high unemployment areas, so that people will move, so both eliminating the disparity of wages and reducing the unemployment in the black spots.

We have seen how the setting of minimum living standards by government, backed up by the will to hire people or pay them benefits at this minimum can create unemployment. Union power and rigidities in the market will interact with this government intervention to raise unemployment further.

How much unemployment is created by any given minimum wage level, depends on the competition from abroad for the products made in the U.K. The higher wages are pushed by the minimum wage, the less of our goods can be sold in world markets. As we sell less abroad, so demand at home must fall in order to cut imports and keep our trade in balance. As both foreign and home demand fall, demand for labour falls with them and excess supply of labour is created at the minimum wage.

It is not therefore the minimum wage as such that matters, but the ratio of our unit labour costs to competitors'. The more prosperous our competitors the more in other words we can afford to pay ourselves without causing unemployment. But the converse holds: as world prosperity declines, as

our competitors gain in efficiency, as new competitors emerge, our wages must fall or our efficiency rise to avoid rising unemployment.

All this has ignored frictional unemployment. Much unemployment simply reflects people leaving old jobs and finding new jobs after a period of search. The average unemployment from this source is equal to the number of people each year who leave or lose jobs and later find new ones (labour turnover) times the average time they spend searching (search time). For example in the U.K. approximately 4 million people become unemployed every year and find new jobs. Excluding those - perhaps as many as $3/4$ million at present - whom we can regard as permanently unemployed for reasons we have discussed above, these people may spend an average of about 4 months searching. In recessions they will spend longer as wages drop relative to expected future wages. At present unemployment of this sort stands at around $1\frac{1}{2}$ million. However, this frictional unemployment is also influenced by government intervention, because the social security and tax system subsidises search, particularly in the early months of unemployment in most countries. For example, in the U.K. the earnings related supplement introduced in 1966 (now being phased out) raised benefits up to about 70% of net of tax earnings for most people more or less regardless of their earnings, for the first six months of unemployment. Lower paid workers do not benefit from this supplement, but only because for them the basic benefits

with supplementation are already in general higher than this relative to their net of tax earnings.

Money Supply, Devaluation and Budget Deficits

It used to be widely believed following the teaching of Lord Keynes that governments could reduce unemployment permanently by running budget deficits and printing money in sufficient quantities to prevent interest rates rising ('reflation'). This it was argued, would raise demand for labour at the going level of wages, so lowering excess supply and unemployment. However, Keynesians recognised realistically that this could not work alone in an open economy like the U.K. under fixed exchange rates because the trade balance would go into deficit as demand rose above a certain point. This balance of payments constraint therefore limits the size of budget deficit permissible in an open economy under fixed exchange rates.

To loosen this constraint, Keynesians proposed that reflation should be accompanied by devaluation either by changing the exchange rate in large amounts or by floating exchange rates. Unfortunately, we know this cannot work if minimum wages fixed by the government are indexed to prices, as they must be since they are intended by society to maintain the real living standards of the lower paid. For all wages and prices rise in the same proportion as the devaluation. To give a simple arithmetical example, suppose the devaluation is 10% and imported and exported goods contribute 30% to costs and prices. Initially, the devaluation raises prices by 3%. Wages because indexed

then rise by 3%, raising prices by a further 2.1%.

This raises wages by 2.1% and so on in an infinite series, the effect on wages is in the end $\sum_{i=0}^{\infty} 0.7^i (3\%) = \frac{3\%}{1-0.7} = 10\%$. Consequently, prices rise by 10% also.

In the short run while this process is running its course, wages will drop relative to our competitors' and this may increase our sales abroad and so our national output if suppliers move fast enough. In the short run unemployment would fall. But as soon as the process has run its course relative wages are back to where they were, and with them exports, output and unemployment. There will therefore be no permanent reduction in unemployment this way.

As for the short run, there are two problems. First, the policy works by raising prices and wages. Secondly, as people come to realise that the long run effect will only be to raise wages and prices, they anticipate these effects and, to preserve the prospective purchasing power of their earnings, they raise their own wages and prices in advance. The result is of course that the whole process speeds up and the short run may disappear altogether - this is so-called 'rational expectations'. These two problems mean that a policy of raising the budget deficit and devaluing will not only cause inflation with no fall in unemployment in the long run, but will only in the very short run, if then, succeed in reducing unemployment while stimulating inflation very rapidly, once the public has grown wise to the nature of the process.

This difficulty has now been widely recognised. For example, even the Cambridge Economic Policy Group do not now favour devaluation because of its inflationary effects,

though they still believe that the public can be fooled sufficiently after devaluation to get real wages and unemployment down for some period of time.

Some Keynesians - e.g. the NIESR - favour incomes policy as a means of making devaluation reduce relative wages. Yet analysis suggests - as does extensive U.K. experience - that incomes policies must break down after a time. Where minimum wages are indexed this is most obviously so. In our earlier example, incomes policies would mean that initially, the minimum wage would rise 3% but that all other wages would not be allowed to change. Yet the markets dictate that then other wages must rise in line, for they are determined by the minimum wage! The government can withstand these pressures for a time, but, unless it is prepared to suspend the market economy altogether, it must give way in the end.

The conclusion is unavoidable. A decision by society to fix a minimum real wage will cause unemployment which no amount of reflation or devaluation can eliminate. Instead the policies will only cause inflation and rapidly at that with little gain in lower unemployment even for a brief period.

The last hope of the Keynesian is tariffs or import controls to accompany reflation. Unfortunately, these can work no more effectively than devaluation in lowering unemployment or avoiding inflation, and into the bargain they create inefficiency ('distortions') in resource allocation. The reason is simple. A tariff is simply a partial devaluation. Minimum wages must be raised to

compensate for it as much as with a devaluation. As they are raised, they penalise the export industries as well as the import - substitute industries helped by the tariff.

Pursuing our previous example, suppose now that half of the contribution to prices of traded goods comes from exports, half from imports - implying 15% from imports, 15% from exports. Say a 20% tariff on imports would do the same for net trade as a 10% devaluation. This would now raise the price index by 3% as before. Minimum wages would rise in consequence, ultimately by 10%; so would export prices. Overall competitiveness at the end of this process would be unchanged, real wages would be the same and the only effect would be to alter the balance of competitiveness in a trade reducing way - with exports now less competitive and import substitutes more competitive, each by 10%. Of course, things would not work out as exactly self-cancelling as this; the general point however remains that there is no substantive gain from this process. On the contrary, while statistically it is possible output will increase e.g. if the goods with high elasticities were chosen for tariffs - the distortion to resource allocation involved will lower welfare.

The Facts for the U.K.

This account of the theory can be summarised as follows:

1. The trend in unemployment is the result of factors which raise real unit labour costs above competitive levels. These factors are largely the responsibility of Government.

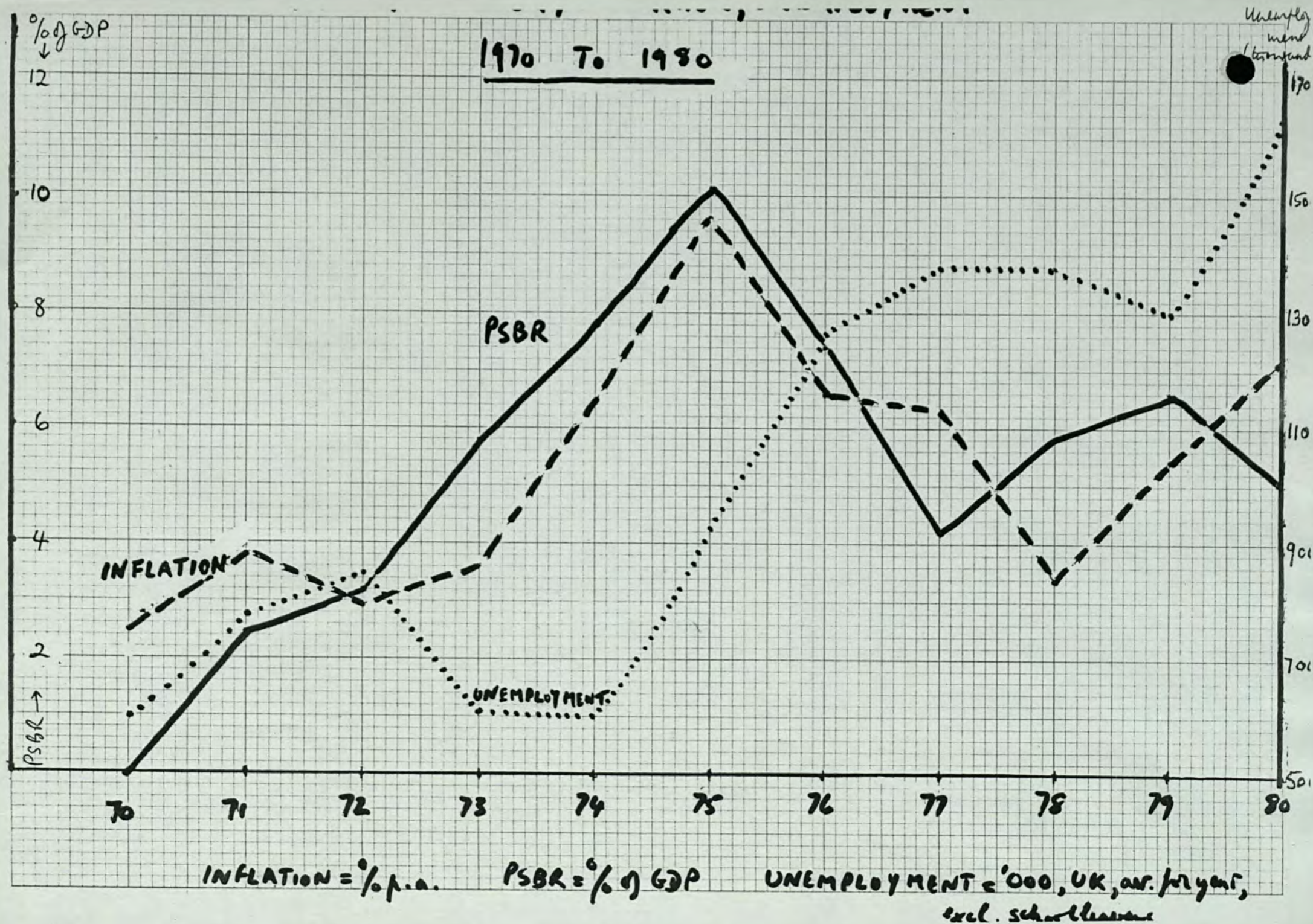
2. Reflation causes inflation and at best only a transitory drop in unemployment.
3. Devaluation and import controls cannot make a contribution to reducing unemployment, apart possibly again for a transitory impact; import controls on the contrary introduce damaging distortions.

What do the facts show for the U.K.? Before I answer that question, I must issue a public health warning in the spirit of the famous remark about 'lies, damned lies and statistics'. It is usually possible to fit any theory to the past, provided one uses sufficient ingenuity in providing ad hoc additions or modifications of the theory. This is the reason why it is so difficult to settle topical controversies in economics.

Nevertheless, controversies do eventually get settled. The way they do, as Kuhn (1970) and Lakatos (1970) have suggested, is that the ad hoc modifications necessary to the one theory relative to those necessary for its rival, in accounting for the facts, become numerous enough to discourage new and even old adherents.

I am not going to be foolish enough to say that Keynesian theories cannot be made to fit the facts. Furthermore there are still plenty of Keynesian economists about, in the U.K. and elsewhere. But, the facts do not any longer fit easily into a Keynesian framework, whereas a new classical approach can explain them persuasively.

First the facts on reflation, inflation and unemployment (Chart 1). In the U.K. up to 1971, there were fixed exchange rates; virtually all macroeconomists are agreed that under



these a government can pursue 'stop-go' policies without more than temporary inflationary consequences because the world monetary environment dictates domestic inflation. It is our experience since 1971 when we started to float that is relevant, for under floating a country's inflation rate is domestically determined. A Keynesian model predicts that reflation will cause a persistent reduction in unemployment and a slow and modest rise in inflation except in circumstances of 'full employment' (typically defined in the U.K. as $\frac{1}{2}$ - $\frac{3}{4}$ million unemployed). A new classical model predicts that reflation will cause only a transitory reduction in unemployment and a rapid, substantial rise in inflation, whatever the unemployment rate.

In 1970/71, the budget was balanced. In 1975/76, the PSBR was 10% of the GDP. In 1979/80 it was 5½% of GDP. Unemployment rose steadily through this decade from around $\frac{1}{2}$ million to about 2½ million today. It dropped in 2 twenty month episodes, 1972-73 and 1977-78, respectively by 350 and 100 thousand. The first was the Heath/Barber boom, the second the Callaghan/Healey pre-election boom. Immediately after each unemployment rapidly resumed its upward trend, taking respectively 18 months and 6 months to recapture its previous peaks. These are surely rather transitory reactions.

Meanwhile inflation rose from 6% in 1970 reaching a peak of 25% in 1975, falling back after Mr. Healey's 'IMF measures' and then returning to a lower peak of 18% in 1980 following the Callaghan/Healey boom. These surely are rapid and substantial reactions.

Suppose it was accepted that the facts favour more closely the new classical than the old Keynesian theory. Do they favour the new classical against the neo - Keynesian or eclectic theories, such as motivate the Treasury or the LBS or the NIESR models? Here we get onto difficult ground; the problem is how 'neo' is your Keynesian model, for it is possible to change the models in ad hoc ways to such an extent that they get quite close to the predictions of new classical models. However, the more they are modified, the more the original theory is lost so that it is not clear what is being tested in these models. Since these models are largely devices for ensuring that their proprietors can make defensible forecasts, it seems doubtful to me in fact that any one coherent theory is embodied in them. In particular the LBS model has clearly shifted a long way towards a new classical position[†]; and the Treasury model is following it to an increasing extent.

Secondly the facts on devaluation (Chart 2) and import controls. During the 1970's there have been a series of depreciations, from 1970 to 1978 the pound dropped against the average of other currencies by 37%. The drop was particularly rapid in 1972 and 1973 (13%) when our inflation rate had not yet escalated sharply; so it therefore raised competitiveness. It was welcomed then as an accompaniment and help to the 1972 reflation. It failed with that reflation to halt the permanent rise in unemployment; it had only a transitory impact as we have seen. The rise in competitiveness was also transitory because inflation quickly eroded the effect. Subsequent depreciations up to 1978 largely reflected our inflation rate

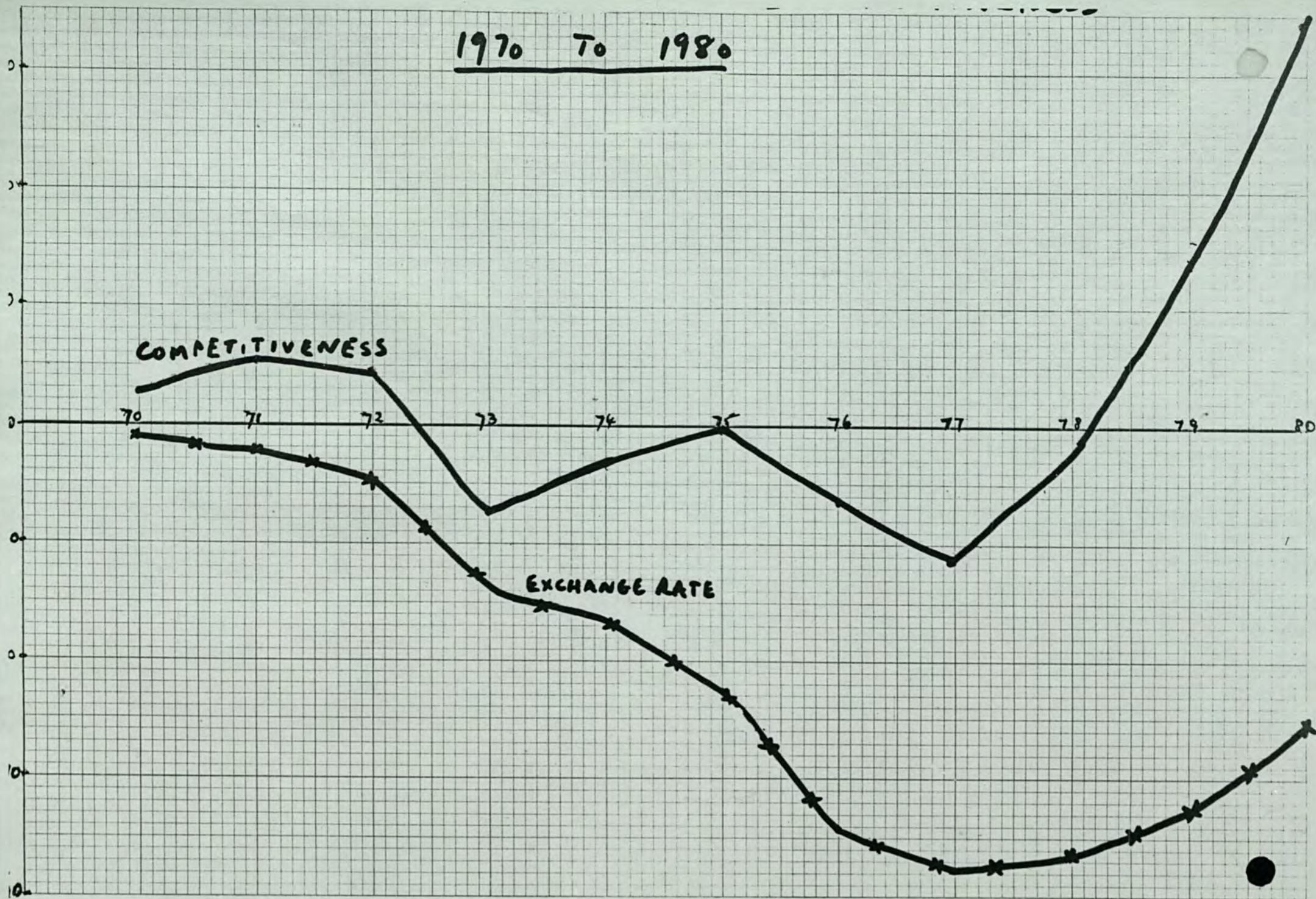
[†] See for example the analysis by the director of the LBS Centre for Economic Forecasting, Dr. Alan Budd.

1970 To 1980

COMPETITIVENESS

EXCHANGE RATE

EXCHANGE RATE = EFFECTIVE (Trade-weighted) Dec. 1971 = 100 . COMPETITIVENESS : 1975 = 100 .
(Relative unit labour costs)



and so did not distort competitiveness. Since 1978, the pound has appreciated in spite of our higher inflation rate and so has lowered competitiveness. This has probably contributed somewhat to the rapid rise in unemployment since 1980; these effects too will be transitory judging by the CSO's leading indicators and other signs that the economic cycle is close to its turning point.

As for import controls, they have been creeping steadily upwards during the 1970's. We now have voluntary or mandatory agreements to restrict imports of a variety of textiles, of Japanese cars and of shoes, to mention the most obvious; in 1970, the agreements extended to little more than cotton textiles. The effect of such a creeping process cannot clearly be evaluated; but there is certainly no evidence that they have affected the rise in unemployment in any way. There is clear evidence on the other hand that we are paying above the going international price for our Japanese cars (the same car in the U.S. sells for substantially less than here). Is this the worst of all worlds?

I come last to the evidence on unemployment. The Keynesian theory has to account for the rising trend in unemployment in terms of inadequate aggregate demand. Yet we have had a rising PSBR in the 1970's, so the public contribution to demand has hardly been inadequate.

This leaves world demand; there has certainly been a slowdown in the growth of world trade in the 1970's, but the Keynesian theory suggests that this should not be a problem; reflation, accompanied by devaluation or import controls, should

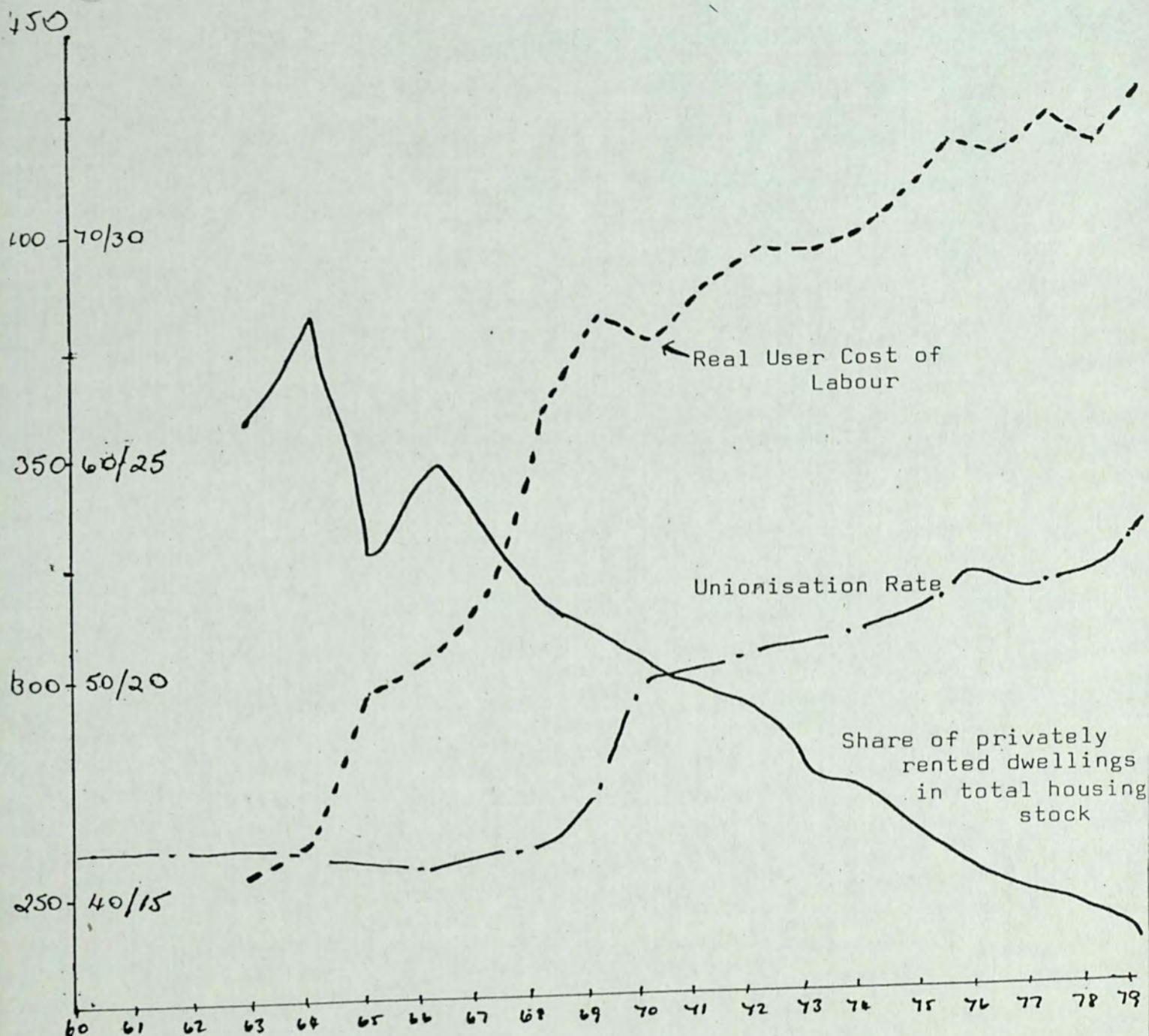
be able to re-employ the resources freed by export industries. This it has palpably been unable to do, in spite of substantial reflation and devaluation, with creeping import controls.

On the other hand a number of factors making for rising unemployment in the new classical view have been present in the last decade and a half (Chart 3). Real social security benefits grossed up for employers' and employees' taxes have risen 65% in that period ($3\frac{1}{2}\%$ per year). There has been a rash of legislation imposing other costs on employers such as redundancy payments, industrial tribunals, health and safety regulations. Unionisation has risen from 42% to 54% of the labour force, and the union wage mark-up is widely estimated to have risen from around 12% to around 25%. The share of private rented dwellings in the housing stock has fallen from 25% to 13%. Finally all these unfavourable trends have unwound themselves against an increasingly tough world environment in which our new competitors, the developing countries, have maintained rapid growth rates against a slowing world growth rate (Beenstock and Willcocks, 1980). What surprise then that our increasing lack of competitiveness has shown up in steadily rising levels of unemployment and underemployment?

These are the facts that have caused many economists, once Keynesians, to move towards a model close to the new classical view. That they do not go the whole way is understandable; it is difficult to make the intellectual leap

CHART 3

SOME INDICES OF LABOUR MARKET INEFFICIENCY



SCALES:

For Real User Cost

250 - 450

For Unionisation Rate

40 - 70

For Share of Dwellings

15 - 30

of abandoning wholesale the earlier suppositions. The current neo-Keynesian model, as I have already argued, is theoretically ambiguous; but it should be regarded as a staging post in an intellectual conversion.

More rigorously, some of us have attempted to build a model which, while remaining true to the institutional features of British economy, embodies rational expectations and follows the logic I have described of equilibrium market behaviour. This, the Liverpool Model, fits reasonably well the facts of the post war U.K. environment as is documented elsewhere (Minford ,1980).

In particular, on unemployment this work suggests that the rise in union power since the mid 1960s is responsible for as much as one million of current unemployment. It also suggests that every 10% rise in real social security benefits to the unemployed raises unemployment by some $\frac{1}{2}$ million. Estimates of the effect of the housing distortions are not available but regional disparities in unemployment suggest it is significant.

Policy measures:

The government must regain momentum in these areas. There must be further legislation to curtail and over a period eliminate the ability of unions to raise relative wages and enforce restrictive labour practices. But I would also suggest a series of cuts in real social security benefits available to the employable, accompanied in so far as limits on public sector borrowing permit by cuts in income tax rates and national insurance contributions. Every 10% reduction in real benefits would save directly up to £2 billion per year in 1981/82 prices; given that the PSBR is not exceeding the targets

of the monetary plan for other reasons this would be available for tax cuts. It would clearly be sensible to concentrate these cuts on taxes and National Insurance contributions levied on lower-paid employees in order to re-inforce the incentive effects of reducing benefits.

Though such measures would in their direct impact hit the least well-off, the indirect effects would be to lower real wages generally and increase job opportunities. Therefore in their full impact, they reduce the real wages of those in employment as well as the unemployed and spread employment to the unemployed. Furthermore, the additional tax revenue obtained from the additional employment would also be available for redistribution in the form of tax cuts in the order of £1½ billion at 1981/82 prices for every 10% cut in real benefits. Provided the tax cuts are used to make disproportionately large reductions in the tax burden on the lower paid then it should happen that those unemployed who become employed will obtain higher real incomes and welfare than before, as should those in lower paid jobs on an after tax basis.

Those who remain unemployed will be worse off, but their decision to remain unemployed will be a voluntary one; the question society must ask is whether the subsidisation of the unemployment decision is worth the cost in output and employment. In a free society it is impossible to force people on benefits to work, even on 'social priority' schemes; the unemployed regard such schemes with an enthusiasm reserved for labour camps. There is therefore a 3 sided choice between low-income subsidies, freedom and resource waste. It is not possible to say how society will resolve this difficult choice, which faces virtually all Western economies at the present time and is at its most acute in the Benelux and Scandinavian economies besides our own. One can only draw attention to the costs and benefits. The present suggestions however, seem to constitute a minimum response

These suggestions will no doubt strike many as being 'politically impossible', even 'naive'. But much the same was said of policies to control the money supply in the early 1970's, and it has taken nearly a decade of inflationary experience to convince our leaders that the politically impossible was necessary in the monetary area. As we face the prospect of permanent unemployment of the order of 2 million, which cannot be eliminated by 'reflation', measures such as these, 'tough' and unpalatable as they may sound, are the only way to create the necessary jobs to bring unemployment down.

While any forecast of the effects of such an alteration in policies must be inherently uncertain, estimates based on the Liverpool model suggest that a combination of a 15% cut in real social security benefits to the employable and a reduction of the union mark-up to its level in the mid-1960s,

each spread over 3 years from 1982 to 1984, would reduce unemployment in the UK by around 1½ million by the mid 1980s. Cuts in tax rates associated with the resultant saving to the Exchequer would increase this estimate significantly. Can we afford not to price jobs back into the market by such measures?

Policy Conclusions

The broad policy conclusions are clear:

1. Public Sector Borrowing and money supply growth must be brought down, as far as possible along a pre-announced path, to eliminate inflation.

2. To tackle unemployment we must in particular lower the penal marginal tax rates created at the bottom end of the income scale. Given constraints on public borrowing, this will involve some cut in real benefit rates. We must reduce the union mark-up and other union restrictive practices. We must free the housing market. In general we must eliminate the obstacles to the creation of viable jobs in the private sector.

In the next 3 years this government still has the opportunity to make good progress in achieving these aims. The recent Budget has restored life to the Medium Term Financial strategy, the best hope of achieving a return to price stability. It is now up to Ministers to turn their attention to unemployment, and find the courage to make the labour market work properly, the other major task which they were elected to perform.

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cc JR



NAPM
Employment Expenditure file

CABINET OFFICE

70 Whitehall London SW1A 2AS Telephone 01-233 3299

From the Minister without Portfolio
The Rt Hon Lord Young of Graffham

The Rt. Hon. Norman Fowler M.P.,
Secretary of State,
Department of Health & Social Security,
Alexander Fleming House,
Elephant & Castle,
London, S.E.1.

14th January, 1985

to Norm.
att **LABOUR COSTS AND EMPLOYMENT** *att*

Thank you for sending me a copy of your letter to Tom King of 21st December in response to his of 5th December.

This is simply to say that I should be glad to join in the discussions which you have with Tom and Nigel Lawson about the employment effects of changes in the national insurance contributions structure. I suspect that employers' willingness to recruit employees is more sensitive to the costs of employing them at lower levels of pay than at higher levels. I hope that it might be feasible to devise a structure of contributions which is neutral in terms of total Government receipts but has a beneficial effect on jobs.

I am copying this letter to Nigel Lawson, Tom King, Norman Lamont, John Redwood and Sir Robert Armstrong.

Lawson

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15 JAN 1985



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DEPARTMENT OF HEALTH & SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

The Rt Hon Tom King MP
Secretary of State for Employment
Department of Employment
Caxton House
Tothill Street
LONDON
SW1H 9NF

cc Mr. Phillips
Mr. Murphy
Mr. Bick
Mr. Hoppell
Mrs. Baskell
Mr. Ward
Mr. Smees
Mr. Montague

21 December 1984

Dear Tom.

LABOUR COSTS AND EMPLOYMENT

You copied to me your letter of 5 December to Nigel Lawson about your Employment Exercise Group considering the employment effects of changes in the national insurance contribution structure.

I do, of course, fully recognise that any changes in present arrangements must take account of the crucial importance of creating new opportunities for employment. That is why I have repeatedly stressed in recent speeches that a major principle underlying my current review of social security is the removal of barriers to employment. And, as you will know, I have promised in the House that the review will look at the national insurance system, including the contributions structure.

But we must take account of the reasons for the present national insurance system. This rests on two principles - establishing and limiting people's rights to certain benefits, of which the retirement pension is the most important. I am in sympathy with your aim but we cannot deal with one issue on national insurance in isolation.

I should be very happy to discuss this with you and Nigel Lawson, as you suggest. It would be best to do so when I can give you a clearer idea of the conclusions which I have drawn from my review of social security.

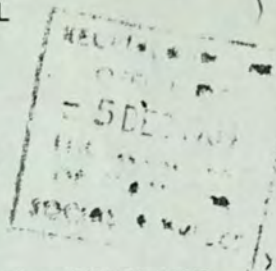
I am copying this letter to Nigel Lawson, David Young, Norman Lamont and John Redwood, and to Sir Robert Armstrong.

Yours

NORMAN FOWLER

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Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Great George Street
LONDON
SW1

5 December 1984

Dear Nigel,

LABOUR COSTS AND EMPLOYMENT

As you know, my Employment Exercise Group recently considered a technical note on the employment effect of changing the structure of National Insurance contributions.

In discussion of the note, the Group felt that the particular option chosen had a number of substantial disadvantages which might make it difficult to apply in practice. They were however impressed by the potential employment gains which could be achieved by lowering the cost of labour at the lower end of the wage-scale, provided that there was no large transmission into wage increases. The Group felt that ideas of this kind were worth further careful examination to see whether they might form an additional element in our overall policy approach towards the economy and employment.

The Group were of course fully aware that because of the general budgetary and National Insurance issues involved further examination of such proposals would be for you and Norman Fowler. They therefore suggested I might write to you both, drawing your attention to the Group's discussion and suggesting that this might be an area worth looking at. You will know from discussions in the House that changing National Insurance contributions is a live issue in the Party, and I am sure it would be useful to consider the possibilities.

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I would of course be happy to discuss this area with you and with Norman, to whom I am copying this letter. Copies also go to David Young, Norman Lamont and John Redwood in the No 10 Policy Unit.

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SECRETARY OF STATE'S OFFICE	
Alone	
pl.	Mr Leppell, Ministers
cc	Para Sec; Mr Legg, Mr Bennett, Mr Smees, Mr Montagu, Mr Ward, Mr France

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16 JAN 1935



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C. J. R.

PRIME MINISTER

EMPLOYMENT EXERCISE

*in meeting
folder*

We will be discussing at our meeting later today the paper attached to the letter of 3rd January from Tom King's Private Secretary to yours. This refers in Chapter 5 to the options for extending training provision for 16 to 18 year olds which are currently being considered by MISC 107.

It may be helpful to you and other colleagues to have by you the attached note, prepared by the Enterprise Unit, summarising the Group's discussions to date and the kind of scheme it seems likely to come up with. I should emphasise that the Group has yet to consider its draft report and Departments are not therefore committed to specific proposals. I think, however, that the note gives a fair and useful indication of thinking within the Group as a whole. I am sorry that, due to my absence from the office, I was not able to circulate the note earlier.

I am copying this to Nigel Lawson, Keith Joseph, Peter Walker, Patrick Jenkin, Norman Fowler, Norman Tebbit, Tom King, John Redwood and Sir Robert Armstrong.

Ref

Lord Young

14 January, 1985

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EDUCATION AND TRAINING AT 14 TO 18: A NEW INITIATIVE

An inter-departmental group was set up in October under the chairmanship of the Minister without Portfolio to examine possible changes in existing provision for 14 to 18 year olds. The Group (MISC 107) has made considerable progress towards outlining proposals for developing more coherent arrangements for this age group and expects to report its conclusions to E(A) next month. This note is a short summary of the Group's thinking and likely conclusions.

2. There is a strong case for a further initiative on 14 to 18 year olds:

- (a) despite the substantial numbers of school leavers now receiving training within the Youth Training Scheme, there are still some 200,000 youngsters under 18 who are unemployed at any one time;
- (b) existing schemes including the Youth Training Scheme (YTS), Technical and Vocational Education Initiative (TVEI) and Certificate of Pre-Vocational Education need to be co-ordinated and reinforced so as to produce a better return on the existing investment;
- (c) £200 million a year is currently spent unproductively on supplementary benefit payments to 16 and 17 year olds who are neither employed nor in training;
- (d) the United Kingdom lags seriously behind its major competitors in the standard of training in its work force. This hinders our ability to provide jobs for the future. The UK is the only country in which a majority of young people leave school at 16.

3. Subject to further consideration of costs and how these might be funded, MISC 107 has agreed to recommend a new training scheme that would build on the existing YTS. It would offer two year places for youngsters leaving school at 16 and one year places for those leaving at 17. Like YTS, the scheme would be mainly employer-based. It would also be voluntary in that neither employers nor youngsters would be required to participate in it, and employers would be free to continue to offer normal

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employment outside the scheme to youngsters in this age group. The scheme would however be designed to be comprehensive so that it should be regarded as the normal route into employment for those who chose to leave full-time education.

4. The scheme would not be a "special measure" but a proper training scheme leading to recognised occupational qualifications such as those currently offered by e.g. the City and Guilds of London Institute (CGLI), Business and Technician Education Council (BTEC) and Royal Society of Arts (RSA). All trainees would be expected to aim for a specific qualification. In this sense the scheme would reflect the best features of the apprenticeship system, which has substantially collapsed over the last ten years. MISC 107 will recommend that a working group be set up to examine the existing structure of qualifications and take action to develop new or revised courses where these are needed. It will be important to secure recognition for on-the-job experience and develop skills in assessing trainees' progress.

5. In more detail:

- (a) the scheme would be open to employed and unemployed young people. The aim would be to guarantee places to all unemployed school leavers by September of the year in which they left school (on the lines of the current December guarantee of a place on YTS);
- (b) trainees would receive allowances. MISC 107 is likely to recommend a two-tier structure. If allowances in year 1 were at the same level as the current YTS allowance (£26.25), allowances in year 2 might be, say, £30;
- (c) it is estimated that the scheme would provide for some 420,000 young people each year. This compares with the current intake to YTS of 330,000 (numbers are adjusted in each case to relate to individual entrants, rather than numbers recorded as "starting" in the scheme, to eliminate double counting). The total size of the scheme would however be more than twice that of YTS, because the majority of trainees would stay for 2 years instead of 1;

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- (d) costs would depend critically on the scale of employer contribution, together with any offset from savings from other programmes. If employers were prepared to fund 60 per cent of the trainee allowance - in recognition of the scheme's contribution to meeting the costs of training their existing employees and the "value added" by additional trainees - the gross cost to Government might be some £360 million a year, in addition to the costs of YTS in its existing form. There would however be offsetting savings, including possibly some £240 million on SB. This offers the prospect of keeping first year costs (1986/87) within £100 million. These figures assume a high profile of recruitment into the scheme of both employed and unemployed young people; a lower recruitment profile e.g. for the employed would bring down the costs still further.

6. MISC 107 has considered two other options. One is for a scheme providing training up to trainees' 18th birthday, except where young people are already entitled to a longer period of training under existing rules. This would be significantly cheaper than the scheme outlined above. But it would be unlikely to appeal to employers or young people because of its arbitrary impact on the length of training to which individual young people were entitled; and it would be difficult to reconcile with sensible longer-term training arrangements. A second option would be to provide some form of community service, not necessarily involving training, for unemployed young people up to age 18 who have completed YTS. This has no obvious advantages compared with the scheme proposed by MISC 107, except its relative cost. There is no consensus within the Committee in favour of either of these options.

7. A training initiative on the lines proposed would have major repercussions on the further education system. MISC 107 has also discussed how to build on existing initiatives to develop vocational education at 14 to 16. The urgent need is for better in-service training for teachers, particularly to disseminate the lessons of TVEI. MISC 107 is being invited to recommend

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additional funding of some £10 million per annum in 1986/87 to help finance such training. It would be important to see that this spending was properly targetted. Additional resources would be needed if the Group wished to recommend further extension of TVEI.

8. Introduction of a new training scheme offering places for all 16 and 17 year olds would enable serious consideration to be given to withdrawing supplementary benefit from this age group. From consultations we have been able to undertake so far, it seems possible that employers would be prepared to offer an adequate number of places to enable us to honour a September guarantee (though we shall probably still need some places - possibly up to 20 per cent - based on training workshops or community projects, at least in some areas). There is no evident justification for continuing to offer SB as of right to 16 and 17 year olds who have the guaranteed option of a training place under the proposed scheme.

9. Removal of independent entitlement to SB for 16 and 17 year olds would reduce public spending by some £245 million a year. Much of this reduction would be achieved by adopting a 2 year training scheme, even if rights to benefit were not specifically removed, since young people on the scheme would receive a training allowance and not SB. The PSBR effect would however be offset to the extent of £135 million by reduced tax and NI contributions payable by trainees. A new allowance-based training scheme should also contribute substantially to reducing young people's expectations about pay, not only at age 16 to 18 but at higher ages.

10. MISC 107 has not sought to develop a detailed specification for the proposed scheme. This would essentially be for MSC to work out in conjunction with all the interests concerned following publication of the Government's proposals, with the aim of launching the new scheme in September 1986. Both CBI and TUC have indicated their support for the concept of a 2-year training scheme, though their response to specific proposals would be influenced by the Government's attitude on SB.

Enterprise Unit

11 January 1985.

JOBS SEMINAR: 14 JANUARY

At the seminar, Ministers will need to discuss four major issues:

1. The Treatment of 16 to 18 year olds

The Government is already virtually committed to removing supplementary benefit for 16 to 18 year olds, and to extending the YTS. The extension of YTS will, of course, cost a considerable amount. But the indications are that, if employers can be induced to take on a slightly greater share of the cost, most of the remainder can be met out of the abolition of supplementary benefit. We therefore support both measures.

It is much less clear whether any change should be made in national insurance contributions for 16 to 18 year olds. The cost of such a change would be high and the idea will probably be opposed both by the Chancellor and by Norman Fowler. We suggest that you should not press it.

2. Changing National Insurance Contributions for Employers

Both the Treasury and DHSS now seem willing to contemplate changing the rates of employer contribution, so that it is more attractive to employ people on low wages. Tom King is also in favour of the idea. The change would be revenue neutral, and might well generate tens of thousands of new lower paid jobs. This is the cheap and easy way of answering criticisms from Layard and the SDP without adopting their grand designs. We recommend the idea.

3. Expanding the Special Employment Measures

Tom King's draft paper outlines a series of ways in which several hundred thousand additional people could be taken

off the register at a net cost of roughly £500 million. The Chancellor would no doubt prefer to keep the money for tax cuts. But we believe that expansion of the special employment measures is vital: otherwise, there will be no rapid decrease in the unemployment figures and the Government will appear hard-hearted. The result will be increased pressure for unnecessary capital investment programmes which cost far more and have much less effect on the unemployment count. Moreover, changing the rules and shape of the community programme as Tom King suggests can itself exert useful downward pressure on pay, and offer the long-term unemployed the chance of doing morale-boosting work.

4. 'Passport for a Job'

Tom King has now had ample opportunity to study the passport proposal, and he recommends a pilot project. We believe that such a project would do no harm and might point the way to very important changes. If the passport scheme were aimed at small businesses and individual employers, it would offer them an opportunity to break free from a series of cumbersome and damaging regulations. This must be worth trying.

TIMING AND PRESENTATION

Norman Tebbit has written a sensible page of caution about the tone of Tom King's draft document. There will need to be substantial redrafting in due course, for which outside help may well be needed. But time is now short: all the ideas have been debated for months, and there is no sense in referring them for further consideration. The seminar should reach clear conclusions, so that the Chancellor, Norman Fowler, Tom King and David Young can all be given a firm and consistent steer.

If the seminar agrees to all the proposals, Tom King will have sufficient material out of which to make a good paper. If H and E(A) committees also decide in favour of changes on employment protection, wages councils, shop hours and the private rented sector, and if Norman Fowler's reviews and the Chancellor's budget both live up to expectations, the Government will be in a position to announce - and will be seen to have - a powerful and coherent programme for tackling unemployment. The seminar needs to decide how this programme will be presented. There are two principle issues:

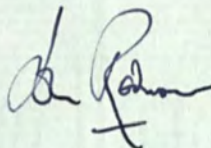
- i. Timing. Norman Tebbit's fears about the timing and relationship of the proposed measures in relation to PESC reflect fears that his Department might be squeezed to pay for them. You may wish to reassure him on this point. The groups of measures have to be self-financing and related to one another. It will be necessary to coordinate the budget, the announcement of the social security reviews, the release of Tom King's document, and the public report for Misc 107. It is essential that all these should occur close to one another, so that the press sees the unity of the programme. But the announcement should be properly spaced out over at least two or three weeks, so that the impact is sustained. You may also want to draw the whole series together by holding a press conference of your own, with all the relevant Ministers present, at the end of the sequence.

- ii. Interconnections. Since each of the announcements is related to all of the others, it will be important to ensure that each Minister says enough, but not too much, about what the others are doing. You may wish to establish the principle that announcements early in the sequence should herald,

A good case can be made for presenting the opposite approach ie consolidating as much as possible into one announcement

but should not explain in detail, the measures that will be taken by Ministers later in the sequence.

It would be a great pity if the seminar failed to reach conclusions either on the four major substantive points or on the crucial issues of timing and presentation. There will be few other opportunities to discuss these matters. It is therefore important to ensure that the meeting does not turn into a drafting session for Tom King's paper: drafting by committee will make the paper worse, not better. The drafting needs to be done by some first-rate stylist, after the substantive issues and the overall scheme of presentation have been firmly settled, and after sufficient measures have been chosen to give everyone involved a suitable product to sell.



JOHN REDWOOD



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For meeting folder

CC, JR
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PRIME MINISTER

EMPLOYMENT EXERCISE

I have read with interest the paper attached to the letter of 3 January from Tom King's Private Secretary to yours. As I have not been able to play a direct part in the deliberations of the group which produced this work, it may be useful for me to set out my views in writing before next Monday's meeting.

2 First, the question of whether we should publish a White Paper based on the present approach: I believe we should be very careful indeed before proceeding. I judge the present approach might very easily lead to an intensification of questions aimed at the Government on the basis of "why is the Government not doing more about unemployment?"; and "why does the Government not tell us what it expects unemployment levels to be in the future?". The former will strengthen those of our critics who claim that, if we wished, we could reduce unemployment. And a refusal to predict future levels of unemployment will make it look as if either we are ignorant, or that we are deliberately refusing to state what we know.

3 I therefore think that, if we are to proceed with a public document, we must stress carefully the limitation of what Government can do; and emphasise that, whatever the initiatives taken by Government, the outcome lies in the hands of many agencies whose roles are as important as that of the Government. We must make clear that the

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Government's role is limited, and only if others within the economy take up the opportunities which we help fashion will the economy grow and unemployment fall. There is something of this in the present document, but it is not yet clearly established as one of the central messages. I believe we will only have the public impact we seek if this message is firmly established: at the moment the document contains within it all the notes that we would wish to have played, but is not yet a tune which could be sung.

4 On the particular proposals, I would not wish to oppose the extension of the Community programme, nor action on national insurance charges. But these will have to be seen in the context of the public expenditure decisions which we will be called upon to make in the course of the year. However, we need to see the results of the review of social security payments before judging the impact of any changes on that front together with tax changes which the Chancellor may have in mind. Perhaps, therefore, it is a little early to choose between some of the possible options.

5 I am copying this to Nigel Lawson, Tom King, Keith Joseph, Peter Walker, Patrick Jenkin, Norman Fowler, David Young and to Sir Robert Armstrong.

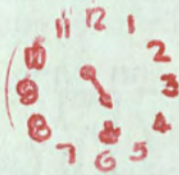
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PRIME MINISTER

Employment: meeting on 14 January

The meeting is to discuss the draft Employment document with a covering minute by the Secretary of State for Employment, circulated by Mr King's office on 3 January.

2. In his covering minute Mr King proposes publication of a document very soon after the Budget putting across the Government's employment policy on the lines of the draft and containing proposals on the following matters:

- a. taking the 16-18 year olds out of unemployment on lines to be proposed by the Minister without Portfolio in his MISC 107 Group;
- b. matters affecting employment and unemployment arising from the Social Security Reviews;
- c. the employment implications of 1985 Budget decisions;
- d. other possible measures to assist employment (eg changes to National Insurance Contributions, an extension of the Community Programme, a pilot "passport" scheme, or an increased disregard for long-term unemployed taking part-time work).

MAIN ISSUES

3. The main issues for consideration are:

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- i. whether to publish a document on employment;
- ii. if so, when to publish;
- iii. whether the present draft is broadly satisfactory, and, if not, which areas require improvement;
- iv. what possible new policy measures should be considered further.

Whether to publish

4. In considering whether to publish a document, the meeting will wish to take a view on the general tactics of handling the employment issue vis a vis the Government's backbenchers, the Opposition parties and the public generally. There can be little doubt that the adequacy of the Government's policies to promote employment will be a major political issue over the next few months and that the Government will need to defend its record and win understanding for its approach as vigorously as possible. The question is whether it is better to do this in speeches and debates as occasion arises or to go on to the offensive with a major published document. The latter has the advantage of enabling the arguments to be deployed in a comprehensive and sustained way. The disadvantage is that it provides an easier Aunt Sally to attack. If such a document is widely judged to be unconvincing and inadequate, the Government will be worse off than if the attempt had never been made. Much will therefore depend on the meeting's political judgement of how persuasive the draft document is likely to be.

Timing

5. You will wish to establish as clearly as possible what Mr King means by his proposal to publish "very soon after the Budget, some time in March". Will publication be in time to influence the Budget debate? If not, will it make sense to have two separate Government initiatives on the economy within about two weeks? The options on timing are effectively as follows:



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- i. well before the Budget (ie before mid-February);
- ii. immediately after the Budget (ie close enough to the Budget to be in practice part of the same package);
- iii. well after the Budget (ie not before late April).

The main difficulty about i., as Mr King recognises, is that decisions about new policy measures (notably on the 16-18 year olds and the social security reviews) cannot be taken in time. The main difficulty about iii. is that employment will be a major issue at Budget time and, if an employment document is thought to be helpful, it ought to be deployed then rather than later.

6. This analysis points to an employment document as part of the Budget package but Budget security will make it difficult to finalise the text in time for publication to coincide with the Budget Debate. If the Budget timing option is favoured, the precise arrangements will need to be studied further.

Content of the draft

7. Before discussing possible new measures the meeting will need to consider whether the exposition of present policy in Chapters 1 to 4 of the document is sufficiently persuasive. Although it will not be desirable to go over the draft in detail, the meeting should identify:

- any sections which ought to be omitted altogether
- subjects and arguments not dealt with which should be added
- passages which particularly need to be improved.

8. The section on public spending on infrastructure (paragraphs 4.13 to 4.16) will need to be looked at particularly carefully bearing in mind the pressure on this front from the CBI and TUC in the NEDC and from some Government backbenchers.

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Possible new policy measures

9. It would be premature to take any final decisions at this meeting on new policy measures, for the following reasons:

a. we must wait for the Secretary of State for Social Services' proposals on the social security reviews and the Minister without Portfolio's proposals for the 16 to 18 year olds;

b. the public expenditure constraints are exceptionally tight; the options must therefore be costed on a comparable basis and the means of financing them by offsetting savings fully explored;

c. it will be necessary to take account of the overall economic situation and the likely room for manoeuvre in the Budget; the Chancellor will not be discussing these matters with his colleagues until the pre-Budget Cabinet on 14 February.

10. Nevertheless it might be useful for the meeting to express preliminary views on:

- whether it is desirable to have one or more new employment initiatives, rather than resting on defence and explanation of the Government's approach and fiscal relaxation in the Budget

- which of the measures discussed appear at this stage to be most attractive (subject to further consideration and finding a way of meeting the cost)

- which measures (if any) ought to be ruled out now.

11. The possible new measures are discussed in Chapters 5 and 6 of the draft document and there is a useful list of them in paragraphs 5 and 6 of Mr King's covering minute. The most important are the following:



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- i. More training for the 16-18 year olds, reducing unemployment by about 200,000 at a cost not yet properly estimated but possibly as much as £1 billion (before allowing for savings from changes in the rules for entitlement to benefit).
- ii. Doubling of the Community Programme for the long-term unemployed, reducing unemployment by about 120,000 at an additional gross cost of £540 million (£170 million net).
- iii. Restructuring of National Insurance Contributions so as to reduce the costs of employing people at lower wages (the effect on revenue would depend on how far any reductions for lower paid workers were offset by increases for higher paid workers).

Any preliminary views on these three proposals in particular would be helpful in guiding further work.

HANDLING

Mr Tebbit has sent a minute

12. You will wish to ask the Secretary of State for Employment to introduce the draft document. The Chancellor of the Exchequer, the Minister without Portfolio and the Secretary of State for Trade and Industry are likely to have major comments on the broad political issues raised. You will want to hear particularly from the Secretary of State for Social Services about the relationship with the social security reviews.

CONCLUSIONS

13. You will wish to reach conclusions, so far as the discussion allows, on the following matters:

- i. whether the Government should publish a document on employment policy;
- ii. if so, when should it be published;

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iii. whether the exposition of existing policies in Chapters 1 to 4 of the present draft is satisfactory and, if not, which areas require improvement;

iv. whether the document should contain one or more new policy measures and, if so, which candidates should have priority in the further work.

Plg

P L GREGSON

8 January 1985

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5 of 25, 2 of 11

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

3 January 1985

*Dear Andrew,***INDUSTRY AND EMPLOYMENT SEMINAR - 14 JANUARY**

As agreed, I am now circulating the draft of a possible Employment Document, which has been drawn up by a Group chaired by my Secretary of State and including Lord Young, Norman Lamont, Peter Morrison and John Redwood, plus my Secretary of State's covering note to the Prime Minister about the document. These are to form the main item for discussion at the 14 January meeting.

As with papers for previous seminars, the circulation of this letter and the attached papers should be strictly limited to those who need to see them for briefing purposes.

I am copying to David Peretz (Chancellor's Office), Elizabeth Hodgkinson (Department of Education and Science), Michael Reidy (Department of Energy), John Ballard (Department of Environment), Steve Godber (Department of Health and Social Security), Callum McCarthy (Department of Trade and Industry), Leigh Lewis (Minister without Portfolio's Office) and Richard Hatfield (Cabinet Office).

*Yours sincerely**David Normington*

D J NORMINGTON
Principal Private
Secretary

SECRET



NEW ST. ANDREWS HOUSE
EDINBURGH EH1 3SX

Rt Hon Nicholas Ridley MP
Secretary of State for Transport
2 Marsham Street
LONDON
SW1P 3EB

19th December 1984

Dear Nick,

REVIEW OF ROAD TRAFFIC LAW

Thank you for sending me a copy of your minute of 10 December to the Prime Minister, enclosing a draft announcement of the review of road traffic law.

Since the review will cover road traffic law throughout the country, including Scotland, I would be grateful if this could be made explicit in the announcement. I suggest that in the first line of the third paragraph of your proposed announcement you might add after "setting up":

"with the agreement of my rt hon Friend, the Secretary of State for Scotland,".

I am sending copies of this letter to the Prime Minister, Willie Whitelaw, Quintin Hailsham, Leon Brittan, Nigel Lawson, Nicholas Edwards, Douglas Hurd and Sir Robert Armstrong.

*Yours ever,
George.*

CONFIDENTIAL

File



DSG

10 DOWNING STREET

From the Private Secretary

17 December 1984

REVIEW OF ROAD TRAFFIC LAW

The Prime Minister has seen your Secretary of State's minute of 10 December about the proposed review of road traffic law. The Prime Minister is content with the proposals set out in the minute, subject to the views of colleagues, and has no objection to the choice of Dr. P. North as Chairman.

I am sending copies of this letter to Janet Lewis-Jones (Lord President's Office), Richard Stoate (Lord Chancellor's Office), Hugh Taylor (Home Office), David Peretz (HM Treasury), John Graham (Scottish Office), Colin Jones (Welsh Office), Graham Sandiford (Northern Ireland Office) and Richard Hatfield (Cabinet Office).

David Barclay

Miss Dinah Nichols,
Department of Transport.

CONFIDENTIAL

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ANNOUNCEMENT OF REVIEW OF ROAD TRAFFIC LAW

My rt hon friend, the Secretary of State for the Home Department and I are concerned that road traffic law should not only promote road safety and efficient traffic management but should also be fair, easy to understand and capable of effective enforcement. The present law, which has developed piecemeal, does not always fulfil these aims.

We propose to continue the process of reform first announced in our election manifesto of 1979 by reviewing a number of aspects of the law which are causing particular difficulties.

We are therefore setting up a small review committee with these terms of reference:-

"To consider what improvements might be made to the following aspects of road traffic law, particularly in respect of simplification, effectiveness and acceptability:

- a. the structure of and penalties for the offences in sections 1-3 of the Road Traffic Act 1972; causing death by reckless driving; reckless driving, and careless driving;
- b. whether offences which are endorseable with penalty points can be divided into 'points' and 'no points' offences and whether the present penalty point values need any amendment;
- c. the structure of and penalties for offences relating to licensing, construction and use and failure to comply with traffic signs;
- d. whether new types of penalty for traffic offences would be appropriate in place of or in addition to existing types of penalty, in particular the possible wider application of statutory driving tests for certain types of offences or in certain circumstances."

The Committee will have an independent chairman, a second outside member and members from my Department and from the Home Office. Dr. Peter North, Principal of Jesus College, Oxford, has

accepted our invitation to chair the review body, and / / to
be the second outside member. The official members will be:

We hope that the Committee, which will invite evidence from interested parties, will be able to report in about a year. The process of reform is a continuous one and we may wish to refer further matters to the Committee in due course.

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Summary file.

12 December 1984

MR TURNBULL

In this quarter's economic bulletin from the University of Liverpool, Paul Ashton has set out an interesting proposition for dealing with long-term unemployment.

He points out that over the last 2 years the increase in tax thresholds has little more than offset the changes in Housing Benefit: although it is now marginally more worthwhile to work than it was 2 years ago, it is still much less worthwhile than it was in 1978 and 1979. Replacement rates (the usual measure of whether it is worth working or not) were 9 percentage points higher in 1983 than in 1978 and 1979 for families at average earnings levels with dependent children. Ashton reckons that an unemployed man with a wife and 2 children would find himself no better off taking a job at £6,650 per annum; and with 4 children, he would be worse off on a salary of £8,000.

He goes on to point out that in a recent PSI report it is revealed that the long-term unemployed are not making much effort to look for a job. In the 15 month period to September 1981, one quarter of the long-term unemployed surveyed had not made a single job application; and less than half of them had made more than 5. Less than 30 per

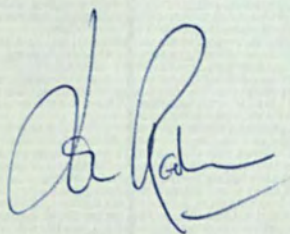
cent of those surveyed had obtained a single job interview in the period.

Whilst some of the long-term unemployed are in areas where there is little prospect of an interview or a vacancy, these figures do reveal what common sense tells you is true: that the longer you are unemployed, the more hopeless the situation becomes, and the less equipped you are to do something about it.

Ashton concludes that we need an enlarged and modified Community Programme, so that every long-term unemployed person could be provided with a CP place. He thinks there is no need to offer anything above benefit: the cost would therefore be kept to £750 per place to cover administration, work expenses, materials and equipment. He believes this could be self-financing, as he thinks that the private sector would then start generating new low-wage jobs equivalent to benefit levels, which would reduce the unemployment costs as people came off benefit.

There are two things in his scheme which we have not recommended. The first is an element of compulsion, as he thinks the long-term unemployed should have to take a CP place. The second is his bullishness concerning the likely growth of private sector jobs at low pay rates to take up the slack. However, the attached article is both illuminating and interesting, and encourages us further in

pursuing the benefit/Community Programme approach to making
the labour market work better.

A handwritten signature in blue ink, appearing to read 'John Redwood', with a stylized flourish at the end.

JOHN REDWOOD

Chapter 4

Replacement Ratios and Unemployment Decisions

by Paul Ashton

Since our last look at replacement ratios in December 1983, the 7% increase in tax thresholds above the inflation rate effectively reduced the proportion of work income received when unemployed. Working in the opposite direction, however, the April changes in the Housing Benefit (HB) 'tapers' (see Quarterly Economic Bulletin, March 1984) slightly increased replacement ratios for recipients of this benefit with earnings above the needs allowances, and added 7 percentage points to their marginal rates of tax.

New benefit rates

Last month the new social security rates came into effect. Supplementary benefits to the unemployed were increased in line with the RPI (less housing) at 4.7%. For those in work the HB needs allowances for adults were increased by 4.8%, and for child dependents by 8%. Set against this is the second instalment of the increase in the tapers – an additional 3 percentage points on marginal tax rates for those affected, making a total increase of 10 points since our last review. This represents a significant disincentive to earn more by working overtime, or by seeking promotion or further training.

Other changes in benefit include a 5.4% increase in child benefit to £6.85, and similar increases in Family Income Supplement for lower-paid families. The rules have been changed for payment of the latter benefit, however, and only new claimants received the increase in November. Other claimants must wait until the expiration of their existing awards which run for 12 months.

The net effect of the tax and benefit changes since December last varies from household to household and at different income levels, but given the rise in earnings over the year most replacement ratios would have fallen slightly.

Replacement ratios

This small improvement in replacement ratios follows a slight improvement last year. But replacement ratios are still well above those of 1978 and 1979. On the DHSS's reckoning of work income relative to unemployment benefits (which like that of the IFS ignores work expenses and passported benefits), replacement ratios in 1983 were around 9 percentage points higher than in 1978 and 1979 for families with dependent children at average earnings levels.

Our tables show how acute the problem of the unemployment trap still is: an unemployed man with a wife and two children, for example, would find himself no better off taking a job at £6,650 p.a. With four children, an unemployed man taking a job with a salary of £8,000 p.a. would find himself worse off by over £1 a week. Families with older dependent children or with higher housing costs will need to earn even more to exceed their unemployment income.

Beveridge and the long-term unemployed

Given the examples quoted above and those in the following tables, and given that we now have 1.25 million long-term unemployed, we should recall Beveridge's caution that:

The danger of providing benefits, which are both adequate in amount and indefinite in duration, is that men, as creatures who adapt themselves to circumstances, may settle down to them.

Beveridge Report, para. 130.

Evidence of the declining interest of the long-term unemployed in seeking work is given in a recent PSI report commissioned by the Department of Employment, **Long-Term Unemployment and Labour Markets**, (PSI, 1983). The report shows, for example, that in a 15-month period to September 1981, a quarter of the long-term unemployed surveyed admitted to not having made a single job application and that less than half had made more than five. Not surprisingly therefore, less than 30% of those surveyed had obtained a job interview in that period. The longer the period of unemployment, the less likely was an unemployed person to have attended an interview.

Whatever the precise reasons for this low level of job search, whether it is related to the level of benefits to the unemployed, or to the psychological effects of prolonged unemployment, or whatever, there seems little hope of remotivating the long-term unemployed as things stand. The situation is likely to deteriorate over time – indeed the PSI report noted that 41% of job-seeking males had reduced the time spent seeking work over the 15-month period.

Some drastic action is called for therefore if the long-term unemployed are not to lose interest altogether in joining or rejoining the workforce. There already exists a scheme to help those who have not worked for a year or more: the Community Programme (CP). This scheme offers twelve months work in the local neighbourhood on projects of use to the community but which would not normally be undertaken on a commercial basis. The rates of pay offered are the local hourly rate for the job for the number of hours worked. However, the scheme is voluntary, often only part time, and for some unemployed would entail taking a drop in income from their present level of benefit. There are currently over 25,000 unfilled vacancies, to which 20,000 more are shortly to be added.

An enlarged and modified Community Programme

What is proposed is that a (full-time) Community Programme place be offered directly to each of the long-term unemployed with a penalty imposed if the offer is refused. This penalty would extend to complete withdrawal of benefit after a certain number of offers are turned down. Such a drastic measure, it is maintained, is in the individual's own interest. Beveridge himself advocated that:

Men and women who have been unemployed for a certain period should be required as a condition of continued benefit to attend a work or training centre, such attendance being designed both as a means of preventing habituation to idleness and as a means of improving capacity for earning. (para. 131)

He added too that, "conditions imposed on benefit must be enforced where necessary by suitable penalties" (ibid.).

The predictable outcry from the Opposition and from pressure groups should not deter the government, and certainly not this government, from imposing the kind of conditions Beveridge saw as necessary and in the long-term interest of the long-term unemployed. It.

Since there are currently too few places to ensure an offer is made to all the long-term unemployed, it is proposed that (a) the number of CP places be substantially increased, and (b) a gradualist approach be adopted, applying the measures in the first instance to those unemployed the longest (say over three years), gradually reducing the qualifying period to one year as more places come on stream. However, it would not in practice be necessary to provide every long-term unemployed person with a CP place, nor need it cost very much to effectively end long-term unemployment.

Benefit-wages

It is proposed that entrants to the scheme be paid the same in net earnings (plus an allowance for work expenses) as they currently receive in benefits: no financial incentive is needed. What long-term unemployed people need most is the dignity of work and the feeling of self-respect that employment engenders.

The cost of each place on the scheme, then, is limited to administration costs, work expenses, and any materials and equipment used – approximately £750 p.a. per place. The number of places required will be substantially less than the number of registered long-term unemployed. This is because (i) a (small) proportion of the unemployed have adequate undisclosed incomes presently being supplemented by social security benefits: they will turn down the

offer of community work, and (ii) more importantly, new jobs offering (low) wages which, when supplemented with means-tested in-work benefits will provide an income equal to or a little above the benefit-wage levels, will emerge offering alternative work for the unemployed who prefer to work in the private sector in 'real' jobs offering more interesting and varied work.

Each person taking one of those new, low-wage jobs in the private sector will provide a net saving in benefits which will finance 2–3 jobs in the CP scheme. For example, an unemployed man with two children taking a job at £60 p.w. will receive £2.40 more than his benefit-wage (more if his work expenses are lower than £8.50) once FIS and HB are received. The net cost to the state of supplementing his wages will be £53.32 (including child benefit) against £101.40 (plus an amount for work expenses) payable as a benefit-wage – a saving of at least £47 p.w. or £2,440 p.a., enough to pay for over 3 CP work places. So, if enough low-paid jobs are created as a result of imposing conditions on the provision of benefits, **the total cost of effectively eliminating long-term unemployment could be nil.** For if the average benefit saving to the state is £2,000 p.a. per newly-created low-wage job, then the creation of 340,000 jobs would wholly finance enough CP jobs to provide all the remaining long-term unemployed with a community job. And even if only 250,000 new jobs were created (surely a conservative figure?) the net cost of providing the other million unemployed with a job on the CP scheme would be only £250 million. If it went the other way, with say 500,000 new jobs created, the exchequer would have a net surplus of £440 million! Either way though the unemployment figures would tumble by 1.25 million.

Guide to mnemonics of table:

NI National Insurance
PASSP passport benefits (FSM + FMN + FDOP)
CB child benefit
WEX work expenses
FIS family income supplement

NET net income + benefits
RENT RB rent rebate
RATE RB rate rebate
MRT marginal rate of tax (%)
W RATES water rates
R/R replacement ratio

HEATING heating allowance for under 5s
SB supplementary benefit
CH/ALL SB child allowance (age related)
FSM free school meals
FMV free milk and vitamins (infants)
FDOP free dental, optical + prescriptions

SINGLE PERSON: RENT OF £12.50 RATES OF £4.00

EMPLOYED					UNEMPLOYED						
50.00	GROSS				28.05	SB					
3.43	TAX				0.00	CH ALL					
4.50	NI				12.50	RENT					
0.00	CB				4.00	RATES					
0.00	FIS				0.00	HEATING					
10.53	RENT REBATE				0.00	FSM					
3.37	RATE REBATE				0.00	FMV					
0.00	PASSPORT				1.50	W RATES					
8.50	W EX				1.60	FDOP					
47.47	NET				47.65	TOTAL					
REPLACEMENT RATIO = 1											
GROSS	TAX	NI	CB	FIS	RENT RB	RATE RB	PASSP	WEX	NET	MRT	R/R
50.00	3.43	4.50	0.00	0.00	10.53	3.37	0.00	8.50	47.47	%	1.00
60.00	6.43	5.40	0.00	0.00	8.03	2.57	0.00	8.50	50.27	72.00	.95
70.00	9.43	6.30	0.00	0.00	5.21	1.69	0.00	8.50	52.67	76.00	.90
80.00	12.43	7.20	0.00	0.00	2.31	.79	0.00	8.50	54.97	77.00	.87
90.00	15.43	8.10	0.00	0.00	0.00	0.00	0.00	8.50	57.97	70.00	.82
100.00	18.43	9.00	0.00	0.00	0.00	0.00	0.00	8.50	64.07	39.00	.74
110.00	21.43	9.90	0.00	0.00	0.00	0.00	0.00	8.50	70.17	39.00	.68
120.00	24.43	10.80	0.00	0.00	0.00	0.00	0.00	8.50	76.27	39.00	.62
130.00	27.43	11.70	0.00	0.00	0.00	0.00	0.00	8.50	82.37	39.00	.58
140.00	30.43	12.60	0.00	0.00	0.00	0.00	0.00	8.50	88.47	39.00	.54
150.00	33.43	13.50	0.00	0.00	0.00	0.00	0.00	8.50	94.57	39.00	.50
160.00	36.43	14.40	0.00	0.00	0.00	0.00	0.00	8.50	100.67	39.00	.47
170.00	39.43	15.30	0.00	0.00	0.00	0.00	0.00	8.50	106.77	39.00	.45
180.00	42.43	16.20	0.00	0.00	0.00	0.00	0.00	8.50	112.87	39.00	.42
190.00	45.43	17.10	0.00	0.00	0.00	0.00	0.00	8.50	118.97	39.00	.40
200.00	48.43	18.00	0.00	0.00	0.00	0.00	0.00	8.50	125.07	39.00	.38

COUPLE WITH NO CHILDREN: RENT OF £13.50 RATES OF £4.50

EMPLOYED					UNEMPLOYED						
50.00	GROSS				45.55	SB					
0.00	TAX				0.00	CH ALL					
4.50	NI				13.50	RENT					
0.00	CB				4.50	RATES					
0.00	FIS				0.00	HEATING					
13.50	RENT REBATE				0.00	FSM					
4.50	RATE REBATE				0.00	FMV					
0.00	PASSPORT				1.50	W RATES					
8.50	W EX				3.20	FDOP					
55.00	NET				68.25	TOTAL					
REPLACEMENT RATIO = 1.24											
GROSS	TAX	NI	CB	FIS	RENT RB	RATE RB	PASSP	WEX	NET	MRT	R/R
50.00	0.00	4.50	0.00	0.00	13.50	4.50	0.00	8.50	55.00	%	1.24
60.00	0.00	5.40	0.00	0.00	13.50	4.50	0.00	8.50	64.10	9.00	1.06
70.00	2.80	6.30	0.00	0.00	11.48	3.78	0.00	8.50	67.66	64.40	1.01
80.00	5.80	7.20	0.00	0.00	8.98	2.98	0.00	8.50	70.46	72.00	.97
90.00	8.80	8.10	0.00	0.00	6.22	2.12	0.00	8.50	72.94	75.20	.94
100.00	11.80	9.00	0.00	0.00	3.32	1.22	0.00	8.50	75.24	77.00	.91
110.00	14.80	9.90	0.00	0.00	0.00	0.00	0.00	8.50	76.80	84.40	.89
120.00	17.80	10.80	0.00	0.00	0.00	0.00	0.00	8.50	82.90	39.00	.82
130.00	20.80	11.70	0.00	0.00	0.00	0.00	0.00	8.50	89.00	39.00	.77
140.00	23.80	12.60	0.00	0.00	0.00	0.00	0.00	8.50	95.10	39.00	.72
150.00	26.80	13.50	0.00	0.00	0.00	0.00	0.00	8.50	101.20	39.00	.67
160.00	29.80	14.40	0.00	0.00	0.00	0.00	0.00	8.50	107.30	39.00	.64
170.00	32.80	15.30	0.00	0.00	0.00	0.00	0.00	8.50	113.40	39.00	.60
180.00	35.80	16.20	0.00	0.00	0.00	0.00	0.00	8.50	119.50	39.00	.57
190.00	38.80	17.10	0.00	0.00	0.00	0.00	0.00	8.50	125.60	39.00	.54
200.00	41.80	18.00	0.00	0.00	0.00	0.00	0.00	8.50	131.70	39.00	.52

COUPLE WITH 1 CHILD (1 UNDER 5): RENT OF £14.50 RATES OF £5.00

EMPLOYED					UNEMPLOYED						
50.00	GROSS				45.55	SB					
0.00	TAX				9.60	CH ALL					
4.50	NI				14.50	RENT					
6.85	CB				5.00	RATES					
20.00	FIS				2.10	HEATING					
13.58	RENT REBATE				0.00	FSM					
4.56	RATE REBATE				1.60	FMV					
4.80	PASSPORT				1.50	W RATES					
8.50	W EX				3.20	FDOP					
86.79	NET				83.05	TOTAL					
REPLACEMENT RATIO = .96											
GROSS	TAX	NI	CB	FIS	RENT RB	RATE RB	PASSP	WEX	NET	MRT	R/R
50.00	0.00	4.50	6.85	20.00	13.58	4.56	4.80	8.50	86.79	%	.96
60.00	0.00	5.40	6.85	15.00	12.33	4.16	4.80	8.50	89.24	75.50	.93
70.00	2.80	6.30	6.85	10.00	11.08	3.76	4.80	8.50	88.89	103.50	.93
80.00	5.80	7.20	6.85	5.00	9.83	3.36	4.80	8.50	88.34	105.50	.94
90.00	8.80	8.10	6.85	0.00	8.56	2.96	0.00	8.50	82.97	153.70	1.00
100.00	11.80	9.00	6.85	0.00	5.66	2.06	0.00	8.50	85.27	77.00	.97
110.00	14.80	9.90	6.85	0.00	2.76	1.16	0.00	8.50	87.57	77.00	.95
120.00	17.80	10.80	6.85	0.00	0.00	0.00	0.00	8.50	89.75	78.20	.93
130.00	20.80	11.70	6.85	0.00	0.00	0.00	0.00	8.50	95.85	39.00	.87
140.00	23.80	12.60	6.85	0.00	0.00	0.00	0.00	8.50	101.95	39.00	.81
150.00	26.80	13.50	6.85	0.00	0.00	0.00	0.00	8.50	108.05	39.00	.77
160.00	29.80	14.40	6.85	0.00	0.00	0.00	0.00	8.50	114.15	39.00	.73
170.00	32.80	15.30	6.85	0.00	0.00	0.00	0.00	8.50	120.25	39.00	.69
180.00	35.80	16.20	6.85	0.00	0.00	0.00	0.00	8.50	126.35	39.00	.66
190.00	38.80	17.10	6.85	0.00	0.00	0.00	0.00	8.50	132.45	39.00	.63
200.00	41.80	18.00	6.85	0.00	0.00	0.00	0.00	8.50	138.55	39.00	.60

COUPLE WITH 2 CHILDREN (1 UNDER 5, 1 11-15): RENT OF £15.50 RATES OF £5.50

EMPLOYED					UNEMPLOYED						
50.00	GROSS				45.55	SB					
0.00	TAX				23.95	CH ALL					
4.50	NI				15.50	RENT					
13.70	CB				5.50	RATES					
25.00	FIS				2.10	HEATING					
14.43	RENT REBATE				2.50	FSM					
4.94	RATE REBATE				1.60	FMV					
7.30	PASSPORT				1.50	W RATES					
8.50	W EX				3.20	FDOP					
102.37	NET				101.40	TOTAL					
REPLACEMENT RATIO = .99											
GROSS	TAX	NI	CB	FIS	RENT RB	RATE RB	PASSP	WEX	NET	MRT	R/R
50.00	0.00	4.50	13.70	25.00	14.43	4.94	7.30	8.50	102.37	%	.99
60.00	0.00	5.40	13.70	20.00	13.18	4.54	7.30	8.50	104.82	75.50	.97
70.00	2.80	6.30	13.70	15.00	11.93	4.14	7.30	8.50	104.47	103.50	.97
80.00	5.80	7.20	13.70	10.00	10.68	3.74	7.30	8.50	103.92	105.50	.98
90.00	8.80	8.10	13.70	5.00	9.43	3.34	7.30	8.50	103.37	105.50	.98
100.00	11.80	9.00	13.70	0.00	8.00	2.90	0.00	8.50	95.30	180.70	1.06
110.00	14.80	9.90	13.70	0.00	5.10	2.00	0.00	8.50	97.60	77.00	1.04
120.00	17.80	10.80	13.70	0.00	2.20	1.10	0.00	8.50	99.90	77.00	1.02
130.00	20.80	11.70	13.70	0.00	0.00	0.00	0.00	8.50	102.70	72.00	.99
140.00	23.80	12.60	13.70	0.00	0.00	0.00	0.00	8.50	108.80	39.00	.93
150.00	26.80	13.50	13.70	0.00	0.00	0.00	0.00	8.50	114.90	39.00	.88
160.00	29.80	14.40	13.70	0.00	0.00	0.00	0.00	8.50	121.00	39.00	.84
170.00	32.80	15.30	13.70	0.00	0.00	0.00	0.00	8.50	127.10	39.00	.80
180.00	35.80	16.20	13.70	0.00	0.00	0.00	0.00	8.50	133.20	39.00	.76
190.00	38.80	17.10	13.70	0.00	0.00	0.00	0.00	8.50	139.30	39.00	.73
200.00	41.80	18.00	13.70	0.00	0.00	0.00	0.00	8.50	145.40	39.00	.70

COUPLE WITH 3 CHILDREN (1 UNDER 5, 1 5-10, 1 11-15): RENT OF £16.00 RATES OF £6.00

EMPLOYED					UNEMPLOYED						
50.00	GROSS				45.55	SB					
0.00	TAX				33.55	CH ALL					
4.50	NI				16.00	RENT					
20.55	CB				6.00	RATES					
27.00	FIS				2.10	HEATING					
15.73	RENT REBATE				5.00	FSM					
5.56	RATE REBATE				1.60	FMV					
9.80	PASSPORT				1.50	W RATES					
8.50	W EX				3.20	FDOP					
115.64	NET				114.50	TOTAL					
REPLACEMENT RATIO = .99											
GROSS	TAX	NI	CB	FIS	RENT RB	RATE RB	PASSP	WEX	NET	MRT	R/R
50.00	0.00	4.50	20.55	27.00	15.73	5.56	9.80	8.50	115.64	%	.99
60.00	0.00	5.40	20.55	25.00	13.73	4.92	9.80	8.50	120.10	55.40	.95
70.00	2.80	6.30	20.55	20.00	12.48	4.52	9.80	8.50	119.75	103.50	.96
80.00	5.80	7.20	20.55	15.00	11.23	4.12	9.80	8.50	119.20	105.50	.96
90.00	8.80	8.10	20.55	10.00	9.98	3.72	9.80	8.50	118.65	105.50	.97
100.00	11.80	9.00	20.55	5.00	8.59	3.29	9.80	8.50	117.93	107.20	.97
110.00	14.80	9.90	20.55	0.00	7.14	2.84	0.00	8.50	107.33	206.00	1.07
120.00	17.80	10.80	20.55	0.00	4.24	1.94	0.00	8.50	109.63	77.00	1.04
130.00	20.80	11.70	20.55	0.00	1.34	1.04	0.00	8.50	111.93	77.00	1.02
140.00	23.80	12.60	20.55	0.00	0.00	0.00	0.00	8.50	115.65	62.80	.99
150.00	26.80	13.50	20.55	0.00	0.00	0.00	0.00	8.50	121.75	39.00	.94
160.00	29.80	14.40	20.55	0.00	0.00	0.00	0.00	8.50	127.85	39.00	.90
170.00	32.80	15.30	20.55	0.00	0.00	0.00	0.00	8.50	133.95	39.00	.85
180.00	35.80	16.20	20.55	0.00	0.00	0.00	0.00	8.50	140.05	39.00	.82
190.00	38.80	17.10	20.55	0.00	0.00	0.00	0.00	8.50	146.15	39.00	.78
200.00	41.80	18.00	20.55	0.00	0.00	0.00	0.00	8.50	152.25	39.00	.75

Chapter 1

Twilight of the Union Bosses

by Patrick Minford

The prospects for the British economy are dependent on the outcome of the miners' strike. The hope must now be that many miners will accept economic logic and go back to work, and that there will be no concessions on the principle that uneconomic pits must be closed as soon as possible within an orderly programme of transition; those miners who remain on strike, perhaps for much of next year, will then de facto be closing down the pits at which they work, so accelerating the closure programme and causing themselves greater transitional hardship than necessary.

Summary of Forecast

	1984	1985	1986	1987	1988	1989
GDP Growth ¹	2.4	3.5	3.4	2.8	4.2	3.5
Inflation ²	4.5	3.1	2.2	2.1	1.3	1.2
Unemployment (millions) ³	3.1	3.1	3.0	2.8	2.6	2.2
Exchange Rate ⁴ (1975=100)	77.6	77.4	77.7	78.7	79.0	79.0
Treasury Bill Rate	9.7	7.9	7.1	6.6	6.4	5.2
5 Year Interest Rate	11.0	8.2	7.1	6.1	5.0	3.8
Current Balance (£ billions)	-0.4	0.5	3.3	5.0	4.5	4.3

¹ Expenditure Estimate at Factor Cost

² Consumer Price Index

³ U.K. wholly unemployed excluding school leavers (new basis)

⁴ Sterling effective exchange rate, Bank of England index

If this happens, other unions will take note of the new environment. The effects of that will be dramatic. So far miners have continued largely to act as if they had not experienced a sharp decline in membership (by more than 5% of the labour force in four years) and as if there had not been three Acts passed radically cutting back their immunities from the ordinary processes of the civil law. But with the defeat of the miners, they would no longer be able to ignore these realities, or hope that they could be reversed by 'direct action' of the NUM type. Realism will finally prevail. We should then see union wage agreements truly designed to ensure job security instead of job-destroying real wage increases; such agreements will also be in line with what union members appear (naturally enough) to be demanding, if opinion polls and rank and file attitudes to recent strikes in the docks and at Austin Rover are a guide.

Much is therefore at stake. The government must win this strike and be seen very clearly to win, however long it takes. It is encouraging that in recent weeks evidence of a firmer attitude has emerged, including on the use of the law; notably, nationalised Austin Rover management has, with effect, used the 1984 law in its own strike while the National Coal Board has at last firmly withdrawn from damaging negotiations which merely amounted to a string of its own concessions.

One issue raised by allies of the National Union of Mineworkers that has confused many well-meaning people is that of the 'social costs and benefits' of pit closure. It has been argued that, because pit closure causes unemployment, the social gains of pit closure are less than the commercially calculated gains (by the amount of additional unemployment benefits and lost taxes). This argument is absolutely fallacious. It does not allow for the effect on jobs of spending in better ways (for example, raising tax thresh-

holds) the revenue now used in supporting uneconomic pits; when this is allowed for, jobs are created (net), not lost. The reason is that, if the money is spent on high cost pits, very little supply (of economic output) per pound spent emerges (in fact in the long term it is negative) whereas, if it is channelled into tax cuts, more people are drawn into work across the whole of efficient industry with a correspondingly large rise in supply per pound spent. The arithmetic of such calculations is discussed in the section on 'job-creation' below.¹ The implication is that the commercial calculations on pits *understate* the social gains; this will need to be taken into account by any outside body that is called in to review pits in line with the Coal Board's agreement with NACODS, the pit deputies' union.

Of course, there are noneconomic social considerations, such as the problems of small mining communities. This has always been recognised and is the reason for the generous redundancy and job transfer terms being offered to miners. Even so, some communities will be reduced, or broken up; however, to hold up the nation's economic progress in the name of preserving particular small communities for their own sake (when jobs are available to those who will move) is unlikely to command much support nationally. History is full of examples of communities that had to move with the times, not least mining communities.

The Chancellor's Autumn Statement:

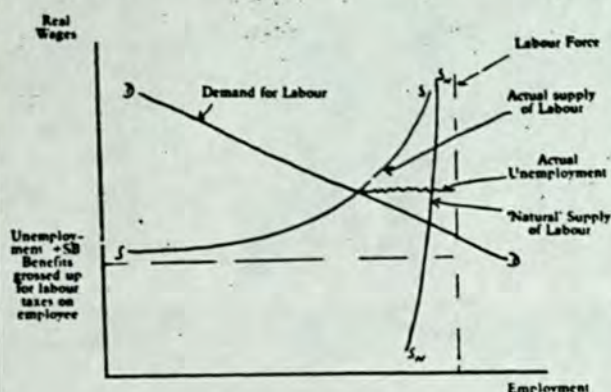
The absence of any Cabinet strategy for reducing public expenditure has been again highlighted in the autumn breast-beating by spending ministers 'defending their corner'; even Ian Gow, previously a main protagonist of spending discipline, has succumbed - no doubt under calculating pressure from his officials - to the seasonal idiocy, apparently by threatening to resign over housing cuts in his ministry. Yet here if anywhere it should be obvious that there is no sense in pumping in public money, when council houses are being privatised (at a loss) as fast as they are built. The plea that public spending on construction is good for employment is false, as explained in the next section; it is based on old Keynesian thinking which this Cabinet at least is supposed to have seen through.

This Cabinet should be able to agree on privatisation as a principle to be applied as widely as possible within the public sector.² Around that principle a programme for systematic reduction of public expenditure over a first five-year period could probably be agreed. This would be easily explainable to the people and would give a secure basis for sustained tax cuts; at present no one can have any confidence that the programme of tax cuts will not need to be

¹ And also at greater length in 'The Costs and Benefits of Coal Pit Closures' by Patrick Minford and Peter Kung, *Public Service Review*, November 1984.

² For more details of the possibilities, please consult my article, 'State Expenditure: A Study in Waste', *Economic Affairs*, Special Supplement, Vol. 4, No. 3, April-June 1984.

Basic Framework for Analysing UK 'Supply-side' and Unemployment - Illustrated Graphically.



1. Explanation of Diagram

The diagram shows the UK Labour Market, with the price of labour (real wages) on the vertical axis and the quantity of labour on the horizontal one; it is of course a standard 'supply and demand' diagram. Employment is determined at the point where supply equals demand; unemployment is the difference between this and the total 'labour force' (shown as the dashed line on the right).

The Demand for Labour is shown as increasing as real wages fall; this comes about via two mechanisms (1) substitution of labour for capital (within alternative efficient production techniques) (2) expansion of British exports or import-substitutes because of falling British costs in competitive world markets (this rise in exports or fall in imports allows domestic demand to rise also within the constraint on the balance of payments on current account).

The Supply of Labour is divided into two parts: the 'neutral' supply (S_N) which would occur if there was no benefit system and the actual supply (S , the relevant one) which is bent back towards the left by the unemployment and other benefits available when out of work. As average wages fall, so more and more people find themselves receiving net wages close to benefit levels; the result is that the wage they demand has a 'floor' under it (they will not reduce their wage demands, as job opportunities contract, but will rather stay on the dole than take the lower-paid jobs). Wages cannot obviously fall below benefits grossed up for income tax, the horizontal dashed line.

For a more detailed but non-technical explanation, see Patrick Minford, David Davies, Michael Peel and Alison Sprague, *Unemployment - Cause and Cure* (Martin Robertson, 1983) or - more briefly - A. P. L. Minford, 'Trade Unions Destroy a Million Jobs', *Journal of Economic Affairs*, Vol. 2, January 1981.

2. Some Other Points to Note

1. Demand for Labour relationship cannot be shifted (except temporarily) by fiscal and monetary policy; it is drawn up assuming there is current account balance.
2. Demand for Labour is increased (shifted to right) by higher productivity per man and by lower labour taxes (N.I. contributions, e.g.) paid by firm.
3. Supply of Labour is increased by lower income taxes (including N.I. contributions) or lower benefits for unemployed (curve shifts to right) and decreased by higher union mark-up (curve shifts to left).
4. Some key responses (estimated from UK data since 1964): long-run elasticity of demand for labour to unit labour costs (i.e. percent rise in employment for 1% fall in labour costs) = 1; long-run elasticity of wages demanded by workers to benefits grossed up for income tax = 0.5; long-run elasticity of wage demands to higher union penetration of workforce = 1.

Compare now spending money on tax cuts, the Chancellor's stated priority. A number of such tax cuts are shown in Table 1. We assume that the tax cuts have no effect on labour-intensiveness because they will be spent in much the same way as the 'neutral' taxes that finance them. But they have an effect on incentives to supply and demand labour. - See Box for a guide to the mechanism involved. Rises in tax thresholds make it worthwhile for unemployed people to take lower-paid jobs than before; this is an improvement of the 'unemployment trap', and a rise in labour supply at given wages. Cuts in firms' National Insurance contributions lower labour costs and so cause an increase in labour demand at given wages. The result in either case is a rise in the supply of output the economy is capable of producing and the number of jobs it is capable of sustaining; the implication is that demand can rise to this level without causing problems and jobs at this level of demand are 'real' (i.e. sustainable) jobs.

It can be seen that rises in tax thresholds dramatically dominate all other measures in the Table except National Insurance Contributions by employers which are a close second. It follows of course that money diverted from public expenditures at the top of the Table to tax cuts at the bottom will create jobs; for example closing high cost pits and cutting tax thresholds will create 7.7 thousand jobs (per £100 million diverted) in the medium term and 15 thousand in the long term.

The PSBR target and demand:

The calculations in Table 1 are based on the supply effects of these expenditures - i.e. the medium to long term effects on jobs. But it may be asked what about the short-run demand effects?

'Real jobs' are jobs which last and are not merely the product of a temporary boost in demand. Therefore this question reveals a search for temporary palliatives rather than enduring solutions to unemployment.

As for such palliatives, however, the Liverpool Group can find no evidence that directing demand to say construction from tax cuts stimulates aggregate demand; any analysis to that effect that we know of is based on old-fashioned Keynesian 'multipliers', which are quite discredited. When all factors (interest rates, exchange rates, labour intensity, import content, etc) are allowed for, there is no obvious effect either way that we can find.

It seems therefore most sensible to decide on the composition of 'job-creation' expenditures on the basis solely of their effect on real sustainable jobs as in the last section.

If demand is an issue it should relate to the PSBR target itself. Indeed that is usually implicitly what is intended by proponents of infra-structure spending; they wish it to be financed by a higher PSBR and it is from the financing that they adduce additional demand.

This is old ground we are now covering. The main problem with using the PSBR to stimulate demand (via a 'temporary' boost to borrowing) is that of credibility. The object of the MTFs was to persuade people that the government would stick to its counter-inflation strategy over the foreseeable future that it is in power, in spite of all the pressures in a Parliamentary democracy to exceed

Table 2: A feasible PSBR and tax cuts profile assuming government expenditure is constant in real terms.
(£ billion, cash figures)

A. Treasury Arithmetic*	1985/6	1986/7	1987/8	1988/9	1990/91
Money supply target (mid point of range, M0)	6	5	4	3	1
Approximate implied inflation (Treasury assumption)	3½ (4½)	2½ (3½)	1½ (3)	— (3)	1 (2½)
Public expenditure programmes (of which asset sales)	132 (2½)	136½ (2)	141½ (2)	146 (2)	150 (—)
Other adjustments (of which debt interest)	22 (16½)	22½ (16)	22 (16)	22 (16)	22 (16)
Revenue at constant tax rates	148½	157½	165½	173	182
MTFS PSBR (% of GDP)	7(2)	7(2)	7(1¼)	7(1¼)	2(½)
Implied MTFS tax cuts (cumulative)	1½	5½	9	12	12
Public expenditure programmes excluding asset sales (at constant 1985/6 prices)	134 (134)	138½ (134)	143½ (134)	148 (134)	150 (132)
B. Adjustments to this if Liverpool Forecast substituted for Treasury's (+ indicates Liverpool estimate is higher than Treasury's) - same PSBR as in A.					
	1985/6	1986/7	1987/8	1988/9	1990/91 Long Run
Debt Interest	—	-½	-½	-1	-3½
Tax cuts	—	—	—	—	+1½
Public expenditure programmes excluding asset sales (at constant 1985/6 prices)	134	134	134	134	134
C. Bringing tax cuts forward via borrowing more in early years (effects as compared to B).					
	1985/6	1986/7	1987/8	1988/9	1990/91
Debt interest	—	+0.1	+0.1	+0.2	+0.2
PSBR	8	8	8	4	2
Tax cuts (cumulative)	2½	6½	10½	13	13½

* The figures in this part are based on the 1984 Budget Statement, crudely adjusted for 1986/7 onwards on the basis of the Treasury's Autumn 1984 Statement (from which the 1985/6 figures are taken).

+ Effect of Liverpool Inflation forecast assumed to be neutral on PSBR (i.e. revenue and expenditure effects cancelling).

is in other industries and 30 per cent of the jobs expenditure are in other part of a ±5 per cent change very much smaller, amounting to (17). The effect for compositional changes is created by an extra one per cent in each programme area. The results show quite clearly that, while the change in social capital jobs, in terms of jobs created, is rather different. The effect is not regarded as very small to illustrate some marked differences of changes in the future. Expenditure generates about 100 jobs per million pounds, whereas in other industries social capital formation only generates about 40 jobs per million pounds. Within government and Health clearly stand out as the largest effect per pound. In the Health (32 prices) generates about 100 jobs per million pounds, whereas in other industries social capital formation only generates about 40 jobs per million pounds. Local spending on other institutional effect alone for jobs per million pounds. The effect of an extra million pounds in almost certainly local education, are much smaller than on private industries and the smallest effect with 100 jobs per million pounds. The number of jobs social capital formation is much smaller than for government current and 40 jobs are created for the main reason for this is the direct effect on the case. The effects on other are much larger than for current importance of indirect

effects of social capital formation via the demand for intermediate inputs from other industries. Given the methodology used to obtain these results detailed comparisons between the main programme areas should be made with care. The estimates do however suggest that social

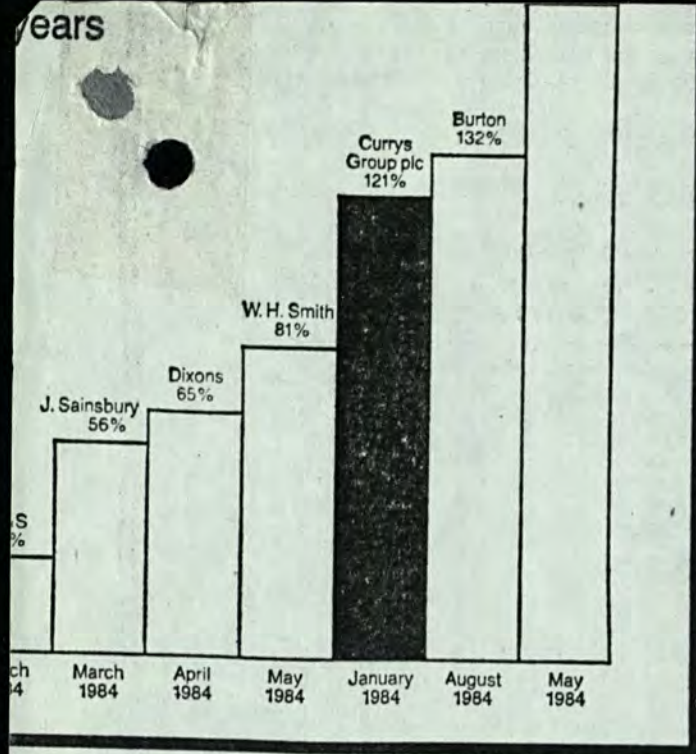
TABLE 11.8 : Alternative policies: impacts on employment, inflation and the balance of payments

Differences from a base run	Year		
	1	4	6
<u>Employment generated (000s) per flbn PSBR</u>			
Reduction in standard rate of tax	166	203	199(b)
Reduction in national insurance contributions(a)	65	120	132
Increase in public current expenditure	185	90	72
Marginal employment subsidy	144	103	81
<u>Effect on prices (%) per flbn PSBR</u>			
Reduction in standard rate of tax	-1.9	-3.4	-5.3
Reduction in national insurance contributions(a)	-2.4	-3.4	-4.6
Increase in public current expenditure	0.7	1.0	1.1
Marginal employment subsidy	-3.2	-1.1	-1.1
<u>Effect on the balance of payments as % of GDP per flbn PSBR</u>			
Reduction in standard rate of tax	-0.5	0.1	0.2
Reduction in national insurance contributions(a)	-0.1	0.1	0.2
Increase in public current expenditure	-0.2	-0.1	-0.1
Marginal employment subsidy	-0.3	-	-

SOURCE: Simulation results as described in Whitley and Wilson (1983).

- (a) Equivalent to an average employment subsidy.
 (b) This corrects a typographical error in Whitley and Wilson (1983), Table 4.
 capital formation involving the building of dwellings results in many more jobs per million pounds than in the other categories. The immediate demand for dwellings impinges almost entirely on the construction industry which has a low propensity to import and a relatively low level of average productivity. In addition, construction of dwellings is particularly labour intensive work. In contrast, social capital formation in Education generates

years



VALUABLE TIBLE LOAN STOCK.

Currys - ns' bid.

end growth of Currys Group plc are contained in the letter to shareholders with the 52 weeks to 30th January 1982.

ensure that the facts stated and opinions expressed herein are fair and accurate and

the five year contract signed in 1982 is technically in its second year.

There is even a strong suggestion that the Department of Trade and Industry, still deeply concerned at the possible damage the niggles over the contract is doing to other would-be British contracts with India, suggested this autumn that rival GEC should help out with specialist knowledge. NEI denies

gression on Rihand, it is on the mend." He also claims that the time penalty risks or fines for lateness on the contract are not as big as some people imagine, and that the shipping, transportation and erection costs of the plant — in hostile terrain — are reimbursable by NEI... saving it from too mortal a savaging.

Maggie Brown

Tax cuts 'the way to create more jobs'

THE Government is right to believe that tax cuts would be a more efficient way of stimulating the economy and creating jobs than the same money spent instead on more public spending, according to an independent study of the Treasury's spending plans published today.

In marked contrast to most other analyses, two researchers at Warwick University's Institute for Employment Research find that an extra £1 billion of public borrowing would create 203,000 jobs after four years through income tax cuts, but only 90,000 if funnelled through increased public spending.

The same money spent on cutting National Insurance or paying subsidies for extra jobs creates respectively 120,000 and 103,000 jobs.

Other articles in Public Expenditure Policy 1984-5, edited by Paul Cockle, argue that education will be hardest hit by planned cuts with real spending per pupil falling, and that a crunch on defence spending could sweep away a major defence role such as the Trident deterrent.

Local authority spending is likely to come under firmer control than in past years not because of rate-capping but because of the more draconian system of grant clawback if councils overspend, LSC lecturer, Richard Jackman says.

The Warwick employment researchers challenge another conventional wisdom with calculations showing that the extra jobs created for £1m of public spending are greater in areas of current spending,

especially health and education, than in investment in "social capital formation," including fashionable infrastructure.

The Government gets most jobs per public spending pound in education, with 97 jobs created for every extra million pounds, whereas the most jobs intensive capital programme — housing — shows an increase of only 64 jobs. Each million on defence creates only 22 jobs.

They warn, though, that their conclusion on the greater job-creating impact of tax cuts depends on the assumption that tax cuts would reduce the extent to which workers push up wages in pursuing a target for real take-home pay. This is one of several competing theories in this controversial area of economics and implies that tax cuts cause lower wage demands, lower inflation, more consumption and greater international competitiveness.

A separate article shows that the government's scope for tax cuts until 1986-7, though less than officially assumed, is relatively secure at between £4 and £5½ billion regardless of several different scenarios including a wage revolt in the public sector, an American slump and a "revitalised Britain." This, though, assumes that a revolt against the long depression of public sector wages relative to private ones would be offset by cuts in spending programmes.

Public Expenditure Policy 1984-5, edited by Paul Cockle, MacMillan, £8.95.

Christopher Huhne



Prime Minister

SPEECH TO 1922 COMMITTEE

I promised to let you have some notes that might be helpful to you in deciding what you wish to say to the backbenchers tomorrow about employment and unemployment.

In my view there are five key points:

- (i) To make clear that you are absolutely aware of the degree of concern that they feel about unemployment.
- (ii) To reaffirm that the central plank in employment policy must be a strong and expanding economy.
- (iii) The wide range of measures that we have already taken to help create more jobs through training and other special employment measures.
- (iv) Fiscal measures to encourage employment.
- (v) Your determination that we should continue to work to develop our plans in every cost-effective way to encourage employment.

Sound and Expanding Economy

Inflation under 5 per cent has now led to record investment levels.

Autumn Statement showing firm public expenditure control led to immediate reduction in interest rates, and possibility of further reductions in the months ahead.



Employment and Training Measures to Encourage more Jobs

Success of YTS.

Proposed doubling of places on adult training.

Increase of Enterprise Allowance Scheme.

Changes in industrial relations and employment law.

£2 billion going into employment and training measures like YTS, Community Programme and Enterprise Allowance Scheme.

Fiscal Measures to Encourage Employment

NIS abolition.

Raising of tax thresholds to reduce unemployment.

Substantial public investment already in infrastructure (hospitals, roads, sewers, railway electrification).

Further Developments

Tom King has confirmed further programme of work to help stimulate more jobs, and ease transition period with help for unemployed.

David Young is working on particular aspects of job creation.

The key question is what you say about the future, and whether you should go on to say anything further than the reference to my and David's work.

You mentioned yesterday your concern not to raise expectations too high. The problem is to strike a balance between the



impression that we are doing nothing and that therefore we don't care, and the other extreme that the impression is given of some major change of course.

I therefore think that you should stick at the reference to the further work that I and David are doing coupled of course with the significance for employment of Nigel's work on tax thresholds.

T K

12th December 1984

112 DEC 1984



CONTROL

PRIME MINISTER

REVIEW OF ROAD TRAFFIC LAW

When my Private Secretary replied at the end of last year to your office's letter on reducing the burden of regulation, she mentioned that the Home Secretary and I were considering the case for a basic review of road traffic legislation. This would have the object of producing a simpler structure, easier to understand and with sentencing related more clearly to the offences committed. More recently, I referred to the possibility of a review in a speech to the ROSPA conference in October and there have been some, albeit rather confused, references to this in the media.

Leon Brittan and I have now decided that a fundamental review of the whole body of road traffic law would be too large a task to take on at one time. We have, therefore, set our sights a little lower and are constituting a small review body, with an independent Chairman, one other independent member and two officials from each of the Home Office and my Department, which will consider a number of the most difficult issues where it is known that the present law is not working well. We have cleared our plans with other interested Departments, who are all content for the review to go ahead in this form.

Whether the Committee might later tackle other matters and so eventually take in most of the problem areas, is a question we have left open for the moment but it looks an attractive possibility if their consideration of this limited list is judged a success.

Our choice for chairman, Dr Peter North, Principal of Jesus College, Oxford, has agreed to take on this task. We are anxious to make an announcement quickly and so get the review formally under way before the Recess. I am enclosing a copy of the announcement I would propose to make through a Parliamentary Answer. It assumes that we have already appointed the second

Prime Minister (2)

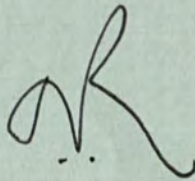
To note at this stage. Mr. Kidley
proposes to announce a review of
some aspects of road traffic law
- see list at A.

DMB
11/12

independent member. (Lady Anglesey is considering an invitation.) But if the search is protracted and the degree of public interest justifies it, I would propose to announce the review and its chairman, and to leave the announcement of the other members until later.

I envisage a report from the new body in about a year. That would give us time to consult on and consider those recommendations before the end of this Parliament, and, I would hope, enable us to announce that we have proposals ready for the next which could be widely seen as more effective, comprehensive and acceptable than the present system.

I am sending copies of this letter to Willie Whitelaw, Quintin Hailsham, Leon Brittan, Nigel Lawson, George Younger, Nicholas Edwards, Douglas Hurd and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'NR' or 'NRidley', with a stylized flourish at the end.

Nicholas Ridley
10 December 1984

MANPOWER
Seminar
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SECRET

15A



PRIME MINISTER

EMPLOYMENT EXERCISE

1 I attach the draft of the Employment Document. I emphasise that this is far from its final version, but I promised to let you have this early so that you could see the lines on which we have been working. The Group that I have been chairing includes David Young, Norman Lamont, Peter Morrison, and John Redwood and Nigel Lawson has been receiving the various papers.

2 We have started from the basis that the document should cover the whole spectrum of the Government's approach on employment and unemployment. It might form the basis of a published document, and the draft has been so written that most of it could very easily be converted into a White Paper.

3 The document starts with the background to the present situation, looking not only at the UK but also at what is happening elsewhere. We have set out the problems but emphasised the achievements as well. Against that background we assess the challenges we still face and compare different possible approaches. From this we develop a range of proposals which could form the basis of a convincing response to the situation. In presenting these it will be particularly important to ensure that they are seen to flow from our existing policies.

4 You will notice that Sections 5 & 6 are completely different from the first four sections. Sections 1-4 are much closer to the sort of final form that we would want for a White Paper. 5 & 6 raise a number of issues for discussion on the various possible steps that we could take to increase employment and reduce unemployment.

SECRET



5 Section 5, on further action to increase employment, covers the following areas:

- (a) Possible restructuring of National Insurance Contributions.
- (b) My proposals on Wages Councils.
- (c) The minimising of bureaucratic and administrative burdens including the current scrutinies and my "passport" proposal.
- (d) The Young Workers Scheme.
- (e) Current action to improve labour market mobility including pensions and housing policy.
- (f) Development of training and re-training, including my proposal for training loans.
- (g) Encouragement of more flexible working patterns (eg jobsplitting and early retirement).
- (h) The 16-18 year olds, this being the relevant part of David Young's study as far as the Group is concerned.

6 Section 6, on what might be done to help the long-term unemployed covers:

- (a) Employment subsidies, which we reject.
- (b) A "benefit plus" scheme, also rejected.
- (c) Possible extension of the Community Programme.

SECRET



(d) Enlargement of schemes run by DHSS and my Department to help long-term unemployed people to make better use of their time.

(e) Early retirement and the Job Release Scheme.

(f) Changing Supplementary Benefit regulations to encourage part-time work.

A PUBLISHED DOCUMENT?

7 We need to decide whether a document along these lines should be published, and if so when. This must depend on:

(a) When will the various components of our proposals be ready?

(b) What is the best time for us to get maximum impact from them?

(c) How great is the pressure likely to be for an early Government response if we encounter particularly bad unemployment figures during the winter?

8 The earliest I can see a document being produced is late January. But this would essentially deal only with the status quo. Such a published document could be based on the first four sections of the attached report, plus a fifth section spelling out the employment and unemployment measures already taken, and those in hand but not yet decided, e.g. David Young's work for 16-18s.

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9 An alternative would be to produce a published document very soon after the Budget, some time in March. This would be able to take account of the employment and unemployment implications of the major decisions to be taken over the next few weeks, including David Young's MISC 107, Norman Fowler's social security reviews, the review of administrative and bureaucratic burdens, and of course the Budget. The White Paper would then be a much more convincing document. Again, the first four sections of the attached report could be used suitably revised, with sections 5 and 6 changed following decisions.

10 I believe that this later date is the one to choose. To get the impact we want it is essential to include definite proposals from MISC 107, including both the training option for 16-18 year olds and the consequent benefit changes. The employment aspects of Norman Fowler's reviews must also be included.

11 We should also look seriously at four other areas:

(a) The restructuring of National Insurance Contributions to favour low wage employment. Since this is a matter for the Treasury and DHSS, I have already written to Nigel Lawson and Norman Fowler suggesting such an examination.

(b) The expansion of the Community Programme and the consequent reduction of long-term unemployment. While this would have public expenditure implications, the Community Programme has a low net cost in relation to its gross cost, and in my view this could be maintained for an extension. This suggestion reflects the concern of my Group that the current and future levels of long-term unemployment are likely to be affected only slowly, if at all, by rising employment.

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(c) A passport scheme to introduce an element of de-regulation into the labour market by removing employer liability to pay tax and National Insurance for certain employees. The Group thought a pilot scheme would be sensible. This would have to be co-ordinated with the outcome of the social security review.

(d) Increasing the Supplementary Benefit disregard for long-term unemployed people taking part-time work. This is for Norman Fowler to consider in the overall context of his social security reviews, and I have written to him about it.

PUBLIC EXPENDITURE IMPLICATIONS

12 When considering the likely costs of these proposals it is, I think, important to distinguish between what we can do to help increase employment in general, and what we need to do to reduce the hard-core of unemployment. Most of the public expenditure implications of the former will come from the Chancellor's work on tax thresholds etc and Norman Fowler's work on the benefit system. My proposals on the labour market and wages councils have only minimal Exchequer costs. There are two large groups of unemployed, however, for whom I believe extra help is required. They are the young, and the long term unemployed, both of whom have special problems which are unlikely to respond to our more general measures to increase employment. Between them these two groups account for around 1½ million of the unemployed, and I believe any programme to tackle unemployment should contain special provision for them.



12a My paper has concentrated on the most cost-effective way of providing this. The Community Programme's low net cost makes it the cheapest way to reduce long term unemployment. The degree to which any YTS/benefit changes could be cost-neutral is not yet clear, but I am confident that my programme represents the most effective way of tackling these special problems that is, at the same time, consistent with our overall economic strategy.

13 Lastly, what might the impact of these proposals add up to in terms of reducing unemployment? With every possible health warning attached - and I am not including anything resulting from the restructuring of National Insurance Contributions - I would suggest a possible estimate of around 400,000 reduction in unemployment by winter 1986/87. The major components of this are a 200,000 reduction in unemployment from the 16-18 proposals, on the assumption that unemployment is no longer an option for this group; and 120,000 from the doubling of the Community Programme.

SUMMARY

14 In summary therefore, I believe a document based on the attached draft, published very soon after the Budget, would be the right choice. This would present the Government strategy towards employment, state what had been done so far, and what further steps we proposed.

15 The new elements in future policy towards employment and unemployment would then be:

- (a) proposals associated with MISC 107's work on the 16-18s;

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(b) decisions affecting employment and unemployment from Norman Fowler's reviews;

(c) the implications of Budget decisions in this area;

and, if colleagues so decided,

(d) a change in the structure (or level) of National Insurance Contributions;

(e) an extension of the Community Programme;

(f) a pilot "passport" scheme;

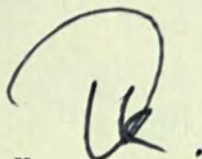
(g) an increased disregard for long-term unemployed people taking part-time work.

16 What I would therefore propose is that we discuss the document at our meeting on January 14, at which we ought to decide:

(a) Whether the attached draft might form the basis of a published document setting out the Government's strategy towards employment.

(b) If a published document is desirable, what is the most appropriate timing.

(c) If a post-Budget document is decided, whether any of the additional options suggested by my Group should be given serious consideration.

T K 

December 1984

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POSSIBLE DOCUMENT ON
EMPLOYMENT

Department of Employment
December 1984

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INTRODUCTION

1 This document sets out the Government's approach to employment and unemployment. It emphasises the strategy which has governed the approach so far, summarises what the Government has done, and looks ahead to the strengthening and development of policies to help generate jobs.

2 The Government's employment strategy has three interlocking parts. First and most important is the pursuit of a sound and stable framework of economic and industrial policy. Sustained growth of employment, and lower unemployment, need a sound economic and financial policy which will help industry and commerce to remain competitive and to increase output. The key initial step has therefore been to control inflation and help restore competitiveness. The reduction of inflation has been a major achievement, though there must be no letting up in the drive for lower costs and prices and greater efficiency.

3 The second part of the strategy involves specific ways of encouraging the growth of employment, within the economic policy framework. Removing impediments which prevent employers creating jobs or individuals making best use of their potential increases employment. The Government has taken action to modernise training to ensure that those seeking jobs can acquire the skills and aptitudes required to fill them, has promoted mobility by improving the housing market, and has abolished the national insurance surcharge. These and many other measures to increase adaptability and flexibility help create jobs.

4 Thirdly, the fight against inflation and the recession have combined to intensify changes in industry which cost many existing jobs. The Government recognises that problems of unemployment for particular groups or localities can be severe and long-lasting. Indeed, even with employment growing as it is, the creation of new jobs is bound to take time to work through to lower unemployment. The Government has tackled these problems, and the human penalties of unemployment, through the range of its employment measures.

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These are a necessary complement to the creating of new jobs by employers which the other elements of the strategy encourage.

5 The strategic approach then is economic policy which supports the growth of output and wealth and hence employment growth; the removal of impediments to job creation; and special attention to deep-seated unemployment problems.

L. L. Lawrence Arthur Lawrence

T. A. Attwood

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CHAPTER 1

THE EMPLOYMENT PROBLEM

1.1 The employment of our people and the reduction of unemployment is a major challenge as Britain wins back prosperity. Employment is now rising, by a quarter of a million in the last year, but a major sustained growth in jobs will be necessary if we are to see a real impact on unemployment. Policies to meet this challenge must start from a clear understanding of the realities - the facts, the problems and the opportunities. Unemployment is an international problem, affecting all industrialised countries, but Britain does have to face particular difficulties. This Chapter explains how Britain came to the present situation and how it can best generate and sustain more jobs.

1.2 The most basic truth is that jobs arise when enterprises are able to produce goods and services which customers at home and abroad want and can afford to buy. Thus in a nation like Britain, which is dependent upon international trade for its economic well-being, many jobs depend particularly upon the efficiency and growth of our trading sector, both manufacturing and services, competing internationally in prices and costs, in quality, design and marketing. Profitable production is the key to employment, not only directly but in helping to pay for public services and as a main source of new wealth-creating investment.

1.3 For industry and commerce the task for managers and entrepreneurs is to adapt continuously to changes in markets and customer choice, and industrial enterprise must be partnered by an efficient and fair jobs market in which people are prepared to meet change, allowed to do so, and helped where necessary to adjust. This means greater flexibility in acquiring new skills, in taking on new responsibilities or methods of work, and accepting earnings which are in line with economic circumstances.

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1.4 Too often, however, we have ignored the importance of wealth creation as the route to more jobs and higher standards of living. Our unemployment problem is many-sided and deep-rooted: but its central cause has been a reluctance or inability to adapt sufficiently both in our attitudes and working practices. Our recent experience in the vastly changed circumstances of the world economy demonstrates this.

1.5 During the 1950s and 1960s living standards rose throughout the West. There was a general expectation of continuing growth, higher real wages, more leisure and virtually full employment, and it was widely assumed that Government economic policies could ensure steadily increasing prosperity. Higher living standards were seen as a right rather than something to be earned; the vital link between prosperity and efficiency, and industry's basic need to meet market demands, was often overlooked.

1.6 The world recession, triggered by the large oil price rises in 1973, required major adjustments within the economies and labour markets of all countries. These should have been tackled by some fundamental policy changes but many Governments responded simply by relaxing financial disciplines. Inflation rose alarmingly - in Britain to 26% in one year - and economic stability was threatened as business planning became more uncertain. Public services grew faster than their supporting economies, so that government spending and hence taxation increased, reinforcing demands for higher wages. Some countries - notably Britain - were slow to adjust either in industrial products or in ways of work. In some cases, productivity gains and reductions in overmanning were held back; in others high labour costs led to more substitution of machinery for manpower than if wages had not been pushed up so fast.

1.7 Most Governments responded differently to the 1979 oil price rise. They had learnt the need to control inflation as a pre-requisite for a sound economy. They therefore acted, some more quickly than others, to curb budget deficits and control monetary growth. This was essential, but involved a

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short term cost in lower growth and higher unemployment, because of the time required to adjust to new market conditions. Nevertheless, most countries are now adopting the consistent approach of the UK Government since 1979, that sustained growth without inflation can be assured only through prudent financial policies.

1.8 As a trading nation - exporting nearly one third of its output - Britain could not have hoped to escape entirely these effects of world recessions. But we have suffered more than most because of our special difficulties. Over a long period our growth rates of output and productivity have been below those of most major industrial nations while our inflation has been higher. We have adapted too late and too slowly to change. These long term weaknesses have been reflected in a declining British share of world trade in manufactures.

1.9 There are many reasons for this disappointing performance. Managements have not always shown the enterprise and flair needed to match market needs. Trade unions have often concentrated on short term pay rises and attempted job preservation, instead of looking to their members' longer term security and living standards and accepting the need to compete commercially. Levels of earnings have been too high and pay differentials have been too inflexible. Even now, real wages continue to rise too fast, relative to productivity. Employers generally have seriously under-invested in training of all kinds, while our provision of technical and vocational education has proved wholly inadequate for a modern economy. Resistance to change, on both sides of industry, has further hampered incentives and competitiveness.

1.10 Governments have added their own impediments. Stop-go economic policies have made the job of industry and commerce more difficult. Too many regulations and restrictions have handicapped effective business, while the structure of taxation has reduced incentives and distorted decision-making. Inflation, now increasingly under control, pushed up costs and interest rates, squeezed profits and made investment uncertain.

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1.11 These and other impediments to sustained employment growth are discussed in Chapter 3, together with the action taken by Government to help resolve them. But though crucial, the Government's essential role in economic and industrial affairs - to create the conditions for better competitiveness and higher output - is limited. It cannot in any lasting sense create jobs directly except through public sector employment. This has to be paid for through additional borrowing or taxation which will mean lower disposable incomes or higher interest rates which lead to lower investment, with consequent effects on employment elsewhere in the economy.

1.12 Many of the remedies and the apparently simple solutions for unemployment, discussed later, avoid the question of cost. Others appear to assume that, even in the long run, there is only a fixed amount of work which has to be "shared out" among the existing members of the workforce. While in the short run employment may rise more slowly than the available workforce, as the economy grows through higher productivity and investment, wealth increases and the number of jobs could expand. The short run arguments ignore these dynamic aspects of economic growth in creating employment.

1.13 Future levels of employment are therefore not pre-ordained; they will depend partly upon the state of world trade, but more still upon our ability to control inflation, and on competitiveness, productivity, and wage moderation and our ability to adjust to changed and changing circumstances - that is, upon what we ourselves choose to do. New opportunities are arising all the time and we need enterprise, skill and resolve to win back old markets and create new ones.

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CHAPTER 2

CHANGING PATTERNS OF EMPLOYMENT

2.1 Patterns of employment shift considerably over the years with changes in the structure of output and production, and in people's abilities, skills and choices. It is always difficult to forecast precisely where new jobs will arise, especially in current circumstances with the recession and the potential of new technology to change ways of working. As someone aptly observed, the future is not what it used to be. Nevertheless it is important to understand the major changes that have led to our present position, and to assess as far as we can the factors affecting employment in the years ahead.

Labour Force and Employment

2.2 At present around 33 million people in the UK are of working age. About 26 million - nearly half the total population - are in a paid job or seeking one. This is about 3 million more than 30 years ago, partly because of an increase in the population of working age and partly because a higher proportion of them are in work or seeking work. The number of men has remained around 16 million but the number of women has increased from 7 million to over 10 million.

2.3 There were twice as many married women in or seeking jobs in 1981 as in 1947. However, since about 1977 the proportion of married women active in the labour market seems to have levelled off at about 50%, no doubt mainly because of the recession. There have also been changes in male activity rates in recent years, in particular a decline amongst those aged over 55, reflecting the increasing trend towards early retirement.

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2.4 The future prospect is for the labour force to continue to grow, though more slowly as the population increases and a higher proportion of women look for work. The rate of growth depends in part on the economic climate, but over the next three years or so it is estimated that the annual increase will average about 130,000 (of this 100,000 will be due to population growth) tailing off towards the end of the decade. The question is how quickly the economy can generate enough jobs both to absorb these increases and to reduce unemployment from its current levels.

2.5 Three factors are especially important in an understanding of the overall employment situation in Britain compared with other countries. First, a higher proportion of total population is in work in the UK, 66% in 1982, than in our three main Continental competitors (France (61%), Germany (61%) and Italy (55%)) though our proportion is slightly lower than Japan (71%). Secondly, although the proportion of men of working age who are in the labour force has declined in all these countries, the proportion of women is significantly higher in the UK (58%), USA (62%) and Japan (57%) than in the Continental European countries. Thirdly, the UK has one of the highest proportions - 45% in 1981 - of young people above statutory minimum school leaving age and below 20 who are in work or available for work.

Employment Patterns

2.6 Of the 26 million people in the labour force, some 23 million are in work. In Britain, as in other countries, employment in the service sector has been increasing. Between 1959 and 1983, service sector employment rose from 9.8 million to 13.2 million (64 per cent of total employment) while manufacturing employment fell from 7.9 million to 5.5 million. Partly because of these trends, there has been a large increase in the numbers in non-manual occupations - from 8½ million in 1961 to over 11 million in 1981 - with a rising proportion of people in scientific, technological and professional occupations. The number of people in Britain who are self employed has also shown steady growth, to about 2½ million in 1984, about one in ten of the employed labour force.

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2.7 In most countries part of the benefit of economic growth has been taken in the form of reduced working time. This has meant fewer hours per week, fewer weeks per year because of longer holidays, and shorter working lives. For men the reduction in working life as the retirement age has come down has been as important as reduced hours per week. However, we still tend to work more hours and have shorter holidays than in other countries. In 1983, manual workers in manufacturing industry worked an average of 41.3 hours a week - more than in most other leading industrial nations.

2.8 The number of part-time workers in the UK has increased markedly, by over a million in the last 10 years. This is partly because of the changing pattern of employer demand (eg long opening hours of supermarkets) influenced by the structure of National Insurance Contributions, and partly to accommodate the preferences of individuals. Nearly 5 million people worked part-time in March 1984, representing some 23% of all employees as compared with 15.4% in 1971. 90% of all part-time workers are women, and in the year to March 1984 there were some 215,000 new female part-time jobs, a substantial proportion of the total growth of 335,000 in service sector employment.

Unemployment

2.9 Unemployment has been rising for many years as output growth has failed to keep pace with the growth of productivity and of the size of the labour force. The average level of around $\frac{1}{2}$ million in the 1960s more than doubled in the 1970s and has doubled again in the 1980s. This is not simply a British problem: since the oil price rises in 1974 and 1979 the upward trend has increased rapidly in almost all the major industrial economies. Initially, unemployment rose more rapidly in the UK than in other countries, but the rate of increase has slowed markedly in Britain to below that being experienced elsewhere. The current rate of 12.9% compares with 7.3% in the USA; 8.3% in Germany; 9.1% in France; 10.4% in Italy; 13.7% in the Netherlands; and 15.6% in Belgium.

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2.10 For all these countries, high unemployment among the young has been a new and worrying feature. Youth unemployment partly reflects the effect of depressed labour markets on new labour force entrants, but in Britain also reflects relatively high pay for the under 18s. The average earnings of young men relative to adults rose from 42% in 1951 to nearly 57% in 1981.

2.11 Long-term unemployment has also become a major cause for concern. The recession and slow growth of new employment opportunities have caused the numbers of long-term unemployed to increase much more than unemployment generally. Over 1½ million people have now been out of work for at least a year. Of these 700,000 have been unemployed for over two years and 400,000 for over three years. Five years ago about 340,000 people had been unemployed for over one year, of whom nearly 172,000 had been so for more than two years, and some 100,000 for over three years.

Prospects

2.12 Future growth of employment depends on the relationship between the rates of growth of output and of productivity. If output increases more quickly than output per man, employment will rise. As a rough rule of thumb, each percentage point increase by which output growth exceeds productivity growth would mean 200,000 more jobs each year, and 150,000 fewer unemployed and vice versa. Thus a very rapid increase in productivity may in the short run lead to lower employment if it exceeds output growth. But in the long run increased productivity is clearly essential to maintain growth and increase employment. Government policy therefore seeks to set a framework within which output and productivity can grow, and to influence the factors affecting them, including the control of inflation, technology and investment.

2.13 Prospects for individual industries and occupations will depend on their response to market changes. In general there may well be some continued decline in the trend of manufacturing employment (currently about 5½ million) alongside increasing output and productivity, even if there is some initial

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increase as employment recovers from the recession. The service sector is the area of strongest potential growth, with private-sector services providing most new jobs. The strength of job growth here depends on movements in pay, productivity and growth in the economy, since many services depend on higher output or greater consumer spending power. There will be many additional part-time service jobs which would tend to increase the proportion of women in employment.

2.14 Occupational changes are likely to be more rapid than in the past, and the shift from blue collar to white collar jobs will continue. This will partly come from changes in the structure of industry but even within individual industries more jobs will require higher levels of skill, and there will be fewer unskilled or semi-skilled jobs. The skills required will increasingly have a technical or technological bias, with more emphasis on "knowledge" skills and less on manual skills. And the faster the technological change, the greater the likely shift in occupational structure.

2.15 The application of new technology is certain to have a profound influence on employment. But though some people have expressed fears over the effects of new technology in destroying jobs, history shows that it generally creates wealth and employment. We cannot afford to fall behind our international competitors in introducing new technology to improve efficiency. So far, however, new technology has been introduced relatively slowly in this country; it should be more rapid in the next few years, with better business profits leading to more investment.

2.16 Most estimates of the employment effects of new technology have been largely confined to its direct effects in displacing jobs. But the indirect effects within and outside the industry concerned can include lower prices, higher real incomes, higher investment demand and improved competitiveness in quality, design and delivery, all of which will tend to increase employment. One recent study which looked at these wider employment effects suggested that while the industries making the change did lose jobs, this was more than

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offset elsewhere in the economy. This happens as the investment required to introduce new technology itself creates jobs; and as resulting cost reductions lead to lower prices, higher real incomes, and thus an expansion of demand.

2.17 There are of course transitional problems. New jobs may arise later than old ones disappear, and in different industries and locations. The more willing and able that people are to move to new tasks (with re-training where needed) and new areas, the less the problems and burdens of change will be.

2.18 Finally, some groups will continue to be particularly seriously affected by unemployment. The long term unemployed find it less easy to get jobs even when employment generally is increasing and unless there is strong growth in female employment, the large growth in the number of women seeking work may mean that female unemployment will continue to rise more quickly. However, among those aged under 18 unemployment should gradually decline for demographic reasons and through lower relative pay and the impact of Government's Youth Training and Young Workers' Schemes.

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CHAPTER 3

PROGRESS SO FAR

3.1 Since 1979 the Government has been pursuing a consistent strategy towards employment. The creation of employment comes directly or indirectly through the efforts of industry and commerce, and Government's main role is in helping establish a sound framework within which they can operate. This Chapter summarises the various aspects of Government's policies to date, as they have affected employment and unemployment.

ECONOMIC AND INDUSTRIAL POLICY

3.2 Economic policy since 1979 has had two major aims. The first is the control of inflation. Through the establishment of the Medium Term Financial Framework and the control of public expenditure the Government has restored financial and economic stability to the economy, and provided a foundation for economic growth. But in some sectors the response of industry in supplying the goods and services which people, at home and overseas, wish to buy has been less than adequate. The second aim has therefore been to improve the efficiency with which markets work and adjust, so improving the supply response of British industry to home and overseas demand, and hence increasing employment.

3.3 Much has been done by the Government since 1979 to improve incentives and the operation of markets. As a result profits and new investment are now rising strongly. Controls on prices, dividends, credit and foreign exchange have been removed. Reductions in personal income tax have increased incentives. The tax burden on industry has been lightened through changes in Corporation Tax allowances and rates. Share incentive schemes have been extended, and direct investment is encouraged - for example through the Business Expansion Scheme. Action has been taken to simplify and speed up the planning system, and to restrict the burden of local authority rates.

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3.4 Competition has been encouraged. Restrictions on competition impede industry's response to new opportunities and inhibit the adjustments within the economy which bring new jobs. A strong legislative framework therefore now exists to promote competition and control monopolies and mergers. Particular monopolies that distort markets are being dismantled; regulations on particular industries have been removed; and nationalised industries have been returned to the private sector. So far 10 major companies and many smaller ones involving so far some 170,000 jobs have been transferred under the privatisation programme, with some significant improvements in turnover and profits.

3.5 As a nation we have been slower to innovate and introduce technological changes than some of our international competitors. This has reduced long-term job prospects. The Government has helped to stimulate necessary progress and adjustment in industry through its Support for Innovation Programme. Substantial financial support - some £270 million in 1984/85 - is available to help with research and development costs for new products and for the introduction and application of new technologies (such as microelectronics, robots, computer aided design and manufacture). Technical advice and consultancy schemes have been made available to help management become aware of technological and market opportunities.

3.6 Management performance is crucial to the success of British industry. Quite apart from the control of costs and price competitiveness, product design, marketing, quality and delivery on time, all these are crucial in winning the customer's favour at home and overseas. British managers have not been as good at securing high performance in these areas as their counterparts in other countries and they may be less well-equipped with up-to-date techniques of planning and financial control. This partly reflects the lower status British people have accorded to managers and industry than the professions. The Government has worked hard to change this and gain wider recognition of the value to the country of successful industrial performance and good business management.

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3.7 The Government has recognised the crucial importance of the small firms sector in stimulating wealth creation, enterprise and employment. 95% of businesses in the UK are small, and they contribute 20% of GNP. Some 6 million people work in small firms. High priority is given to encouraging small firms, and many measures have been introduced to help them. These include fiscal measures to reduce taxation, measures to widen and improve sources of advice and training, and measures to make it easier for small firms to get finance.

MAKING THE JOBS MARKET WORK BETTER

3.8 An ineffective jobs market damages employment by placing barriers between individuals who wish to get jobs and employers who wish to employ them. It is important to recognise that economic forces operate in the jobs market as in other markets. If the jobs market is inflexible, this will tend to reduce employment, because employers do not find it worth their while to provide more jobs, or because individuals are unable or unwilling to take those on offer. The Government's approach has been to encourage adaptation to changes by setting out the realities of how the jobs market works, by recognising and acting when desirable protection for individuals has instead become an obstacle to job creation, and by seeking out and testing new ideas.

3.9 A basic influence on employment is its cost. The evidence shows that the higher the cost of employment in real terms the lower will be employment, since employers are more likely to economise on labour if it is expensive relative to machines and other inputs. And higher labour costs imply lower profits and worse competitiveness, which discourages employers from expanding output and investing in more capacity. These links between a rising real cost of employing people and the disincentive to jobs needs to be much more widely recognised. A reduction in the rate of growth of real wages - not necessarily the level - would be a major encouragement to employment. This could be achieved without people in jobs suffering a reduction in their standard of living, and would help the unemployed back into work.

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3.10 Pay is essentially a matter for employers and employees themselves to determine. Only in this way can the different circumstances of each individual enterprise be taken into account. At the same time the Government has repeatedly stressed to those concerned that they have to recognise the effect of pay levels on the competitiveness and profitability of firms on which future investment and jobs depend. In the short term, higher pay benefits those in work even though it leads to less employment with, in effect, the unemployed paying the price; in the long run, the economic and employment consequences are bound to be harmful.

3.11 The Government, as a major employer itself, has negotiated on the principles that pay should reflect what is needed to recruit and retain employees, and what can be afforded. It has encouraged management and unions in the private sector to take a realistic approach to pay negotiations and to remove artificial constraints from them. It has repealed Schedule 11 of the Employment Protection Act 1975 (which could be used to require employers to pay the same wages as in other employment); and it has rescinded the Fair Wages Resolution (which had a similar effect in relation to public sector contracts).

3.12 More directly, the Government has introduced the Young Workers' Scheme which encourages levels of pay which reflect the experience of young people entering work. This, and the training allowance of the Youth Training Scheme, have resulted in more realistic levels of youth pay. The Government has also reduced employers' non-wage labour costs by abolishing the National Insurance Surcharge as from October 1984.

3.13 Sound industrial relations based on good understanding and realistic bargaining are important to the labour market and so to jobs. Effective and constructive trade unions have an established and essential contribution to make here for the long-term support of jobs. In recent decades, however, the combination of out-dated and rigid attitudes, political preoccupations and excessive power has meant that many unions have failed to make such a contribution, at high cost to those of their members who have become unemployed.

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3.14 The Government has taken action to encourage a positive attitude to change and greater efficiency through a more balanced framework of industrial relations law. The Employment Acts 1980 and 1982 made a start. Closed shops - with all their potential for impeding better working systems - can now be established and continued only if supported by a substantial majority of those they cover. Anti-competitive practices like refusing to let firms without closed shops tender for commercial contracts are now unlawful. And the protection of the law has been restored to those whose businesses and jobs are threatened by irresponsible or indiscriminate industrial action.

3.15 The 1984 Trade Union Act is somewhat different in that it deals primarily with relations between trade unions and their members. In future, direct elections to union governing bodies will have to be by secret, usually postal, ballot: ballots will have to be held at regular intervals by unions wishing to spend money on politics. And unions can no longer call a strike without risking legal action unless they first win the majority support of members concerned in a ballot. By helping to ensure that unions are thus genuinely representative of their members, these measures should improve both union credibility and industrial relations generally.

3.16 But there are limits to what the law can do: and it is not on the union side alone that new attitudes are needed. More and more employers are now realising the advantages, in getting better performance and acceptance of change, if communication ensures that employees are more closely involved in decisions affecting them at work. The Employment Act 1982 requires larger companies to report annually what they have done to strengthen employee involvement.

3.17 The range of legislative and administrative procedures which employers must follow when taking on or employing people can be another factor limiting employment. While some of these procedures provide necessary protection for individuals and ensure that proper tax or other payments are made, clearer and simpler procedures would in many cases help employment without adverse

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effects. Thus, while maintaining protection for individuals, the Government has relaxed some of the other statutory burdens on employers associated with employment. In 1979 the qualifying period of employment for protection against unfair dismissal was increased to one year. The Employment Act 1980 increased this period to 2 years for employment in firms with 20 or fewer employees.

3.18 Again, the 'red tape' involved in paying tax and national insurance may adversely influence recruitment particularly of unskilled or low wage workers. The PAYE system is complex because it aims to secure payment of tax throughout the year in a way that is both accurate - ideally requiring no end-of-year adjustment - and cumulative. It involves very little work for employees but considerable amounts for employers. To help small employers in particular cope with these requirements, the Inland Revenue published a simple guide in June 1984. More generally, the Government has set up an inquiry to examine the administrative burdens on employers caused by Government legislation and procedures, particularly those burdens which bear hardest on small firms.

3.19 The growth and development of employment requires effective mobility. People must be able and prepared to make job changes, perhaps involving movement from one part of the country to another. But there may be difficulties in their way. One is the lack of availability of suitable housing. Planning constraints on substantial new housebuilding in some of the more popular and attractive parts of the country are one problem, and the Government has tried to help free the housing market and therefore allow people to move more easily. Home ownership has been extended through the sale of council houses to tenants; a start has been made on reducing restrictions on private letting; the rate of stamp duty on house purchase has been reduced; and in the public sector the National Mobility Scheme and the Tenants Exchange Scheme have made it easier for council tenants to move from one area to another.

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3.20 A further inhibition to job changing, especially in white-collar employment, is the operation of pension schemes, whereby an individual can be "locked in" to a job by the financial sacrifice of pension rights movement would require. This problem and ways of easing it are under consideration by the Government and the pensions industry.

3.21 Of course, people will only take a job or move if they see it as in their interests to do so, but sometimes the information on which they will decide may be misleading. Two examples will illustrate.

3.22 First, if the labour market is to work effectively, pay differentials should reflect more closely employers' needs for particular types of employees and the difficulties of recruitment, while providing incentives for people to take up work that is in demand. These factors change over time, and pay structures should be designed to adapt as circumstances alter. The Government has encouraged employers and employees to take account of this in their negotiations.

3.23 Secondly, the interaction of the tax, benefit and social security systems creates the "unemployment trap", whereby some people may be better off out of work than in employment. Since 1979 the Government has sought to protect the position of the worst off, notably by maintaining the value of supplementary benefits, but it has also abolished the Earnings Related Supplement and brought benefit for the unemployed into tax. This will have improved the incentive to work of those who have been unemployed for a fairly short period.

3.24 Training and education must be effective so that people have the right skills or are prepared and able to acquire them as industry's needs change. While training is not in itself a way to generate more jobs, it is an essential support to job creation. Without adequate investment in training, industry and commerce will be unable to adapt and compete.

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3.25 Since 1979 the Government has made improvement of Britain's education and training one of its priorities. The White Paper "Training for Jobs" pointed out that training is first and foremost an investment, and that the main responsibility rests with employers, who can best identify their own requirements. Trainees can contribute by accepting realistic pay or allowances while in training. The Government assists with young people's transition from school to work with the Youth Training Scheme, provides training for those out of work, and funds experimental courses and new developments using new technology and training techniques.

3.26 Much has already been achieved by industry and the Government through the activities of the Manpower Services Commission, particularly in the training of young people. Many of our industrial competitors, particularly their employers, have tended to devote much greater effort to preparing young people for working life than in the UK, where a far higher proportion of young people aged 16 and 17 go straight into the normal labour market. Great progress has been made since 1979 in tackling these problems. Perhaps most important is the Youth Training Scheme, offering school leavers for the first time in this country up to a full year of integrated work experience and training. Now into its second year, the Scheme has been demonstrably successful and as it develops, increasing emphasis is being put on improving training quality.

3.27 But the particular needs of young people start before they leave school. Education plays an important part in preparing young people for working life, and Government initiatives will improve the relevance of education to industrial and commercial requirements. In particular, the introduction of the Technical and Vocational Education Initiative is assisting changes in the school curriculum, with a greater emphasis on technical and vocational subjects. Some 62 local authorities are now running pilot projects for 14-18 year olds and funds are being made available for expansion of the Programme. The Certificate of Pre-Vocational Education is also being introduced to provide young people staying on at school for a year with a qualification more

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relevant to the world of work. Careers education and guidance help to bridge the gap between school and work, and an efficient Careers Service has an important role to play.

3.28 In addition, the links between schools (and colleges) and employers are being strengthened: the DTI's Industry Education Unit is working in collaboration with industry to provide, for example, relevant resource material for schools, colleges and Examination Boards and encourage industry-related expertise in both initial and in-service teacher training.

3.29 Changing the methods by which people acquire skills is of very great importance. Some industries are continuing to make good progress in modernising their training arrangements. But there is still much to do before time serving is fully replaced by training to standards; before unnecessary restrictions based on age or academic qualification are removed; and before skills already learnt are always properly recognised at each stage of training. The Government will continue to urge employers and trade unions to carry forward the reform of such training and, where appropriate, will make continued support of training conditional on satisfactory progress being made.

3.30 In this context, training and retraining of adults is vital. Here again, Britain suffers by comparison with its international competitors. For example, about two-thirds of the labour force in Germany have recognised qualifications of one kind or another: the proportion is similar in Japan while in the USA it is over three-quarters. In Britain the proportion is estimated at about a third. And these three countries all produce an output of professional engineers far in excess of that in this country. Some progress has been made since 1979 to develop and improve our training system for adults, and the education system, in helping to produce highly qualified manpower. A notable achievement is the establishment of the Open Tech, in which distance learning techniques are making for much more flexible training methods. There is however much still to be done in this area.

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3.31 A more responsive jobs market implies new working patterns as well as new skills and adjustments in labour costs. Responsibility for using labour more flexibly and adaptably must lie primarily with employers. Many British firms are introducing new work patterns with such elements as flexible working time, job sharing, more part-time working and different forms of employment contract. Homeworking is a particularly interesting development with the potential of new technology in allowing people to work at some distance from their employers, yet linked by telecommunications. The scope for such innovations varies with the nature of the business and the make-up of the workforce. The Government has encouraged the spread of part-time working through its own Job Splitting and part-time Job Release Schemes. In this as in other areas the Government welcomes appropriate action by employers, and sees its own role as helping to break down barriers to the adoption of worksharing where it does have real advantages.

3.32 Efficiency in the jobs market must of course be accompanied by fairness in work. Discrimination on racial or sex grounds and unfair dismissal must be prevented, and adequate standards of health and safety at work maintained. The Government remains fully committed to these aims and has done much to further them, for example by supporting the legislation with codes of practice for the employment of women and ethnic minorities.

3.33 There are nevertheless important practical realities to be recognised. The search for fairness is bound to impose restrictions on employers' freedom of action. If these become too heavy, they can cost jobs; businesses - especially small or new ones - may be made less profitable, or employers become more reluctant to take people on. Fairness matters, and losing jobs is itself unfair. But it is a bad bargain for society if the attempt to seek fairness results in large job losses.

3.34 Special help for groups who may be at a disadvantage is also being maintained and developed. Schemes run by the Manpower Services Commission to help disabled people into jobs have been improved and the Commission seeks to

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ensure places for disabled people in its main employment and training programmes. Its Fit for Work Campaign and associated Award Scheme urges employers to consider disabled people for all vacancies and to retain newly-disabled employees. The Commission has also set up a Disablement Advisory Service to provide practical advice and guidance to employers on how to make full use of the skills and abilities of disabled people and to promote the wide range of special help that is available, including financial assistance. The Government has retained the Statutory Quota scheme for disabled people with a voluntary Code of good practice in support.

3.35 People from the ethnic minorities are often at a disadvantage in getting jobs, sometimes because of a lack of fluent English. To help them compete with other workers, the Manpower Services Commission is increasing provision for work-related language training. For the most part, however, the Government believes that needs in the ethnic minorities are best met from general programmes for the unemployed rather than special measures confined to them. The Race Relations Employment Advisory Service provides practical help to employers with a multi-racial workforce.

HELP FOR THE UNEMPLOYED

3.36 However successful the country may be in achieving sustained competitiveness and efficiency, there will always be some unemployment as people change jobs. Much more serious, the recession has led to a large increase in long-term unemployment. It is now generally recognised that there are no quick or easy solutions to the present problem of unemployment, and the Government's strategy therefore encompasses a range of measures to help those affected.

3.37 There are two broad lines of approach. First, the benefit system provides income for those out of work while maintaining the incentive for people to get back into work. Secondly, measures have been developed which reinforce the policies summarised in this chapter to increase employment.

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These adopt a variety of approaches to help unemployed people, including temporary work, encouraging them to enter self employment, and to retire early. These schemes form part of a total programme of employment and training measures which are currently costing £2000 million a year and assisting nearly 700,000 people.

3.38 The largest of these is the Community Programme introduced in October 1982. In a full year it provides temporary employment for up to 200,000 long-term unemployed people on projects of benefit to the community, at a cost in 1984/85 of some £560 million. Priority is given to projects which do most to improve the long-term employment prospects of participants while providing work of practical value. To improve the effectiveness of the Programme, from October 1984 participation is being linked with short periods of basic skills training and work preparation. When these arrangements are fully in operation, 50,000 Community Programme participants are likely to benefit from training in a full year.

3.39 The Voluntary Projects Programme introduced in August 1982 also helps prepare unemployed people for work by providing about 40,000 of them a year with constructive voluntary activity. The Programme is being expanded and £12 million is being made available in 1985/86.

3.40 The Government also provides £25 million a year to Community Industry, which provides temporary jobs of community value for 7,000 personally and socially disadvantaged young people. Since April 1983, Community Industry has recruited 16 to 19 year olds outside the scope of the Youth Training Scheme.

3.41 Following successful pilot schemes, the Enterprise Allowance Scheme has, since August 1983, helped unemployed people throughout the country who want to set up their own business but who may be deterred from doing so by the fact that they would lose their entitlement to benefit. Over 60,000 people have joined the Scheme so far and some 1,000 people enter it each week. From April

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1985, resources have been made available to increase this to up to 1,250 people a week, at a cost of £111 million in 1985/86 and £125 million the following year. Surveys have shown that for every 100 firms established under the Scheme, over 50 additional new jobs have been created. The success of this Scheme thus directly contributes to the wider aim of encouraging the growth of new enterprises and self employment.

3.42 The Job Release Scheme makes it easier for older workers to give up work early and to release their jobs to unemployed people. The Scheme has been running for some years; it is currently open to men aged 64 and women aged 59. At present over 83,000 people are in receipt of the allowance paid under the scheme and approximately 350 applications are received each week. In 1984/85 some £284 million has been made available for the scheme.

3.43 This chapter has shown how Government policies are working together over a wide field to get the economy right and to encourage a lasting growth of employment. It has described the special help being provided for those hardest hit by unemployment. The next chapters consider ways of building further on what has been achieved so far.

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CHAPTER 4

THE ECONOMIC AND INDUSTRIAL FRAMEWORK

4.1 Previous chapters have outlined the rationale of the Government's policy, and its success in reducing inflation to below 5 per cent. In the light of the Government's strategy towards employment, its conviction is that sound economic and financial policies are the only basis for sustained employment growth. How should the framework of economic and industrial policy evolve in future?

4.2 Employment is now increasing, but unemployment is still rising albeit at a slower rate. In charting the course for the future, the reasons why unemployment rose to such high levels must be borne in mind. Three factors can be discounted.

4.3 First, the Government does not believe that there has been any shortfall of demand in the economy. Over the whole of the 1970s money demand rose by over 300 percent, with real output growth of only about 20 per cent. Last year money demand increased by about 9 per cent, but again most of this went in increased prices rather than more output.

4.4 Secondly, technological change is not to blame for our high unemployment. Historically, technology and investment have created wealth and employment, and it is difficult to argue that in the recession since the late 1970s, there has been a massive introduction of new technology destroying jobs. Indeed, the problem in Britain is widely recognised as being a sluggish response to new technological developments. We have too little rather than too much, and other countries such as the US and Japan have managed the introduction of new technology much more successfully.

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4.5 Thirdly, the increase in the numbers of people looking for jobs does not explain why unemployment has risen by so much. Of course if employment is static or falling, then a rise in the numbers seeking work will lead to an increase in unemployment in the short term. Thus over the past year most of the new jobs being created have been part-time and have been filled by women entering the labour force, and unemployment has not fallen though employment is rising. But these are short-term considerations. The general proposition that more people seeking work inevitably means higher unemployment is not true, since as Chapter 2 explained, it ignores the potential for growth and employment creation as the economy expands.

4.6 The Government's view, already explained above, is that we have not adjusted quickly or thoroughly enough in what we produce or in our employment practices to the new circumstances of the last 10 years. A major element in securing the framework for this adjustment is to pursue the appropriate economic policy. This means continuing, through the Medium Term Financial Strategy, to seek to restrain monetary growth; to reduce the proportion of the economy's resources pre-empted by public borrowing; and by maintaining firm control of public expenditure to ensure cost-effective use of resources, proper determination of priorities, and to create room for tax reductions. These will improve incentives and aid economic growth and employment.

4.7 There are those who would wish to take a different approach to generating jobs. They suggest a different macro-economic approach, that to create jobs and reduce unemployment the Government should borrow more, and undertake a further substantial increase in public spending. The practicalities of these proposals must be examined.

4.8 Macro-economic policy involves judgement of the best course of action to suit particular circumstances, and to achieve the balance between different policies and objectives. The Government's view is that its current policy stance is right, and that to increase the existing level of borrowing, or to go for major reflation, would be self-defeating. There are several reasons for this view.

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4.9 First of all, it is demonstrably not proven by events in the recent past. Governments in this country and others which have tried to reflate their way out of unemployment have met with failure in anything but the short-term. The effects on employment and unemployment have been short-lived, and the consequences of the reflation on the economy have been damaging, not least to employment, as wage and price inflation have risen.

4.10 It is not difficult to see why. Tax reductions unaccompanied by public expenditure restraints would mean increased borrowing. If excessive monetary growth and inflation were to be avoided interest rates would have to rise. This would depress investment and through their effects on the exchange rate damage industry's competitiveness; in due course unemployment would start to rise. Conversely, if interest rates were held down inflation would be higher.

4.11 Some point to the United States experience as evidence of the success of a more expansionary fiscal policy in creating jobs. But the long-term experience of the US and European economies does not support this argument. The current US budget deficit has led to high interest rates, and the authorities have recognised that this problem must be tackled. Moreover, over the last decade employment in the US rose by 21% while in the UK it fell by 4%. Over the same period real weekly earnings fell in the US by 10% but rose by 19% in the UK. This lends more support to the relationship between real wages and employment than to the role of fiscal policy - which was quite restrictive until the last few years - in creating jobs.

4.12 Some of those who advocate reflation have recognised the danger of renewed inflation, and have suggested agreed prices and incomes restraint to avert this. Past experience indicates the difficulties of this approach. Any form of prices and incomes policies - voluntary or otherwise - results in distortions and leads to a misallocation of resources within the economy as a whole.

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4.13 Should there be a major increase in public spending to provide infrastructure projects which would lead to more jobs? There is of course no doubt about the need for effective capital expenditure. Private sector investment is vital to improving efficiency and increasing output. There is a high and rising level of fixed investment in the British economy as a whole - (forecast) at £45½ billion (1980 prices) in 1984 - a post war record. Manufacturing investment is estimated to have risen by nearly 15% in the first 3 quarters of 1984 compared to the same period a year earlier, and surveys indicate that investment intentions are strong. Investment in the service sector in 1984 is on course to reach its highest ever annual level.

4.14 Nor is the Government opposed to public sector investment where it is appropriate and will earn a proper rate of return. Indeed, aggregate capital expenditure by the public sector has been broadly maintained, in real terms, at the 1978/79 level - some £24 billion in 1984-85. For example, spending on trunk roads has increased by 12% in cash terms in 1984-85 over the previous year; there is a large scale investment programme in water and sewerage services - costing some £620 million in 1984-85; and in 1983 repair and maintenance contracts for construction alone represented additional expenditure by the public sector of at least £5 billion.

4.15 But public spending on infrastructure cannot be considered solely in terms of possible employment consequences. Each proposal must be considered on its merits in the context of an intelligent and constructive approach to infrastructure, public expenditure priorities, and the likely rate of return on the project including the real benefits of quality improvement. Expenditure which is not cost-effective would waste resources and might harm employment and growth in the longer-term.

4.16 The overall employment impact of large-scale infrastructure investment programmes is in any case often overstated since they tend to be capital intensive and are to varying degrees import intensive. The number of jobs created by such projects, even allowing for multiplier effects, is quite small

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and the cost per job often very high. In addition, the consequences of financing the expenditure must be considered. If taxes have to be increased this will reduce disposable income and demand elsewhere. If public borrowing has to rise, interest rates will increase. In both cases there will be an adverse effect on employment.

4.17 Effective employment growth requires consistency in economic policy, but it also requires an ability to supply effectively demand in both home and overseas markets. Government's policies to improve the "supply side" of the economy and encourage enterprise and efficiency are therefore of great importance. Chapter 3 above described some of the main elements of the Government's current industrial policies. These include the encouragement of competition, the privatisation programme, support for the growth and development of small firms, and support for innovation and the adoption of new technology.

4.18 These policies will be continued as part of the Government's general aim to widen consumer choice, to make the market more responsive to consumer's needs here and overseas, and generally to eliminate unnecessary impediments to enterprise and competition. It is important that any industrial support should be selective and limited, rather than large-scale or indiscriminate. While the latter may give some apparent short-term benefits in preserving large numbers of jobs, insulating an industry from the pressures of international competition may prevent or delay necessary restructuring. In the longer term, this only leads to greater employment loss.

4.19 The Government intends to continue its privatisation programme. This will include British Airways, British Shipbuilders warship yards and as many as possible of Britain's airports. The exact shape of the programme will of course be determined by business and economic criteria.

4.20 For a country as dependent on international trade as Britain, another important aspect of generating more jobs is the expansion of trade, and the

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breaking down of trade barriers. Some people argue quite the reverse, that effective support could be given to British industry, and unemployment would be reduced, by restricting imports either generally or selectively for particular products or industries.

4.21 This argument overlooks the indirect effects of import restraints upon industry at large. The direct effect is to support employment in protected industries, but this is brought about by raising the prices of the products of those industries, and this leads to a reduction in the demand for the products of other industries. Generally speaking, any net gain to employment is transitory and in the longer term total employment may even be reduced.

4.22 The Government recognises that in certain special cases the use of temporary import restraints may nevertheless be justifiable. Demonstrable unfair competition where other countries are "dumping" products on the British market may call for action. Again there are cases in which use can be made of the breathing-space which they provide to bring the protected industry to full international competitiveness. But the indiscriminate use of import restrictions would serve only to insulate industry from the pressures of international competition and to prevent or delay necessary restructuring - as well as raising prices and reducing consumer choice.

4.23 Growth in total employment and output in the economy cannot therefore be achieved by extending import controls. Trade policy must continue to aim at the reciprocal opening up of markets, which benefits employment in two ways. First there are greater export opportunities for British business; and secondly the long run effect of more competition in home markets is improved efficiency in domestic production and lower costs which in turn provide the basis for more opportunities for sustainable employment.

4.24 It is suggested by some that industry and employment would benefit from greater special assistance to particular areas of the country. Others argue that such regional incentives distort the national economy, and that overall

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few if any additional jobs are created. Special assistance for particular areas has been part of successive Governments' industrial policy for many years. The present Government has recently reviewed this policy and concluded that although the economic case for it may be weak, there is strong social justification for an effective scheme aimed at reducing regional imbalances in employment opportunities. Changes have therefore been introduced to ensure that this objective - more jobs in relatively badly off areas - is met more effectively. Capital grants - at 15% of approved expenditure - will be subject to a limit related to the number of jobs created; alternatively firms will in future be eligible for a job grant of £3000 for each new job and they will automatically receive the higher of the two grants. The new scheme is also being extended to cover a range of service industries for the first time, and selective assistance to projects that protect existing employment but which otherwise would not go ahead is being continued.

CONCLUSION

4.25 This chapter has briefly described the first part of the Government's strategy towards employment - the economic and industrial framework. Holding a steady course on current policies is the only effective way in which a healthy economic environment and competitive industry can be fostered. This will lead to increased employment and, in time, to lower unemployment. Employment can however be higher, within the framework of current economic policies, if the jobs market reacts flexibly and if existing impediments to employment can be removed. The next chapter deals with some possible ways in which this might be done and employment growth encouraged.

CHAPTERS 5 AND 6

The following two chapters are not in White Paper form. Instead they present a series of possible items for inclusion, together with some of the relevant arguments. These Chapters are therefore an agenda for discussion and decision, after which it will then be possible to draft a final version.

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CHAPTER 5

FURTHER ACTION TO INCREASE EMPLOYMENT

5.1 The economic and industrial strategy is creating the conditions in which output and wealth can grow. Employment growth is one outcome of this increase in wealth. The question is whether employment might be further encouraged by removing barriers to employers recruiting workers or people taking or changing jobs.

5.2 This chapter considers major impediments that may continue to hinder employment and suggests possible lines of further action, consistent with efficient and effective production.

FURTHER STEPS TO REDUCE LABOUR COSTS?

5.3 As chapter 3 pointed out, the real cost of employment is a major determinant of the numbers in work. A slower growth - not necessarily reduction - in real wages would feed through into more jobs. As a broad order of magnitude, a 1% change in the average level of real pay could mean between 150,000 and 200,000 jobs. So if earnings over the last two years had not outstripped prices, the result could have been an extra half million jobs a year created over a period of time. Growth in average earnings still exceeds inflation by nearly 3%, so that employers and trade unions who favour those in employment are pushing up their real earnings at the expense of the unemployed. The Government is exerting its influence, through persuasion and by setting an example as an employer itself, to encourage moderation in wage settlements.

5.4 The Government has also recognised the significance of non-wage costs of employment in affecting the number of jobs and has acted to help, notably

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through the abolition of the National Insurance Surcharge. A further idea now being widely canvassed is a possible reduction or change in the structure of employers' National Insurance Contributions (NICs) so as to reduce the costs of employing people at lower wages.

5.5 Such a proposition does present several problems. It would mean abandonment of the insurance principle on which the National Insurance system is currently based. It could be argued that it would impart an additional distortion rather than removing existing ones; and it would be a disincentive to the employment of high-wage skilled and qualified manpower and perhaps to the acquisition of skills. In addition, the jobs effect depends on the detailed relationship between labour cost changes and employment changes in different sectors of the labour force, on which the evidence is inconclusive. And if reductions in NICs led to higher wage settlements this would reduce the employment effect. For these reasons the change would not have the same effect as a slower rise in real pay. The cost burden would be shifted and any extra costs would have adverse effects on employment.

5.6 On the other hand, the proponents of the idea that NICs should be restructured point to a number of possible advantages. It could give employers an incentive to hire those heavily represented among the unemployed, such as semi and unskilled workers, including many of the long term unemployed. If there were no resulting increase in pay inflationary pressures would not be increased, and depending upon the particular structure adopted, the jobs effect might be created without undue additional cost. Some external studies suggest that the net employment gains could be quite large, confirming the potential for new jobs not only in the high technology areas, but also at the lower end of the wage scale. By enabling more people to find a way into useful employment, lower paid jobs bring social and economic benefits, to the individual worker, the employer and society as a whole.

5.7 Several other countries, including Germany and France, have taken steps to reduce employer labour costs, and the balance of advantage and disadvantage

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of different types of restructuring NICs, which could be revenue-neutral or might involve extra cost, does seem worth serious examination in terms of the magnitude, direction and timing of employment effects in the short run, and any distorting effects in the long run. This would clearly have to be done in the context of the DHSS social security reviews.

5.8 We have also been considering the adverse effects that the Wages Council system can have on the generation of employment opportunities, particularly for young people, and the administrative and other burdens which its rigidities can impose on businesses. We are publishing simultaneously with this document a consultative paper, as a basis for informed discussion, inviting views on these effects and on options for the reform of the system. The objective would be to reduce impediments to the creation of more jobs. This consultation also provides the opportunity for discussion on whether the system should be retained.

FURTHER REDUCTIONS IN ADMINISTRATIVE BURDENS?

5.9 Excessive bureaucracy is widely held to be another obstacle to more jobs. Some of the statutory regulations have already been relaxed, notably the protections against unfair dismissal. But there are still too many forms, procedures and legal obligations, which can be a major burden for some employers and can so easily stifle enterprise and inhibit growth.

5.10 The scrutiny of burdens being conducted in 7 Departments is now in its final stage and proposals for change will emerge shortly. The report will cover a broad range of requirements and practices that can bear on employment, including local government licensing and inspection procedures, and this should lead to some helpful simplifications and lifting of burdens, particularly on small firms. Though the effects on employment might not be rapid, further action in this field could contribute to a more promising environment for employment.

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[The burdens that may be imposed by employment protection legislation are to be considered by E(A) in January].

5.11 One particular way of minimising the effect of administrative and legislative burdens is by a form of "Passport" scheme. This would specifically exempt employers who take on people below a certain wage from PAYE and employers' National Insurance contributions, and from the main requirements of employment protection legislation. The inducements to the employer would be lower labour costs, thereby providing more jobs at realistic wage rates, and the exemptions and less paper work in taking on any new employee.

5.12 This general proposal could be applied in a number of different ways. The scheme could be open to all potential employees, or restricted to those currently unemployed or the long term unemployed. There could be attractions in linking it to the end of training under the Youth Training Scheme as the natural introduction for young people into the labour market. Or the Scheme could be open to anyone prepared to work or to start work under its terms, and perhaps restricted in the first instance to small firms, including new employers. Belgium has a scheme broadly of this kind which applies to a self-employed person recruiting his first employee.

5.13 The best approach would be a scheme to be launched and tested on a nationwide pilot basis and expanded if justified by experience. Detailed study of the impact and cost of some of these options is now under way. Any proposals would need to be linked in with the MISC 107 study of provision for 14-18 year olds and with the DHSS social security reviews insofar as changes in NI contributions are envisaged.

5.14 If an option were chosen which covered 17 year olds, this scheme would replace the Young Workers Scheme. If a different option were selected, it would be desirable to retain the Young Workers Scheme, which has had some effect in reducing relative youth pay and increasing youth employment, and could perhaps be more extensively publicised to urge more companies to take on young people under the Scheme.

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INADEQUATE LABOUR MOBILITY?

5.15 Some jobs remain unfilled or are not created because people are unable or unwilling to move to a different area or to acquire new skills. Barriers to mobility need to be overcome to allow this kind of movement.

5.16 Action already taken on housing policy is noted in chapter 3. The Government is continuing to look for ways of further encouraging provision of accommodation in the private rented sector [H Committee is to consider proposals on de-regulation of the private sector].

5.17 On occupational pensions, the Social Security Bill proposes protecting the rights of 'early leavers' by requiring pension schemes to revalue their entitlements up to pension age, in line with inflation, by up to 5% a year. It will also allow people leaving an occupational pension scheme the right to a transfer value, thus paving the way for greater portability of pensions. Beyond this, consultations have been taking place in the context of the DHSS reviews about the possibility of introducing a more radical option in the form of personal pensions which would give people the freedom to choose their own pension arrangements. The Government is firmly committed in principle to move in this direction.

5.18 Better information about jobs and jobseekers helps mobility and job matching. The MSC Jobcentres will be streamlining the services they offer to make them more efficient and effective, and better suited to the needs of the modern labour market. Jobcentres will increasingly act as a 'gateway' to a range of opportunities for jobseekers. Proposals have been endorsed for a major investment in new technology, including a nationwide system to improve the speed and handling of employers' vacancies, thus helping to fill jobs more quickly. And tests are being carried out on ways of giving people direct access to information about all the options available to them, including new occupations, training programmes, opportunities in other areas and self-employment.

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5.19 The MSC's mobility schemes are being revised in ways designed to make them more cost-effective. New arrangements are to be tested which will link assistance with removal expenses more closely with specific 'hard to fill' vacancies, and which will provide greater access to assistance with fares for those who are interviewed for jobs outside their home area. Though small in scale, these schemes can make a useful contribution to meeting the needs of employers and employees.

5.20 Greater mobility also calls for more and better training and re-training. This cannot now be a once-for-all affair. People in mid-career will increasingly need new or enhanced skills. The continued economic recovery itself depends crucially upon overcoming skill shortages, especially in the new and high technologies. The adult training strategy, as set out in the White Paper "Training for Jobs", is therefore of major importance and an essential complement to our policies for youth training and education. As one element, the MSC's own adult training provision is being restructured into two main programmes, concentrating on job-related training and training to help unemployed people. The job-related programme will be directed to known employment needs and to helping the creation and growth of new businesses. The other programme is specifically designed to help unemployed people improve their basic skills, remain employable and cope with the changing content of jobs and work patterns.

5.21 But the strategy is for action by industry and individuals themselves as much as by Government. So the first task is to persuade employers and individuals to invest much more in their own training, as in our main competitor countries. This is the purpose of the awareness campaign recently launched by the Secretary of State for Employment, in an effort to change attitudes and behaviour over the years ahead. The campaign will be led by the Manpower Services Commission and will actively involve employers, those who provide training and, indeed, the widest possible range of interests, in a sustained series of collaborative events, regional and local as well as national. An important aim will be to break down the barriers to access to training that still exist.

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5.22 A consultative paper has been issued on the proposal for an experimental training loans schemes for adults. It recognises that some people who are indeed willing to invest in their own training so as to improve their job and earnings prospects may face a considerable financial problem in doing so. The scheme would help remove this obstacle. Individuals wishing to take part will provide a proportion, say 20%, of the required funds themselves and will be able to negotiate a bank loan for the remainder, half of which will be provided by the Government. Repayments will be made to the bank, which will in turn repay the Government's share. Up to £5 million is being set aside for the 1985-86 pilot scheme which should cover some 10,000 loans of varying amounts.

5.23 A possible complementary approach to encouraging and helping people to invest in their own training is suggested by the interesting new American practice of developing "individual training accounts". Under collective agreements, for example that between Ford and the Union of Auto Workers, employees contribute to a type of personal insurance fund which they can then draw on to pay for training or re-training throughout their working life or at time of redundancy. We are considering whether arrangements along the same lines could be effective in Britain.

5.24 In the same vein, further suggestions have been made with the object of allowing people to use assets they have built up in their pension funds for training. First, for self-employed people this would mean widening the existing uses of these assets, whether directly or for borrowing-back purposes. This could be relatively easy to do. Secondly, but more difficult, members of occupational pension schemes could have a similar facility against their assets in the aggregated fund. [DHSS have serious doubts about this]. This would have to overcome the resistance of fund managers to telling individuals what their assets are worth. A third change could be to increase the limit of tax relief on contributions for, say, 3 years for someone saving for a training course. This would require Inland Revenue approval.

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MORE FLEXIBLE WORKING PATTERNS?

5.25 The adoption of new patterns of work, related to the needs and circumstances of individual businesses, is of interest as new forms of employment contract develop. For example, GEC runs a scheme whereby two young people share the same job, spending the time they are not at work in further education. Rank Xerox has introduced "networking" under which some of its employees have been helped to set themselves up as self employed, often working from home, with an initial period as subcontractors. This sort of scheme is made possible by the development of telecommunications and other technology that enables individuals to operate at a distance from those employing them. More flexible working time, part-time working and extended shift systems are developing in such diverse enterprises as supermarkets and North Sea oil rigs. Other changes are being introduced such as early retirement schemes and sabbaticals or "career breaks".

5.26 The Government has so far given some encouragement to part-time working through the Job Splitting and part-time Job Release Schemes. Generalised or legislative schemes for reducing working time which have been introduced abroad, especially in Europe, are likely to be ineffective and inefficient. The employment effects are quite uncertain, being dependent upon the reaction of employers and trade unions to the changes. They could increase pay, raise productivity, or work more overtime, with no necessary increase in employment. In general, measures to re-organise working time and patterns must be compatible with competitiveness and the circumstances of individual companies.

5.27 The same factors affect the scope for intervention to limit overtime. It is hard to see how ceilings or target reductions could be imposed or administered cost-effectively in a way which added to jobs while safe-guarding competitiveness. Legal restrictions on time worked as in Italy or punitive taxation of overtime pay, for example, would be complex, costly for employers and inconsistent with the aim of greater flexibility and freedom for employers. Overtime is of course often the most efficient way of coping

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quickly with changes in demand or with small but regular amounts of work outside normal working hours. Systematic high levels of overtime not related to the needs of the job are another matter, but reductions are best pursued by negotiations within individual firms.

5.28 It might be possible for the Government to facilitate and encourage the spread of new working patterns where this is in employers' and employees' interests through the supply of information. Despite growing interest, knowledge of practices that are being adopted and the conditions making for successful change in different enterprises is inevitably sketchy and unsystematic. A clearing house, either inside or outside Government, could provide information and advice about flexible working patterns and provide a focal point for the sharing of experience and views. A particular objective could be to promote the Job Splitting Scheme and the part-time Job Release Scheme which currently have a low take up.

YOUNG PEOPLE AGED 16 TO 18?

5.29 The situation of 16-18 year olds is of special importance both in relation to current employment and training provision and for their longer-term future. In recent years the Government has put resources on an unprecedented scale into improving the transition between school and work, and helping unemployed young people. The Youth Training Scheme, the Young Workers Scheme and other measures costing between them nearly £1 billion in 1984-85 are having a major effect in reducing the numbers of school leavers who are unable to find some form of employment or training and in increasing the numbers receiving systematic work experience and vocational preparation.

5.30 But as a recent study has shown we still lag behind competitor countries like Germany, Japan and the USA in the way we prepare young people for their adult working lives. More can be done to develop a comprehensive strategy for those under 18, taking account of the wages, benefits and allowances of those on the various different pathways from school to adult life as well as their

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continuing education and training. The aim would be to move towards the position where unemployment should no longer be an option for this age group. This would also involve continued efforts to break down barriers to training, including the reform of the apprenticeship system. Every individual should therefore have the possibility of education, training or a job, or some combination, at least until age 18.

[To await MISC 107 conclusions on policy]

CONCLUSION

5.31 This section has put forward a number of ways in which employment might be encouraged, both by removing barriers to employment and by more specific action. Further examination would be required of the practicability of some of them, partly to assess whether employers and individuals would respond in such a way that employment gains were achieved, and partly to estimate their cost-effectiveness, including public expenditure effects. Parallel work, including the DHSS reviews, the burdens scrutiny, and in MISC 107 and E(A) as noted above, will also need to be taken into account.

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CHAPTER 6

THE SPECIAL PROBLEM OF UNEMPLOYMENT

6.1 Even with a sustained rise in employment, there will remain for many years difficult problems of unemployment. With increased prosperity, there are likely to be increased disparities in unemployment between localities and between groups of people. Many communities will prosper, but some where employment has fallen sharply will find unemployment a much more intractable problem. Many unemployed individuals will find new jobs, but some who have little skill and long experience of unemployment will remain out of work.

6.2 The Government has already done much to help alleviate the worst problems of unemployment during the recession. But with real wages increasing for those in work, the unemployed are bearing the burden of adjustment. The question therefore is whether, with increasing prosperity, more could be done to bridge the gap between the "haves" with jobs and the "have nots" without, through specific measures to help the unemployed?

6.3 Perhaps the most significant and worrying aspect of the employment situation is the huge number of long-term unemployed. Some 1½ million people, nearly 40 per cent of the unemployed, have been out of work for more than one year, over 350,000 of them for over 3 years. The numbers are still increasing.

6.4 The long-term unemployed must be regarded as the priority group for any action to deal with the individual problems of unemployment, and this chapter considers a range of possibilities. The discussion builds on experience with the existing employment measures. These are systematically evaluated and reviewed, and there is considerable detailed understanding of how well and cost effectively different schemes work.

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EMPLOYMENT SUBSIDIES?

6.5 Many people advocate employment subsidies whereby employers would receive a payment (or relief from National Insurance contributions) for each long-term unemployed person they took on, either in total or as an addition to their existing labour forces. Such subsidies have some advantages: they can easily be targeted on particular groups of workers or areas; and they put people into "real jobs".

6.6 But analysis shows that most employment subsidy variants would be much less cost-effective than existing employment measures. If they are to have a substantial impact, they must offer substantial incentives. However, they tend to have high "deadweight" (ie many employers receive the subsidy for doing what they would have done in any case), and there is frequently substitution of one unemployed person for another.

6.7 Because of their cost, and because in their more sophisticated forms they are difficult to administer and control, subsidies have not been favoured in discussion of past policy options.

MORE WORK OF COMMUNITY VALUE?

6.8 The existing Community Programme provides 130,000 places for temporary employment with some 200,000 long-term unemployed people participating in the Programme each year. It pays the rate for the job, but with a weekly wage ceiling. The rules provide for minimum substitution and displacement of other jobs, partly by prohibiting private gain from the projects. The gross cost in 1984/85 is about £560 million (£204 million net), and the net cost of taking someone out of unemployment is about £1900. Many other countries, including Denmark, Netherlands and France, have temporary work programmes, providing work of community benefit.

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6.9 There are several possible ways in which additional temporary work for the long-term unemployed might be provided. First, under a "benefit plus" scheme, unemployed people could remain entitled to an amount equal to supplementary benefit with an addition (perhaps of £10 per week) in return for doing useful community work.

6.10 A version of a "benefit plus" scheme was proposed in 1981 when the Community Programme was introduced, and the reaction from all those who would have been involved was strongly adverse. Trade unions were opposed, and there was a unanimous view from employers, local authorities and voluntary bodies that they could not deliver places and would not be able to act as sponsors for projects. In addition, it appears that a "benefit plus" scheme might be no more cost-effective than the Community Programme, and an unconditional scheme without a ceiling would probably have cost more as married men with high benefit entitlement participated.

6.11 While a "benefit plus" scheme has superficial attractions, not least in its effect on pay, the practical difficulties are overwhelming. A "benefit plus" scheme to replace the Community Programme at a larger scale does not therefore seem desirable.

6.12 Secondly, the Community Programme might be expanded under its present rules. This would mean tapping sources of demand which would otherwise lie dormant, such as local authority environmental projects which did not feature in immediate plans. At the maximum this would involve an increase to 250,000 places, catering for over 300,000 individuals per annum. This could be achieved within one year. The additional cost would be £540 million gross (£170 million net) in a full year.

6.13 Thirdly, the Community Programme might be expanded even further to 375,000 places. This would mean breaking new ground with some change to the current rules and new approaches to the generation of projects, eg in planning for a major programme of repair and maintenance of public facilities. In

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particular, it would be probably necessary to allow projects with an element of private gain. This would have the benefit of involving the private sector much more than now, in a wide range of projects eg removing eyesores, improving industrial estates, refurbishing premises; and possibly larger local infrastructure projects. But it would be necessary to keep a close watch on the rules and their administration to guard against more substitution and reduced cost-effectiveness. Timescale for effect would be 2-3 years, depending on industry's response; additional cost estimated at about £1 billion gross (about £350 million net) in a full year.

6.14 Within all these possibilities, there is a question of whether a guarantee of an offer of a place should be offered to some groups of the long-term unemployed, say those who had been out of work for 3 years or more. This would represent a very positive response to the problems of those hardest hit by unemployment, and it would have the incidental effect of clarifying which of the unemployed are, for one reason or another, not really interested in an offer of a job.

6.15 The numbers to be covered under a guarantee scheme would however be very large. Over 350,000 people have now been unemployed for over 3 years and the number is increasing as more people flow in. A guarantee to them would take up all the places in the "maximum" option set out above and it is very doubtful whether a programme restricted to this group - which might contain a relatively high proportion of "unemployable" people - would be at all attractive to sponsors.

6.16 If a guarantee were thought to be important, a more practical option would be to offer a place to all the 18-24 year olds who have been unemployed for more than 3 years. Such people would very largely have missed out on the youth employment programmes now running; the number, about 60,000, would be manageable, and there would be a mix of people with different durations of unemployment within each project.

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6.17 A fourth option for community work might be to introduce an additional, charity-based Programme. National registered charities could recruit an agreed number of long-term unemployed people, with rules governing activities, and be paid a weekly "block grant" for each. This would be rather less than the unit cost of Community Programme in exchange for less red tape. Perhaps 50,000 participants might be attracted over 2 years at an estimated cost of £180 million gross (£67 million net) in a full year. Further study would be needed of likely responses if this were thought to be desirable. It could run alongside the Community Programme.

6.18 In all these options, two practical considerations are important. First, such programmes must as far as possible be provided and delivered locally and by those who best know and understand the local circumstances. Secondly, there should be full involvement of private sector companies, bringing to bear their commitment to the local communities where they operate as well as their actual experience of creating employment. The possibilities of joint ventures between private, public and voluntary organisations would have to be fully examined.

VOLUNTARY WORK SCHEMES FOR UNEMPLOYED PEOPLE?

6.19 Unemployed people suffer not only from reduced income: their skills can decline and with that their chances of getting back into work. The Voluntary Projects Programme (VPP) aims to provide opportunities for work or activity on a voluntary basis which can be undertaken by all unemployed people, without affecting entitlements to state benefit. Sponsors come largely from the voluntary sector and funds are available for a small number of paid employees to run a project. The cost of the Programme in 1984/85 was £7 million.

6.20 A possible development of this programme might be to redesignate projects and pay participants a training allowance for a minimum attendance of a week at a time during which they would cease to draw benefit. It would be necessary to specify carefully the training provided so as to justify the

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training allowance. Such a programme could build on existing schemes to around 50,000 places over 1-2 years. Because training allowances would be paid, the gross costs would be high at £160 million (£86.5 million net) in a full year.

6.21 The Opportunities for Volunteering Scheme administered by national voluntary organisations for the DHSS offers further opportunities for useful activity. The Scheme provides grants, amounting to £5 million a year, to local projects enabling unemployed people to participate in voluntary work, specifically in the health or personal social services. It has proved its value and the Government has decided to continue it on a long-term basis. A consultation paper has been issued seeking views on how this may be done most effectively; it might for example be targetted on particular groups.

6.22 Another more speculative possibility would be to allow long term unemployed people voluntarily to "sign off" the unemployment count for a period to work on worthwhile projects while still receiving benefit, or an amount equivalent to it. To pay benefit to people in some form of work would require legislation, and there would have to be safeguards against substitution and displacement of other employees. Such a scheme would have the same drawbacks as the "benefit plus" proposal, but a small-scale approach with sponsors who were prepared to pay benefit equivalent - thus eliminating the need for legislation - might be cost-effective. It could be run alongside the Community Programme.

EARLIER RETIREMENT?

6.23 The suggestion is often made that, if there are not enough jobs to go around, earlier retirement would reduce the numbers available for work and help get some of the younger unemployed back into work. But this again is the short-term argument that there is a fixed supply of jobs which have to be shared out. Early retirement is a measure with a long-lasting effect in reducing the numbers available for work, and those who advocate early retirement have not considered the potential for employment creation as the economy expands.

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6.24 There are practical problems too. Lowering the statutory age of retirement would have high public expenditure costs in terms of pensions and supplementary benefits, and it would create problems for private pension schemes. Some workers might have to retire before they or their employers wished, and unemployment might not be much reduced if retired employees were not replaced, or if they themselves took new jobs.

6.25 Early retirement can of course be arranged under company pension schemes to suit the requirements of individual employers and workforces. The Government itself, like those in Belgium and Germany, has taken a much more selective approach. The Job Release Scheme encourages workers to retire voluntarily to make way for younger people. This has the advantages of being reversible and specifically focussed on reducing unemployment. This year the age of eligibility has reverted to 64 for able-bodied men, having been reduced to 62 between 1982 and 1984. The 1984/85 gross cost was £290 million (£128 million net) at a cost per person off the unemployment count of £1600. A return to the lower age would cost £46 million gross (£21 million net) in 1985-86 rising to £130 million gross (£62 million net) in 1986-87, enabling a reduction in unemployment of 44,000. Costs would continue to build up each succeeding year.

MORE INCENTIVE TO PART TIME WORK?

6.26 It is often argued that many unemployed people have little or no incentive to seek work since their total income while out of work exceeds their possible income if they found a job. The Government's changes to the social security system have lessened the effect of this "unemployment trap" which does however still apply to some people with high supplementary benefit (mainly because of family responsibilities) and low earnings potential. The relationships of people's incomes in and out of work will be a major feature of the current DHSS reviews.

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6.27 Lowering the rate of benefit, which is already means-tested, does not seem an appropriate solution to helping long-term unemployed people back to work but there is one change which might be worth consideration. At present an unemployed man receiving supplementary benefit (and/or his wife) may earn up to £4 a week without loss of benefit. Beyond that there will be an equal reduction in benefit for any additional earnings. This removes any financial incentive to take part-time work. It might be possible to improve the incentive to unemployed people to seek part-time low-paid work by increasing the amount of earnings that may be disregarded in assessing benefit entitlements. If such a change were effective it would of course increase expenditure on supplementary benefit; moreover it would diminish the incentive to take full-time work both for those who made use of it and more generally through the distorting effects on the whole structure of benefits. The DHSS review of social security will be considering this option.

CONCLUSION

6.28 This chapter has illustrated a number of measures which might be taken to help unemployed people, especially the long-term unemployed, most of them involving a reduction in the numbers. Some of the proposals have little or no cost to the Exchequer, but most would involve additional expenditure by Government. Two important points may be made.

6.29 First, to the extent that this additional expenditure is not met by savings elsewhere, there would have to be an increase in taxation or borrowing over what it would otherwise have been. This will involve some loss of jobs in the economy elsewhere, and there are therefore offsets to the beneficial effects of the measures.

6.30 Secondly, the net cost of such measures - especially the Community Programme - is much lower than the gross cost because of savings in benefit expenditure and increases in tax receipts, so that the actual increase in Government expenditure is a good deal lower than the initial cost might

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suggest. Such schemes can therefore be a very cost-effective way of reducing unemployment, and since they can be targetted on particular groups, they enable help to be concentrated on those who have been hardest hit by the recession.

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Industry & Employment Services
file

Prime Minister

2

19 October 1984

19/10

PRIME MINISTER

David Owen's article on 15 October in the Guardian claimed to set out a way of putting "a million to work".

Some of his points are taken directly from the writings of Professor Layard. The rest is plagiarism from Conservative schemes.

The Layard tax proposals

Layard's work is based on the unsound principle that rigidities in the labour market, sloppy bargaining, trade union pressures and inflation can be solved at a stroke by tax measures. Normally tax measures set up countervailing pressures that thwart the intention, or encourage evasion and avoidance. They cannot revolutionise trade union practices.

There are three proposals related to National Insurance.

a. Abolition of employer's National Insurance

Contributions for additional employees for the first 2 years that they were taken on. This would be an incentive to greater employment with substantial deadweight cost.

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Problems include:

- i. Who counts as an "additional employee"?
 - ii. Won't some people close down existing businesses, and set up under a new name to claim the rebate?
 - iii. How is the rebate to be funded?
 - iv. What happens after the 2 years elapse? Sackings and new recruitments?
- b. Giving "shrinking firms" a rebate of employer's National Insurance Contributions for any number of employees over 90 per cent of the previous year's number. The intention is to keep numbers up in firms that face temporary difficulties. But:
- i. What qualifies as a "shrinking" firm?
 - ii. Couldn't a firm announce 10 per cent redundancies, and then cut by only 5 per cent, then claim a rebate for the remaining 5 per cent, whom they had no real intention of sacking anyway?
(Cf Temporary Employment Subsidy.)
 - iii. How is the rebate to be funded?

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- c. Increase the employer's National Insurance contribution from 10 per cent to 30 per cent, and give a fixed £36 per week rebate to the employer for every worker employed. This is the best of Dr Owen's schemes: it penalises high pay and subsidises low pay, whilst in principle having no net effect on the Exchequer. But:
- i. Employees might sack high-wage employees, or take on fewer, thus aggravating our problems.
 - ii. Companies might pocket the subsidy element and buy more machines, or pay higher dividends, without taking on any more low-paid people.
 - iii. It would be an unavoidable tax on high wage (often high growth) industries, and a gratuitous benefit to low wage (eg textiles) industries.
 - iv. It can be glibly attacked as an even bigger tax on jobs than we currently have.

An inflation tax. You allow your fiscal policy to relax a little, and then as soon as inflation sets in, you tax the benefits of that inflation away. He seems totally unaware of the enormous enforcement problems that would arise, as any inflation tax means second-guessing the market place in its millions of decisions about individual prices and wages. If it is successful it represents the most Draconian series

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of controls and regulations yet devised for tampering with every single market-related price and wage in the economy.

It would distort movements in relative prices, and could lead to queues and shortages. The most likely result of the inflation tax proposal is chaos. If it had any success at all, it would only be at the cost of important freedoms.

Other measures

A major increase in the Community Programme. This would alleviate the immediate problem; but, because of the Programme's wage rules, it would also help to entrench present union rates, which Dr Owen professes to regard as a major cause of unemployment.

Concentrating on the under 25s with a training emphasis.

This is something the Government agrees with and is working on.

Employing more cheap female labour in health and personal social services areas. If this employment was to be undertaken in direct care, and if substantial offsetting economies have been made elsewhere, then it is something that would make sense. Dr Owen fails to say how he would finance it, or whether it falls foul of Labour's sex discrimination laws.

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A £1,000 million capital investment programme, with the accent on housing. The Government is already pursuing a generous capital investment programme, whilst the surge in private sector investment means that total investment has been rising steadily for several years. If it's jobs you're after, you get many more jobs employing low-paid people direct on the public pay roll than indirectly through a construction contract.

An increase in the Loan Guarantee Scheme. No. He does not understand the high risks and bad debts incurred in running it. This rightly led to some reduction in the amount of money being advanced under it. New ventures need equity not debt.

A substantial increase in the Enterprise Allowance Scheme, as Ministers currently are doing.

He speaks favourably of the current review of regional policy, seeking to divert capital grants into job-related grants.

Conclusion

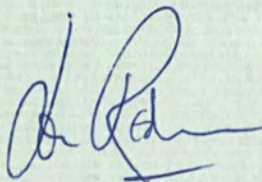
Owen has put together a complex and superficially attractive package which will win a great deal of support. Because its best bits are plagiarism - the highest form of political flattery - it will be attractive to many on our side. It is

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vital that it is countered both by saying that its best bits are copied, and its worst bits are the crackpot academic schemes of Professor Layard, who does not understand how markets work and why prices matter.



JOHN REDWOOD

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17 October 1984

PRIME MINISTER

JOBS AND PAY

There is growing acceptance around the Cabinet table and in the press that ever-higher real pay for those in work keeps others out of jobs. Union minimum rates, the benefit system, and automation stop the market working.

Owen has tried to address himself to this problem. It will naturally invite the question: what is the Government doing about it?

A Solution

If there were no social benefits and inadequate private philanthropy, no labour cartels, and enough honest money around, there would be little unemployment.

We need to restore more of the workings of the marketplace by:

- a. Tackling the labour cartels. The argument that union minimum rates and conditions destroy jobs needs constantly drumming home - your No.10 example in the speech was a good way of doing it.

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But we can do more than educate. Contracting-out public services brings competition, the best force for moderation, into play. Where it has been done - in all too few places - it has brought new labour agreements, new attitudes.

Competition by tender and by opening up restricted markets also works on pay and work practices.

The most important impact of these policies is not their first round impact on pay or jobs - contracting-out actually destroys jobs in round one in the particular services affected - but in their impact on attitudes.

Break public labour cartels for manual workers, and then you can take on more unskilled at low rates without union opposition. Remember the Community Programme is union rates, not benefit-plus. So it does less for more cost than need be.

And wherever possible, split monopolies and break up state monoliths. The Department of Energy is still letting us down on gas. By all means abolish Wages Councils to take government out of the job-destruction business.

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- b. Enough honest money. Low interest rates are a great tonic for construction activity, particularly for private housing, the most labour-intensive.

There is more than enough money around. If anything, the laxity of money growth has led to more inflationary pressures, especially on wages. So do not relax: drive for lower interest rates the honest way by a tough spending round.

And keep on explaining that on investment it is the total that matters, and that's growing nicely.

- c. Tackling the benefit system. We believe that it may now be time to consider a benefit-plus Community Programme.

Canadian and US experience shows that cuts in benefit eliminate the unemployment trap and force people back to work very quickly. But cutting benefits for the long-term unemployed is thankless and heartless work. An easier way of helping the long-term unemployed out of the trap is to offer them work as home helps, companions to the sick and old, rubbish collectors, graffiti removers, etc, paying them £10 more than their benefit. Unlike the present Community Programme, this would avoid enshrining the union rate-for-the-job, and would ensure that all long-term unemployed people both

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had the offer of a job and a financial incentive to take one - regardless of their benefit level. A very big scheme would still cost well under £1 billion.

This should be financed further by substantial cuts in less effective job-creation programmes (Regional Aid - £200 million; DTI industrial subsidies - £200 million; Nationalised Industry EFLs - £400 million; Capital projects - £200 million).

When this idea was raised previously, it was opposed on the grounds that people on different amounts of benefit would be doing the same work for different wages. The voluntary bodies and local authorities (who act as agents for the Community Programme) objected on these grounds. But the mood is changing. We believe that if you now issue a public challenge to the voluntary bodies and local authorities, offering Government money to fund benefit-plus jobs for a substantial number of people, they would find the offer hard to resist. The unions would, of course, oppose the scheme; but how vociferous could they be in their condemnation of such an assault on unemployment? Politically, you would be in a very strong position, either winning the argument or proving that unions prevent jobs.

- d. Consider eliminating the tax on jobs. Instead of adopting David Owen's complicated and risky strategies

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(see other paper) you could simply abolish the employer's National Insurance Contribution, and replace it by an equivalent increase in Corporation Tax. This would transfer the burden from those firms that are labour intensive to those that are profitable; and would significantly reduce the cost of labour vis-a-vis capital investment. It would be completely in line with the onslaught on NIS in the last Budget, and would not be an attack on the contributory principle, since the employee's National Insurance Contribution would be left intact. A bold move of this sort might well alter employers' psychology, and immediately reduces the costs of employing somebody.

The main argument against is the last Budget's Corporation Tax reforms which looked forward to predictable falling rates of Corporation Tax over the life of this Parliament. That pledge would be torn up, and instead the Chancellor would have to plug away at the extra benefit gained from scrapping a whole tax on jobs - the employer's National Insurance.

Conclusion

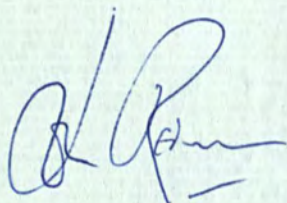
A benefit-plus programme, in order to work, has to be linked to a firmer stand on breaking union restriction and government regulation.

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The first effect is a paradox. A Government pledged to cutting public payrolls takes on a lot more people. It only has to be so if you wish to preserve the existing benefit system more or less as is - it means owning up to the millions already on that form of the public payroll, and giving some of them some work to do.

You could link the scheme to private contracts and have the people organised by private entrepreneurs if you wished to present it as more for less under the contracting-out drive.



JOHN REDWOOD

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Investment figures (Polaris unit)

Employment - 1) any figures on

- loss of jobs due to new technology
compared with

- new jobs due to new technology

2) any reversal of net industries
as a counterweight to
technology.

Training. Y.S.S. -nos kept on.



FILE

cc JR

Reg

15

10 DOWNING STREET

From the Private Secretary

17 September, 1984

Dec Davis,

SEMINAR ON INDUSTRY AND EMPLOYMENT

I attach a checklist of conclusions and matters to be followed up arising from the meeting at Downing Street last Thursday.

The Prime Minister would be grateful if the Ministers indicated could take the action attributed to them in the note, consulting with other colleagues as required (though in such cases no reference to the origin of the remit should be made). As proposals are developed they should be brought to the Cabinet or its Committees as appropriate. Alternatively, papers can be circulated to ad hoc groups of Ministers. This office will be happy to advise on the appropriate channels.

The Prime Minister expects to hold a further meeting, probably in November, when work on the possible discussion document and the measures which could give substance to it is more advanced.

This letter and the checklist are for the sight and use of Ministers only and their Principal Private Secretaries. The Prime Minister has asked for no circulation of this letter or the list; that no copies should be made of them and that action should be initiated by means of separate instructions and not be means of the list itself. In putting action in hand, no indication should be given as to the origin of the remit.

I am sending a copy of this letter and enclosure to Elizabeth Hodgkinson (Department of Education and Science),

SECRET & PERSONAL CMO

Michael Reidy (Department of Energy), John Ballard (Department of the Environment), David Normington (Department of Employment), Callum McCarthy (Department of Trade and Industry), Steve Godber (Department of Health and Social Security), Lee Lewis (Office of the Minister without Portfolio); and to Richard Hatfield and Peter Gregson (Cabinet Office).

*Your sincerely
Andrew*

(Andrew Turnbull)

D. Peretz, Esq.,
HM Treasury.

SEMINAR ON INDUSTRY AND EMPLOYMENT: CHECK LIST AND CONCLUSIONS

Developments in the Labour Market

(i) The Secretary of State for Employment to produce an analysis of the impact of YTS, covering the take-up, the impact it had had on youth unemployment, the extent to which "graduates" of YTS were finding employment or were moving on to YWS, and the extent to which young workers might be displacing older workers.

Expenditure programmes relevant to employment

(ii) The Group took note of the report of the working group and broadly endorsed its conclusions. It was agreed that no major re-allocation between expenditure programmes was needed.

(iii) It was agreed that the inter-departmental Manpower Group, under Department of Employment chairmanship, should evaluate on a regular basis both the special employment measures and other programmes with similar aims.

(iv) It was agreed that when putting forward proposals for expenditure, primarily directed towards cutting unemployment or increasing employment, including support for industries in financial difficulties, Departments should support the proposal with figures for the net exchequer cost per person taken off the unemployment count or per net job. At the same time, adequate weight should be given to longer term supply side benefits.

Link between wages and unemployment

(v) The group endorsed the Chancellor's paper discussing the link between wages and unemployment. It found particularly helpful the counter arguments to the claims which had been made to deny the existence of this link. The Chancellor of the Exchequer agreed to circulate an addendum countering the TUC arguments that the link was disproved by the existence of sectors with high wages and increasing employment such as electronics and sectors with low wages and declining employment such as textiles.

(vi) The Secretary of State for Education and Science in conjunction with the Chancellor of the Exchequer and the Secretary of State for Employment and Trade and Industry to meet Sir Christopher Lawson to carry forward work on a privately financed programme of public education on the economic facts of life. This should make use of the

material included in the Chancellor's paper.

(vii) The Treasury to continue work to establish econometrically the relationship between wages and unemployment.

Passport for a job

(viii) The Group considered the Secretary of State for Employment's report on the Passport for a Job proposal. His preferred option was to provide a certificate to young people falling between eligibility for YTS and age 20 removing them from the scope of PAYE, employment protection and wages councils and granting a credit for National Insurance contributions.

(ix) The Group felt it was necessary to consider whether in practice the scheme would reduce bureaucracy when allowance was made for the machinery that was needed to issue and monitor the use of certificates of exemption; whether it was equitable to exempt one group of workers from tax when others on lower incomes might still be paying tax (this could only be solved by pitching the net wage near the tax threshold though which could make the scheme unattractive); whether workers should be given a credit for NI contributions which would entail the keeping of records or whether like students they should be deemed not to have paid.

(x) The Secretary of State for Employment to continue work on various options for the scheme, ie. different age groups, the size of firm to be eligible and the net wage to be offered taking account of the points made in the discussion. The costings should be agreed with the Treasury. The Secretary of State for Employment in consultation with the Secretary of State for Social Services should consider the inter-relationship between the net wage under the scheme and the social security benefits available to young people.

(xi) The Secretary of State for Employment to continue work on the remits which emerged from the meeting of 24 July on the reduction of administrative and legislative burdens, in particular the case for reducing the scope of employment protection legislation. How far it was possible to make progress generally in this area would be relevant to whether a scheme targetted on young people should be introduced.

Getting across the Government's approach on employment

(xii) The Group discussed the case for a discussion document setting out the Government's approach on employment questions. It was agreed that it would be easier to secure

public acceptance of individual measures where protections were being removed if the measures could be seen as part of a wider picture.

(xiii) The Group agreed to keep open the question of whether to publish a discussion document. It was noted that for this to be successful, the Government would need to have developed a number of measures, eg. on wages councils, employment protection, shop hours, etc., which would form an adequate Government response to the problem of unemployment. Such a document should also contain a section on how jobs had been created. Care should be taken not to jeopardise the Government's success in securing public acceptance that the problem of unemployment could not be laid entirely at the Government's door.

(xiv) The Secretary of State for Employment, the Secretary of State for Trade and Industry and the Minister without Portfolio should work together on ways in which the Government's case could be better presented. They should assemble material for speeches; should carry forward work on a possible discussion document which might be issued early in 1985; and should consider what might be the elements of a package of measures which could give substance to such a document. The Chancellor should be kept closely in touch with this work. The Prime Minister would convene a further meeting, probably in November, to review progress.

Planning

(xv) The Secretary of State for the Environment to bring forward a paper on the improvements which could be made to the planning system to remove obstacles to enterprise and the creation of jobs.

Surplus land and developments in the public sector

(xvi) The Secretary of State for the Environment to bring the papers circulated to the group to E(DL) for discussion and action.

AT

17/9

Secker

File



14

10 DOWNING STREET

Mr FURNBULL

Has this progressed?

I am attracted by a Green Paper on the problem of unemployment, of what has been and is being done to alleviate it, and what further might be done in the future.

But the key to any paper's reception ~~would~~ be the ideas for future action. This is the least convincing and weakest part of the attached draft.

I should add that a discussion document / Green Paper is the best way of communicating ideas. Speeches are less effective, but useful in amplifying and publicising a document

John 17/9

File
13

SECRET - CMO

Not to be circulated outside No. 10

Seminar on Industry and Employment: Meeting held at
10 Downing Street on 13 September, 1984
at 2.30 p.m.

Present:

Prime Minister
Chancellor of the Exchequer
Secretary of State for Education and Science
Secretary of State for Energy
Secretary of State for the Environment
Secretary of State for Social Services
Minister without Portfolio
Lord Cockfield
Mr. Gregson
Mr. Redwood
Mr. Turnbull

Developments in the Labour Market

The Secretary of State for Employment gave an account of recent developments in the labour market. Over the year to March, 1984 total employment had risen by 260,000. Over the year to August, 1984 unemployment had risen by 130,000 with the trend possibly accelerating. Not only were demographic factors adverse, with an increase in the population of working age by 160,000, but the activity rate was also rising as married women came into the labour force seeking part-time work.

The Prime Minister asked how YTS had fared in its first year. The Secretary of State for Employment said it would be a few weeks before all the data required to make a judgement were available but he undertook to provide an analysis of the take up of YTS, the extent to which YTS "graduates" were finding jobs, the effect on youth unemployment, and any evidence of displacement of older workers.

Expenditure Programmes Relevant to Employment

The Group considered the Report of the Working Group on the Cost Effectiveness of different employment related programmes. It was noted that the SEMs generally had lower costs per person taken off the employment register or per net job created than the DoE programmes but against this it

SECRET - CMO

was argued that the very short run effects could give a misleading picture. Some measures, e.g. training or the reclamation of derelict land, would have beneficial supply side effects in the longer term.

It was agreed that the Department of Employment Manpower Group should carry out a regular scrutiny of the cost effectiveness, not just of SEMs, but also of other measures with similar objectives. In addition, Departments putting forward proposals for employment related expenditure, including that to support industries in financial difficulties, should attach to such proposals figures on the cost per person taken off the register or per net job created.

Wages and Employment

The Group welcomed the Treasury paper and, in particular, the arguments provided to counter the claims made by the Low Pay Unit and others that no such relationship existed. The Chancellor agreed to circulate an addendum refuting the TUC claim that the link was disproved by the existence of high wage expanding sectors and low wage contracting sectors.

It was noted that while inflation in Britain had come down, wages were still increasing too rapidly. Unit wage and salary costs were now increasing faster than in most of our major competitors: 4.5 per cent, against 3 per cent in France, no change in Germany and falls of 3 per cent in the US and 5 per cent in Japan.

The Secretary of State for Education and Science said it was so vital to achieve greater public understanding of the link between wages and unemployment but to do so in a way which did not put the Government in a negative light as seeking a low wage economy. The emphasis should be on reducing wage costs through higher productivity. It was not necessary for real wages to fall in absolute terms. Together with the Chancellor of the Exchequer and the Secretaries of State for Trade and Industry and Employment, he would shortly be meeting Sir Christopher Lawson to develop proposals for a privately financed campaign of public education on the economic facts of life. This initiative should use the material in the Chancellor's paper.

It was noted that whenever public sector unions were given a choice between higher wages/lower employment and lower wages/more employment they invariably opted for the former.

The Chancellor said the Treasury were doing further

research to establish econometrically the relationship between wages and employment.

Passport for a Job

The Secretary of State for Employment set out his preliminary thinking on the Passport for a Job proposal. He had considered various options for different age groups and coverage of firms. He saw merit in targeting the scheme on young people for whom unemployment was highest, but was anxious to avoid overlapping with the YTS. He suggested, therefore, targeting the scheme on those between eligibility for YTS and age 20. The scheme would apply to all employers, not just small firms. Young workers in the relevant age group would be given a certificate, (he did not think "Passport" was the correct term as it implied a right to a job) which would entitle employers taking them on at less than a specific net wage without deducting PAYE or National Insurance contributions (for which a credit would be given) and with exemption from wages council and employment protection legislation.

A number of reservations were expressed. It would be difficult to defend exempting one group from income tax when slightly older workers could be paying tax while earning less. The way round this was to set the net wages close to the income tax threshold. It was doubted whether there would be much saving in bureaucracy as Government would need machinery to ensure that certificates were issued only to those eligible and that employers applied the exemptions only to those holding the certificates.

The Secretary of State for Employment suggested the net wage should be set at around £50 per week which was equivalent to about £70 gross. Lord Cockfield thought this was, if anything, too low as it provided little margin above the social security benefits available to young people. The scheme could fail to attract young workers into it. Others thought £50 was too high, making the scheme too costly and creating difficult comparisons with those outside the scheme.

Other points made in the discussions were:

(i) If a credit were given for National Insurance contributions, it would still be necessary for employers to keep records and little paperwork would be saved. It might be preferable to put those in the scheme on the same basis as students.

(ii) Changes had recently been made to the YWS to make it follow on naturally from YTS. Before any changes were made, there should be time to assess the effect of

this.

The Prime Minister said the Secretary of State for Employment should continue work on the scheme, i.e. different age groups, the size of firm to be eligible and the net wage to be offered, taking account of the points made in the discussion. The Treasury should be involved in making costings of these options. He should consult the Secretary of State for Social Services on the inter-relationship between the net wage and the social security benefits available to young people. The Secretary of State for Employment should continue to work on the various remits which emerged from the meeting of 24 July on the reduction of administrative and legislative burdens, in particular the case for reducing the scope of employment protection legislation. How far it was possible to make progress generally in this area would be relevant to whether a scheme targetted on young people should be introduced.

Getting across the Government's approach on employment

Mr. Redwood explained the background to the Policy Unit's suggestion that the Government should issue a discussion document. All too often, measures to reduce legislation were seen as an attack on workers' rights and protections. Setting out the whole picture of benefits to be gained from these efforts would make it easy to secure acceptance of particular measures. A discussion document, possibly to be issued in the spring of 1985, was one way of setting out the Government's approach. The text circulated was intended to do no more than indicate the possible scope and flavour of such a document.

In discussion it was agreed that no decisions should be taken at present on whether such a document should be issued. Much would depend on how it looked when fully worked up and on whether the Government could produce an adequate package of measures to give substance to it. Alternative ways of getting the message across would be a campaign of speeches, Party documents and the NEDC exercise on jobs, should that be resumed.

It was agreed that the Government had been successful in convincing the public that it could not be blamed for most of the rise in unemployment and that unions and high wages were a more important factor. While a discussion document would have to be backed by a programme of measures which represented an adequate response it should not recreate the impression that the Government was taking responsibility for the maintenance of full employment.

The Secretary of State for Employment, the Secretary of State for Trade and Industry and the Minister without

Portfolio should work together on ways in which the Government's case could be better presented. They should assemble material for speeches; should carry forward work on a possible discussion document which might be issued early in 1985; and should consider what might be the elements of a package of measures which could give substance to such a document. The Chancellor should be kept closely in touch with this work. The Prime Minister would convene a further meeting, probably in November, to review progress.

Planning

The Secretary of State for the Environment said he would shortly be bringing forward a paper on the ways in which the planning system could be improved in order to remove obstacles to enterprise and the creation of jobs.

Disposal of surplus land and dwellings in the public sector

It was agreed that the two papers which the Secretary of State for the Environment had circulated to the group should go to E(DL) for discussion and action. It was important to involve MOD as a Department with major holdings of land. The Secretary of State for the Environment said he had started statutory proceedings against local authorities to require the release of nine sites. He was hopeful that this would have an affect in encouraging authorities to act of their own accord.

HT

17/9

PRIME MINISTER

13 September 1984

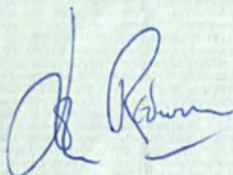
EMPLOYMENT SEMINAR

I discussed the Seminar agenda with David Young this morning.

He thinks it a good idea if, as a result of the discussion document on jobs, you asked him to chair an inter-departmental committee of Junior Ministers and officials to produce some such document and to chase progress on the policies arising from it.

This committee would report through David Young to Tom King and Norman Tebbit. As Tom feels sensitive about David's appointment, it is vital that it should be seen to report to him; as Norman is more robust on many of the issues and is very knowledgeable in the area, he would also be a useful person to report to.

This seems an excellent idea, and would give David an important piece of work to get his teeth into.

A handwritten signature in blue ink, appearing to read 'John Redwood', with a stylized flourish at the end.

JOHN REDWOOD



SECRET

12

P.01382

PRIME MINISTER

Seminar on Industry and Employment: 13 September

See Front cover
This is an item by item handling brief on the agenda for the Industry and Employment Seminar as circulated under cover of Mr Turnbull's letter of 6 September.

Item 1: Recent developments in the labour market

2. You will wish to ask for an oral report from the Secretary of State for Employment and then invite comments, particularly from the Chancellor of the Exchequer, the Secretary of State for Trade and Industry and the Minister without Portfolio.

3. The purpose of this item is to provide a factual background to the policy issues arising under the later items. You will not want the discussion to go on for too long (say not more than half an hour at most) or to stray into the policy issues which arise later.

A
4. The main issue raised in the last Department of Employment note on the monthly unemployment figures dated 28 August was whether there is significance in the apparent acceleration in the increase in seasonally adjusted unemployment (14,000 a month average increase in the three months June to August, compared with 8,000 a month average increase in March to May). The six-monthly comparison (February to August 1984 compared with the previous six months) shows the rate of increase remaining steady. Since the seasonally adjusted series relates to adult unemployment, it does not reflect the effect of the Youth Training Scheme (YTS) on youth employment. Are employers retaining YTS participants rather than recruiting from the adult unemployed? Is the unemployment position better than implied by the seasonally adjusted series?

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Item 2: Expenditure programmes relevant to employment

B 5. This arose from a suggestion in a paper by the Secretary of State for Employment on employment policies discussed at the last seminar that, in case there was no sign of a declining trend in unemployment by early 1986, we ought to start considering how "we could quickly replace those public expenditure programmes and projects which are less labour intensive with those which would raise employment quickly, and what the cost effect could be of supplementing them further". There was no sympathy for the idea of a contingency programme of public works but the Secretary of State for the Environment was concerned that special employment measures operated by the Manpower Services Commission might be evaluated less rigorously than public sector investment programmes. He thought that if the same analysis was applied to some of his programmes they might turn out to be more cost-effective in creating jobs than some of the MSC programmes. It was therefore agreed to commission the report by officials now attached to the letter from the Chancellor of the Exchequer's Private Secretary dated 10 August 1984.

6. You will wish to ask the Chancellor of the Exchequer to introduce this item and then invite comments from the Secretaries of State for Employment, Environment and Trade and Industry and the Minister without Portfolio.

7. The main findings of the report are summarised in paragraph 28 of the paper and the implications for policy in paragraph 29. In the short run the Special Employment Measures emerge, after all, as a more cost-effective way of reducing the count of unemployed than Department of Environment programmes (with the possible exception of Urban Development Corporations and Urban Development Grant) and broad categories of public expenditure such as central Government current expenditure or investment and local authority investment.

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8. The main issues for discussion are likely to be:

i. the limitations of an analysis largely in terms of the effects on employment in the first year

(see letter from the Secretary of State for Trade and Industry's Private Secretary dated 31 August);

ii. whether the analysis suggests a need to change policy (paragraph 29 of the paper implies that the present policy is about right, ie:

- the priority given to Special Employment Measures is probably justified, but further resources diverted to them could well bring diminishing returns;
- within the Special Employment Measures some higher cost measures such as the Enterprise Allowance and Young Workers Scheme are justified by longer term supply side effects);

iii. whether the procedural suggestions are accepted, ie:

- that the DEm's Manpower Group should, if asked, evaluate, with the same criteria as apply to Special Employment Measures, any programme which a department believes is cost-effective in reducing unemployment;
- that there might be a new requirement for public expenditure proposals advanced on employment grounds to be analysed by the criteria adopted in the report.

(This is favoured by the Secretaries of State for Employment and the Environment, but the Secretary of State for Trade and Industry will point out that criteria related to first year employment effects are an inadequate basis for assessing programmes justified in relation to more long term employment effects.)

9. On a point of detail about the new procedure the Secretary of State for the Environment suggested that the interdepartmental Manpower Group should be run by the Cabinet Office rather than the

Attached to B



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Department of Employment since it would in future be looking not just at that Department's own special employment measures but some other departments' programmes. There is however no reason to think that the Department of Employment will assess other departments' employment programmes unfairly. The Manpower Group has worked well in the past and there seem no good grounds for disturbing it; I understand that this is also the Treasury's view.

Item 3: Relationships between wages and unemployment

C
D
10. It is common ground that the Government should stress the link between wages and unemployment. In his minute of 8 August the Secretary of State for Education and Science has asked for a fuller analysis of the economic arguments, as a prelude to renewed efforts by the Government to gain understanding of the link. The paper circulated by the Chancellor's Private Secretary of 11 September is the result.

11. You will wish to ask the Chancellor of the Exchequer to introduce the Treasury note and then invite comments particularly from the Secretaries of State for Education and Science, Employment and Social Services and the Minister without Portfolio.

12. The paper is summarised in paragraphs 1-4. The discussion about movements in real wages relative to movements in productivity in paragraphs 19-22 is particularly interesting. The public at large has been conditioned over many years to regard higher productivity as a good thing and also that higher wages may be acceptable if accompanied by higher productivity. High and persistent levels of unemployment are however now making the man in the street puzzled and anxious about higher productivity. The paper brings out the following points which may have relevance to the public debate:

- i. It is necessary to distinguish between two kinds of higher productivity: increases in labour productivity which merely result from the substitution of capital for labour without any

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increase in overall efficiency; and the more genuine higher productivity which reflects efficiency gains resulting from improved technology and better working practices. It is the second kind of higher productivity which we need to encourage.

ii. Higher productivity must precede higher wages and not the other way around, if unemployment and/or inflation are to be avoided.

iii. In order to ensure that higher productivity results in more jobs rather than higher real incomes of those in work, the growth in real incomes has to be slower than the growth in productivity.

13. Since this lengthy paper was circulated only the day before the meeting, you may feel that the best course is to invite preliminary reactions only and then to ask Ministers to study it with care and put forward, say by the end of September, their considered views on how the points which emerge from the analysis might best be deployed in public debate. It should be borne in mind that the debate will have to be carried on at a number of different levels: in academic circles, in the quality press and in speeches designed to influence attitudes of employers, employees and the public at large.

14. Meanwhile it should be recalled that the underlying increase in average earnings has been running over the past year at around 7.75 per cent compared with an increase in retail prices of around 5 per cent. In the first quarter of 1984, unit, wage and salary costs in UK manufacturing industry were 4.5 per cent higher than a year earlier; this compares with 3 per cent higher in France, no change in West Germany, 3 per cent lower in the USA, and 5 per cent lower in Japan.

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Item 4: Passport for a Job

E
15. You will wish to ask the Secretary of State for Employment to introduce the proposal in the note circulated by his Private Secretary on 10 September, and then invite comments particularly from the Chancellor of the Exchequer, the Secretary of State for Social Services and the Minister without Portfolio.

16. The proposal is essentially to replace the Young Workers' Scheme (YWS), which is now available to 16 year olds and 17 year olds after completion of the YTS, with a new scheme for the age range 18 to 20. Like the YWS the purpose would be to encourage the creation of jobs below a certain wage (say £50 a week). The incentive for the employer would however be not a cash subsidy but relief of tax and national insurance and the main requirements of employment protection legislation. The employee would secure a job which he might otherwise not have had and he too would be free of tax and national insurance but he would forgo sick pay, employment protection and (if relevant) Wages Council awards.

17. Points which may be made in discussion are:

i. Exemption from tax and national insurance for workers in a particular age group would set a major new precedent. Are the likely benefits sufficient to justify this?

←
ii. Bearing in mind that the employee will be relieved of tax and national insurance, his take-home pay will be more than that of some workers receiving higher wages. The scheme will therefore be less effective than the YWS in reducing expectations about take-home pay.

iii. Should not the rigidities imposed by the Employment Protection Acts and the Wages Councils be tackled on a broader front?



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iv. Is the new scheme adequately cost-effective? The YWS is agreed to be one of the most expensive special employment measures in terms of cost per person removed from the unemployment count, but is justified for wider policy reasons. The new scheme's net cost of £86 million for a possible reduction of 40,000 in the unemployment count suggests that it will be no more cost-effective and perhaps less so.

v. Even if the YWS is abolished, there will be an extra cost from introducing the new scheme of the order of £40-£50 million. This will add to the difficulties of this year's public expenditure round.

18. The meeting will need to reach conclusions on:

- whether the concept is acceptable;
- what age-group should be covered;
- whether the new scheme should replace the YWS;
- how the proposal should be further pursued.

Item 5: Getting across the Government's approach on employment

F
19. It would be convenient to ask the Head of the No 10 Policy Unit to open the discussion by explaining the purpose of the draft document. You might then like to invite contributions particularly from the Chancellor of the Exchequer, the Secretary of State for Employment, the Secretary of State for Education and Science (who is very much concerned with improving public understanding in this area), and the Minister without Portfolio.

20. The draft discussion document argues that the main obstacles to employment growth are: excessive wage levels; management failures; inadequate training; excessive regulations and restrictions (including monopolies and cartels); and taxation and subsidy policies. It draws

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attention to action already taken in certain areas (planning procedures, enterprise zones, deregulation of buses, action on the opticians and conveyancing monopoly, sale of council houses, reductions in taxation and subsidies, trade union legislation, and youth training). Finally it indicates areas in which further action might be taken: on planning restrictions; shop hours; competition in providing local authority services; relaxation of the Employment Protection Acts; the housing market and Wages Councils.

21. You will no doubt wish to avoid detailed discussion of the text and concentrate on the main issues of substance and presentation, ie:

a. assuming that the meeting generally endorses the concept of a microeconomic policy for job creation, based on freeing the market, what are the particular areas in which action should be taken over the next year, ie:

Wages Councils?

the Employment Protection Acts?

Shop hours?

Other matters?

b. how is public support for the necessary action best secured ie:

- by separate announcements in the normal way, or
- by a basket of proposals related to the general theme of removing obstacles to employment for the benefit of the "have-nots",
- if so, presented as firm proposals, or tentative proposals for discussion only, designed to soften up opinion for action at a later stage?

c. whether or not new measures are proposed, should more be done to improve understanding of the Government's general policy on employment and its achievements so far:



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- by publishing a document, or
- in a series of speeches.

Background papers

G
22. The Secretary of State for the Environment's Private Secretary circulated under cover of a letter of 10 September papers on two subjects raised at the last seminar on 25 May: unused public sector land and public sector vacant dwellings. Further action to release these unused assets is required from certain central Government departments (notably the DHSS and MoD) and nationalised industries (notably British Rail), as well as local authorities. There will not be time to discuss these papers and some of the relevant Ministers will not be present. You might ask for these matters to be pursued urgently by the Ministerial Sub-Committee on Disposal of Public Sector Assets (E(DL)), under the Chancellor of the Exchequer's chairmanship.

Pl

P L GREGSON

12 September 1984

John Senior
file

11A
SR

60/9

PRIME MINISTER

1. JR
2. CL

12/9/84

Industry and Employment Seminar

I have circulated the attached Agenda note for next Thursday's meeting. Several of the papers have still to come round but you might like to look at greater leisure at

- (i) the Policy Unit document - Flag A
- (ii) the paper on the effectiveness of employment-related expenditure programmes - Flag B. This is summarised in paragraphs 28 and 29 plus table 1.
- (iii) Mr King's paper on Increasing Employment through Deregulation - Flag C

- (iv) Mr. Jenkin's notes on Unused Land and Dwellings in the Public Sector - Flag D. These are not formally on the agenda but it is helpful to know the state of play. It would be better for them to be considered at E(DL) on which MOD are represented.

Still to come are a note by the Chancellor on Wages and Unemployment plus a handling brief from Peter Gregson.

1 September 1984

SECRET

John
Can be conjured out of air
that magic is the
handed trick
Best of intention -> Regional Policy
every thing going
Union offered
Enterprise -
some eg. of others
down by too many
We want to put
Want good deal
look @ progress
of have put
Whom? : say more jobs, telephone more
service, intercity coach, lower price
more jobs, NPT rest motivation.
More to do - have the rest of BL,
ships, energy.
look @ young water - have a scheme
we drops, pricing back in
got against in States, expanding
inference, nonprotection,
So are getting more jobs. do him by cutting
Need more jobs. do him by cutting
through obstacles
hed up giant, big a bottle, conjuring
magic,
Build a barrier of very run
freedom, hard work,
x Room of my own, a room with a view

TK: has been a problem. Foreign student problem
DM: 4TS bight down youth wages - £5 a wk.

PJ: long term bene of wealth creation etc justify these SEM progs

JK: Long term effects can be worse

PM: Couldn't we do something useful e.g. build a reservoir.

NT/PM why not include DTI progs? NT "too wide"

NL/NT are DTI good or bad schemes?

PM/PJ problem of capital on water meters → need too much PJ.

NL procedural → good idea

PM are we spending in best way?

NT Charge rules to get people off register.

TK 60/- off by paying ben in arrears

NT Can look @ DTI ones, DE quick effect but often no follow through, DTI L-km

PJ Urban refurbishment valuable as better environment.

NT But m/c tools created go on creating new jobs -

DM CP 1 in 5 go back to work. in Merseyside refurb own homes.

PM/Chanc ben for young pops too generous. - no costs 100% covered: silly

NF Child additions on SB higher than child benefit.

PM Univ stud go on SB in hols.

NF Why is stud on ho ben? Picking up costs of other depts?

PM young teenagers go out - set up own ho then "can't afford to take a job"
You have wrongly decided that @ age 16 young pop no longer belong to a fam

NF Jan report of Review

PM Casira DOE LGS etc DTI
→ Nigel Vinton Devt Comm.

Maxt adopt Paper + its procedures. Not ^{only} on a 1st yr basis: show

NT other effects. e 2nd & 3rd yr effects.
Remember 1st yr cost & ben only one you can identify

Treas Paper on Wages/Jobs

KJ G. Chander to set up Committees → private money for educational
Campaign on wages/jobs.

PM Good Paper. Used to seeing wages divorced from output & customers.

NL Wages heart of the problem
PM smaller public sector better paid → dilemma here.

Industry and Employment Seminar: 13 September

PM → gap between scientists & industry with new ideas. Agenda

1. Report on recent developments in the labour market

To be raised orally by Secretary of State for Employment.

2. Expenditure Programmes Relevant to Employment

Papers

- Paper attached to David Peretz's letter of 10 August to David Normington

Issues

- (i) Does the Group agree with the analysis of the paper?
- (ii) What policy conclusions should be drawn?
- (iii) Are any adjustments between expenditure programmes called for?

3. Relationships between wages and unemployment

Papers

- Minute from Secretary of State for Education and Science to Prime Minister (8/8)
- Note from the Treasury discussing evidence on link between wages and employment. To be circulated next week.

Big gr in part time.
David Ingham initiative
PM must do more to
deregulate

Unit wage costs getting
more v. competition
Even leading to a big
issue -
the skill rising &
more demog. & more
registering -
PM is there a register of
shortages of lab?

NL - pro the paper
AC - pro training in SEmp measures
DY pro Ent Allowance & Youth training.
DY → US food stamps no benefit brings wages down.
TK - benefit problem read.

NL: Wages Councils major impediment No-tech jobs.

30% priv service sector under Wages Co. + Employ Prot Act.

Product mktts need dereg & competition to keep wages down →
Monopolies cause high wages.

NT/PM Job in new states in US, destroyed in Union dominated areas - same happening here.

PJ Not low pay → its low wage unit costs, customer sensibility etc. need a positive message.

NL/NE Not an absolute reduction in wages, lets growth.
all in favour of Treas paper.

TK etc

Passport for a Job

TK

is feasible

target shd be a diff gp from YTS

Age 18-25
or Small Bus
etc



decided 18-20.

up to £50 a wk.

Wages Councils v. damaging to young people.

PM

shd be a young pop shop on buses → no more than in last job or something like that.

NT

hard care of nice youngsters thrown out by vicious parents.
hard cases make bad law.

NE

→ May need Spec Claims officers to deal with these
2m spec pays too complex.

AC

happy re YTS

Must get them out of system altogether.
Must have gap between SB & Passport.
Must have big enough figure as adult rates 18-20.

Chane

problem in insurance
cost difficult.

PM/Chane etc

need experiment like this.

Chane ante exemption from 4 tax.

Issues

- (i) How well is link established?
- (ii) What can Government do to improve understanding of it? (see also Item 5)
- (iii) How can Government avoid accusation that it seeks a low wage economy. *answer*

4. Passport for a JobPapers

- Note to be circulated by Secretary of State for Employment

5. Getting Across the Government's Approach on EmploymentPapers

Draft Discussion Paper by No.10 Policy Unit

Issues

- (i) Have the elements of the Government's approach to be creation of jobs been correctly identified?
- (ii) Should theme that removal of restrictions and protections will benefit the "have-nots" be stressed?
- (iii) Is a discussion document/Green Paper the best medium?
- (iv) If not how can Government's message be got across? A programme of speeches? Government publications?
- (v) What measures and policy initiatives should the

AC too many people paying V tax.

PW bus. in certs etc dangerous
union with bank this.
do not experiment.

TK wld have to get them out of Revenue

PM lower PE, Indirect tax, lower bens

£5 bn for tax thresholds

Chare win arg - generally deregulate.

DM UWS leave alone, will get better. is a follow on from
UTS.

TK do this taking into a/c the args.

PM TK/D Tuppier dereg package.

NT Many licenses crazy.

Home Office stopping people running radio station includ Radio Scargill.
Cld have more wavelengths.

PM follow up Tuppier.

TK More work agreed

PM Bow 9p type of doc.

TK Need something clear to say
Need suggests in it.

Spring offensive

draw on this & Treasury paper to produce

Spring White Paper.

PM See Keynes W. Paper 1944 Employment Policy
have to be as good as this.

Neddy where are the jobs coming from?

NL

DM

do have to win argument re min wages, other obstacles

PM

We hem down everything.

NL need to know what
we want 1st.

KJ

We need to challenge TUC re jobs

TK

Campaign

PM

each dept head needs to look @ reguls.

Government take over the next year?

6. Background Papers

- (i) Checklist and Conclusions from 25 May meeting - attached to Andrew Turnbull's letter of 29 May.
- (ii) Papers circulated by Secretary of State for Employment for 25 May meeting - attached to Andrew Turnbull's letter of 18 May.
- (iii) Notes to be circulated by Secretary of State for the Environment
 - (a) Public Sector Vacant Dwellings
 - (b) Vacant Under-used Land in the Public Sector.

SECRET AND PERSONAL: CMO

NT raise question Who's to blame for Unr?
Not full blame of govt.

Must not undermine non culpability of govt.
lets do survey of people's views? what do they think?
e.g. re EPA/Wages Councils.

PM Raise question 1st.

~~NT~~
PM DM/TK/NT get together on this

NT Where are we going & how do we get there?

PW Against papers.
harness non-politicians

PM Party of future with pols for future
PW TUs - have their exploitation of power to get wages = less E.
Jack Jones / Hugh Scallan started it.

NL Yes poll.
also re soc sec benefits. Unions to blame for Unr.
Tommy Thompson.

NF At last election many supplanting joint re Unr.
need a document, need a debate
otherwise will lose to spenders.

~~DM~~ PM to provide specific items, job creation section.

TK Not suddenly found all answers, but cant wash our
hands of it.

PM Must have a programme. Slowness of planning.

DM Removing barriers

PM "I always wanted to
build a business."

NL Paper home please.

~~DM~~ PM - DM to do building a barriers
Find the language.

- need a paper on planning.

PS Land - DM to follow up.

PM Must have a discussion doc.
Show we're constructive.

SECRET AND PERSONAL



cc Back up
JR II
(D)

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

A Turnbull Esq
Private Secretary
10 Downing Street
London SW1

11 September 1984

Dear Andrew

INDUSTRY AND EMPLOYMENT SEMINAR

attached
to letter
below.

— As foreshadowed in your letter to me of 6 September, I am circulating herewith a further paper - on the link between pay and jobs - relevant to item 3 on the agenda for 13 September.

I am sending copies also to Callum McCarthy (Department of Trade and Industry), Elizabeth Hodgkinson (Department of Education and Science), David Normington (Department of Employment), John Ballard (Department of the Environment), Michael Reidy (Department of Energy), Steve Godber (Department of Health and Social Security), David Young (Manpower Services Commission) and Richard Hatfield and Peter Gregson (Cabinet Office).

Yours ever
David

D. L C PERETZ

SECRET AND PERSONAL

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

The Right Hon Sir Keith Joseph MP
Secretary of State for Education and Science
Department of Education and Science
Elizabeth House
York Street
London SE1 7PH

11 September 1984

Dear Secretary of State

I enclose a copy of a Treasury paper on "The Link between Pay and Jobs". This follows up the suggestion in your minute of 8 August to the Prime Minister that an analysis should be carried out of the arguments involved and the counter-arguments that have been made by those who have attempted to play down this link. I agree that we need to embark upon a systematic and sustained explanation of our position, and believe that the paper provides useful material for the purpose.

You will see that on one point the paper takes a different position to the point (a) in your letter. You suggest that increased productivity is an acceptable alternative way of lowering wage costs. The paper explains that if we are to have more jobs we need lower real pay levels as well as higher productivity. At the margin employers have a choice between men and machines. If the level of real pay is too high it is possible to increase productivity by substituting machines for men. This has the effect of controlling wage costs - but at the expense of jobs.

It is also worth noting that some of the employers in the US that have been increasing their use of labour most rapidly have been in labour intensive service operations. If that sector of the economy is to prosper here it is important that there is an adequate supply of low-paid labour available. Otherwise they will not be able to compete with more capital intensive products.

More generally of course, there is a need to get labour costs per unit of output as low as possible. So it is important for industry to operate on both fronts: pay and productivity.

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I am copying this letter to the Prime Minister.

Yours sincerely

David Peretz

FP NIGEL LAWSON

(Approved by the Chancellor
and signed in his absence)

CONFIDENTIAL

THE LINK BETWEEN PAY AND JOBS

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11 September 1984

HM TREASURY

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THE LINK BETWEEN PAY AND JOBS

Summary

This paper discusses the proposition that the slower growth of pay will reduce unemployment.

2. It begins by setting out the arguments in support of the proposition. It attempts to distinguish between two aspects of the argument that are often confused. The first is the increased growth of demand that occurs with a lower growth of nominal wages (and prices) for a given financial framework. Lower inflation is likely to boost demand through a combination of a lower savings ratio, lower interest rates, a higher volume of public expenditure for given cash limits and a better trade performance.

3. The second aspect is the improved supply performance of an economy with lower real wages relative to productivity. This should produce more jobs by encouraging a higher level of profitable output; a lower incentive to substitute machines for men; and increased demand for more labour intensive activities.

4. This sets the scene for a discussion of the counter-arguments that have been raised against the proposition that a slower growth of pay will reduce unemployment.

(i) "lower wages imply lower spending and a lack of demand." **BUT** there are other sources of demand, particularly from companies whose income will improve, and the higher level of employment.

(ii) "the extent to which labour costs can be substituted for other costs is very small." **BUT** there is evidence that at the margin there will be substitution. In addition higher profitability means a greater incentive to expand output.

(iii) "there is no evidence that pay and jobs are related; recently the real product wage has been unchanged and yet employment has fallen." BUT this definition of the so called real product wage is only unchanged because of the very sharp fall in employment and hence the increased productivity. Excessive wage costs have meant lower employment.

(iv) "the evidence of the US is not relevant because success on jobs there has been the result of expansionary fiscal policies." BUT the rise in employment has taken place over many years and does not coincide with the higher budget deficit. The key has been in labour market performance and is reflected in the way that higher demand has shown up as real demand not simply higher inflation.

(v) "a low wage/low productivity economy is undesirable as it means low status, insecurity and inefficiency." BUT although a high wage/ high productivity economy is better the higher productivity must come first. To attempt to force higher productivity by first achieving higher wages is a simple recipe for increasing unemployment.

(vi) "we do not know how to achieve lower real wages." BUT experience suggest that slower growth of money wages would mean a slower growth of real wages.

(vii) "competitiveness can be improved more efficiently by a lower exchange rate than lower wages." BUT at best devaluation is a way of reducing real wages by increasing inflation. If the lower real wages are not accepted it means repeated devaluation and accelerating inflation.

(viii) "The Treasury model shows lower wages leading to more jobs because it has been adapted to reflect the views of its proprietors." BUT the reason for adapting the model has been to explain better the experience of 1980 and 1981 where excessive wage costs led to major labour shedding. If anything Treasury model simulations understate the advantage of lower real pay.

(ix) "Trade Unions are not to blame for unemployment." BUT restrictive working practices, strikes and a union mark-up on pay raises wage costs above the competitive level. The result is more pay for employed members and reduced employment in that trade.

5. This is an issue that arouses strong feelings as well as disagreements about the economic analysis. (A list of recent articles on this subject is given in Annex 1). And where there is agreement about the analysis there can be disagreement about the magnitude of effects. Part of the confusion is due to a failure to distinguish between the benefit of pay moderation in helping to accelerate the adjustment of the economy to the rate of unemployment consistent with stable inflation; and the extent to which it can lower that rate by producing significant structural changes to the economy.

6. Part of the confusion is also due to the ambiguity about the term "lower pay". As long as there is some underlying growth of productivity this does not mean that real wages have to fall in absolute terms. They just have to grow less rapidly than trend productivity. For example if the level of real wages was held unchanged over the next five years (more in line with recent US experience) the argument of this paper is that the gains to employment would be considerable - yet the living standards of those in work would not have declined. When the paper discusses "lower pay" it has to be seen in this context and normally means relative to what might otherwise have occurred.

7. There is also confusion about the role of higher productivity in generating new jobs. The Government shares the objective of a high wage/high productivity economy. But this cannot be achieved overnight and it is important that the productivity increase comes before increased pay. It is also important that the reason for higher productivity is better working practices and improved technology. If it merely reflects a displacement of people by machines in response to excessive labour costs the higher productivity and higher incomes will simply be at the expense of the unemployed. Productivity increases are the key to higher incomes in the future.

But they are not a substitute for wage moderation if an immediate improved prospect for unemployment is to be achieved.

Wage Moderation and the Level of Demand

8. It is the behaviour of money wages that is most important for the level of demand within the framework of policy that the Government is operating. To the extent that firms pass on lower labour costs into lower prices, inflation will be lower and, with an unchanged financial framework (ie. monetary targets, PSBR/GDP ratio, and cash limits), this will boost output and employment. If firms do not fully pass on lower labour costs real wages will fall; the effects of this are discussed in the next section from paragraph 15 onwards.

9. Lower inflation and wage costs are likely to boost demand in a number of ways. For example:

(i) lower inflation means less of an erosion of the real value of consumer's financial wealth and reduces the need to save. With a lower savings ratio consumer demand is higher for a given level of disposable income.

(ii) lower inflation increases business confidence and encourages business investment and stockbuilding.

(iii) if cash limits are unchanged, public expenditure will be higher in real terms.

(iv) if monetary targets are unchanged, nominal interest rates will tend to fall and this will boost private expenditure.

(v) if the exchange rate does not rise to fully offset the lower inflation, for example because interest rates are lower, there will be a net improvement in international price competitiveness that will contribute to higher output and employment.

10. In the main these effects stem from a lower price level and involve a faster speed of adjustment of the economy to the financial framework. The main benefit is to reduce unemployment faster than would otherwise have occurred rather than to lower the rate of unemployment consistent with stable inflation.

11. But this should not lead us to underestimate the importance of a more rapid adjustment of inflation. At a time when policy is designed to bring about a reduction of inflation there are likely to be temporary effects on unemployment if wages and prices adjust slowly. Therefore to the extent that wages adjust more rapidly these effects can be reduced.

12. The scale of the further benefits to employment from lower inflation is inevitably uncertain. We have already seen considerable increases to demand over the past two years as a result of lower inflation and wage costs. We do not know the growth of output that is consistent with stable inflation but many economists now argue that, if anything, it is likely to be below recent rates given the present structure of the labour and goods markets. In evidence they point to the apparant absence of significant downward pressure on real wages at current levels of unemployment and reduced downward pressure on inflation at present levels of capacity utilisation. This emphasises the need for a lower growth of real wages as we discuss later.

13. Lower inflation and unit wage costs brought about by productivity increases rather than pay moderation would also bring about increases in the level of demand and output. But by definition these effects on demand would not at the same time reduce the level of unemployment. We have seen some of this effect over the past three years. Higher levels of productivity have helped in controlling wage costs and bringing down inflation which in turn has boosted demand. Output has grown faster than the historical trend but at a slower rate than productivity; hence unemployment has continued rising.

14. So from the point of view of the immediate prospects for unemployment it is important that the demand side benefits of lower inflation

and wage costs should be brought about by wage moderation rather than higher levels of productivity.

Wage Moderation and Supply Behaviour

15. When we come to the effect of wage moderation on supply behaviour and longer term labour market adjustment it is the level of real wages that is important. There are two kinds of effect. With a slower growth of real wages and hence a higher overall rate of profitability employers will be encouraged to increase the level of output; involving both higher levels of investment and employment. And with a given level of output a lower level of real wages relative to other costs will increase the attractiveness of employing labour relative to other inputs.

16. The first of these, the impact of profitability on the level of output, will be gradual but there are also some clear short term benefits. In an open economy such as the UK much of the effect will be seen in the behaviour of exports and imports. Higher profitability will encourage higher output to supply export markets and substitutes for imports. But there will also be effects in non-traded goods markets where the provision of the supply of many services is dependent upon the profitability of supplying them.

17. It will also take time for the impact of a slower growth of real wages to be seen on the mix of labour and capital used. In some processes there is no short term scope for employing more labour. In others substitution is possible but will not follow immediately. In most industries decisions about the extent of labour saving investment will be taken from time to time. And more generally, the relative importance of labour intensive industries within the economy will depend on the pattern of demand. With lower real wages, the price of the products of labour intensive sectors of the economy will fall relative to prices elsewhere and demand and hence employment in those sectors will tend to expand.

18. Taken together these arguments suggest that a willingness to accept lower real wages can reduce the rate of unemployment that is

consistent with stable inflation and lead to a better division of the level of money GDP between real GDP and prices. This is important if the level of unemployment that is consistent with stable inflation has increased in recent years. There is some evidence that this may be the position; for example the continued rapid growth of real wages and signs that unemployment may remain historically high even when the number of job vacancies is back to a more normal level.

19. Strictly speaking, when we talk of the need for lower real wages in the long term we mean lower real wages relative to productivity (output per head). As long as there is some underlying growth of productivity, real wages do not have to fall in absolute terms for unemployment to improve. They just have to grow less rapidly than productivity. There are clear presentational advantages in putting it like this. Unemployment would have been lower, yet the living standards of those in work would be unchanged. If the level of real wages was held unchanged over the next five years (more in line with recent US experience) the gains to employment could be considerable.

20. In judging the impact of a higher level of labour productivity on unemployment it is important to distinguish between alternative ways that higher productivity may come about - increases that reflect overall efficiency gains due to improved technology and working practices; and measured labour productivity increases that merely reflect a displacement of people by machines because of excessive labour costs. The first is likely to have beneficial long term employment effects; the second simply means higher unemployment. But even in the first case, where the productivity increase reflects overall efficiency gains rather than labour substitution, the timescale of the employment benefits will be much longer than if the cost of labour is reduced by lower real wages. Higher profitability brought about by lower real wages will increase the level of output and the impact on the level of employment is likely to be rapid. Higher profitability brought about by increased productivity will encourage a higher level of output but initially without corresponding benefits to employment.

21. Again recent experience shows the short term unemployment costs of improved profitability brought about by higher productivity. As

companies came under pressure to reduce their labour costs they did the easier thing first; they improved productivity rather than reducing or holding down real wages. Profitability has improved but despite the historically respectable output performance unemployment has continued to rise.

22. Great care is therefore required in presenting the case for higher productivity. The emphasis should be placed on its long term benefits, in terms of higher real incomes and potential output. A high wage and high productivity economy is obviously better than a low wage and productivity one. But how do we get from here to there and what is the impact on unemployment? Clearly the high productivity must precede the high wages. To go the other way around would increase unemployment, inflation or both. But even if high productivity comes first and output grows faster it will not reduce unemployment quickly without a slower growth of real wages. Otherwise the productivity increase will show up as higher real incomes of those in work but unemployment will remain high for longer. To achieve both higher incomes and more employment without an inordinate delay requires both a faster growth of productivity and a slower growth of real incomes.

Counter-arguments

23. In the rest of the paper we set out and comment on a number of counter-arguments that have been raised against the proposition that slower growth of pay reduces unemployment. In most cases the counter-arguments have not been attributed to particular sources, mainly because they have appeared in a number of different places at different times. Here we have drawn mainly on the publications of the Low Pay Unit (especially Unemployment: Are Wages to Blame? March 1984 and From the Dole Queue to the Sweatshop July 1984, both by Henry Neuburger) and their director Chris Pond, and on a recent article by David Basnett (FT, 8/8/84). Sir Douglas Wass (Observer, 19/8/84) and A M G Christopher (FT, 26/7/84) have also contributed to the debate. Article presenting the opposite case have appeared from Samuel Brittan (FT, various dates); Forest and Dennison in their Hobart Paper Low Pay or No Pay? and various letters to newspapers; and Professor Hayek in the Times (7/8/84).

24. Lower wages imply lower real incomes and consumers's expenditure and hence lower output and employment. (This case has been made frequently by both Neuburger and Pond on behalf of the Low Pay Unit and it often appears in TUC statements). It is argued that workers will not be able to afford to purchase the products they produce. To the extent that lower wages are not compensated by lower prices there may be some impact on consumer's expenditure. However we have argued that in these circumstances there will be some offset for a time because of a move to a lower savings ratio which has the effect of increasing consumption for a given level of disposable income.

25. But what is ignored in this argument is that there are other sources of demand. Lower real wages imply higher real profits which will stimulate business expenditure and distributions to shareholders. Secondly, lower real wages will probably mean improved cost competitiveness which will stimulate the demand for exports and mean that more expenditure is on home produced products rather than imports. Thirdly there will be scope for more employment for a given level of output which will increase the incomes of those who otherwise would have been unemployed; this will increase the level of consumption and compensate for the lower incomes of those who were originally in work. In other words income and consumption of those who were out of work rises at the expense of those who were in work.

26. More generally this argument harks back to the early thirties when the overall level of nominal demand was growing less rapidly than policy makers intended. That is not the position today. The government's fiscal and monetary policy will ensure that the level of money demand will be maintained. A slower growth of real wages will not in these circumstances create a problem of insufficient demand. By contrast it will improve supply conditions and mean a better distribution of income between those currently in work and those out of work.

27. The relative importance of these factors is an empirical matter, and can only be fully assessed using a model of the whole economy. Simulations on the Treasury and LBS models show that a reduction in

nominal wages leads to increased employment, through a combination of the lower real wage and lower inflation routes. Thus the reduction in employment resulting from lower consumer's expenditure by those initially in work is more than offset by the increases from the other mechanisms. Models are, of course, imperfect and it might be possible to construct a plausible model that did not have this property. But as far as we know a respectable model of the UK like this does not exist.

28. Lower real wages would not help because the extent to which labour can be substituted for other inputs in response to a fall in the relative cost of employing labour is very small. This counter-argument appears in the article by Sir Douglas Wass. It accepts the basic premise that there can be pricing back into work, but downplays its quantitative importance. Examples of the limited scope for substituting men for machines in particular processes are cited in support. Or it is suggested that the fall in the relative cost of labour would have to be large and perceived to be permanent before decisions about the mix of labour and other inputs were altered.

29. This note has made the point that there are a number of ways in which lower real wages can lead to a substitution of labour for other inputs. For example, at the margin decisions are taken about the scale of labour saving investment; and with lower real wages the labour intensive sectors of the economy will expand. The United States has experienced the benefits to employment of a low growth of real wages. Moreover, there is empirical support for the significance of the substitution effects, as we shall see later.

30. In addition we have already argued that it is not only the substitution effect - the replacement of men by machines - that matters from the point of view of supply behaviour. Better profitability will encourage higher levels of output that will also help the level of employment.

31. There is no evidence that pay and jobs are inversely related.

The chart at Annex B from the **Midland Bank Review** (Spring 1984) has been cited a number of times as evidence of the absence of a relationship. Examples are the article by Basnett in the FT and a letter from Tony Christopher on July 26 in the FT. The point made is that from 1978 onwards real wages adjusted for productivity in manufacturing hardly changed but employment fell by over 10%. But this definition of the so-called real product wage cannot be expected to bear a simple relationship with employment. It takes the real wage and adjusts for productivity changes. It ignores the fact that this definition of the real product wage did not rise over this period precisely because employment fell and productivity rose. But we have already pointed out that if the adjustment is in the form of higher productivity output may benefit but employment will not. The key to the prospects for employment is the real product wage without allowing for productivity shifts - particularly those that occur partly in response to excessive real wages.

32. In any case conclusions from a simple relationship like this can be misleading if other factors are not taken into account. There has been a certain amount of careful work in recent years which has tended to provide empirical support for the inverse relationship. It also controls for other factors that were affecting employment at the same time. Much of it was done by economists at the Centre for Labour Economics at LSE, although internal Treasury work and studies by Patrick Minford and Michael Beenstock come to similar conclusions. All these studies show an inverse relationship between pay and jobs, part of which reflects the scope for substituting labour for other inputs when the relative cost of labour falls. Most economists would probably support this view.

33. **The evidence of the United States is not relevant.** Those who argue in favour of the pay and jobs relationship, including the Chancellor, have often cited the example of the US. Over the last ten years there have been 15 million new jobs created in the US, while employment has fallen in Europe. Real earnings rose by around an eighth in Europe over the same period, while they actually fell in the US. The counter-argument is that this evidence is not relevant because the rise in employment in the US was due to expansionary fiscal policies

rather than to the slow growth of real wages - it appears in the articles by Basnett and Wass .

34. The counter-argument does not appear to be based on a close examination of the data. The timing of the rise in employment does not fit with the timing of the rise in the budget deficit. Employment rose by 13 million between 1975 and 1979, a period over which US fiscal policy became more restrictive, but by only 2 million between 1979 and 1983 when it became much more expansionary.

35. Although money GDP has accelerated because of easier monetary and fiscal policy, the striking feature of recent US performance has been the extremely favourable division of nominal GDP growth between output and inflation. The latter is not a reflection of fiscal policy other than to the extent that it has led to a high dollar. The key has been the good supply performance of the economy and the extent to which fast growth of money demand has shown up in real demand. Whereas there has been little downward pressure on real wages in the UK despite high unemployment there has been a considerable degree of wage restraint in the US at considerably lower rates of unemployment. The rate of unemployment in the US that appears to be consistent with stable inflation appears to be considerably below the equivalent rate in the UK. The key to this is the behaviour of the labour market and the moderate rate of pay settlements.

36. A low wage/low productivity economy is undesirable. Basnett says that low wages "go together with low status, insecurity and inefficiency. Low-paid workers are inadequately trained and are given little or no responsibility or prospect for advancement. Their talents are therefore ignored and potential contribution to the economy's performance is wasted" (FT 8/8/84).

37. As already noted, a high wage/high productivity economy is better than a low wage and productivity economy, although Basnett no doubt exaggerates the extent to which there is untapped potential within individual workers as opposed to scope for raising their productivity through organisational and technical changes, including investment

in new equipment. But we cannot overnight become a high wage and productivity economy. In particular, the following two routes sometimes proposed are not sensible:

a. major increases in investment (Who would do it? If the public sector invested much more, or subsidised the private sector to do so, the quality of investment would be low. Productivity in such cases may not always be great. The private sector will invest more when it is profitable to do so. Compared to other countries there is evidence that investment has been higher in the UK relative to the change in output. Hence the Budget changes to corporation tax);

b. the "shock" effect of higher wages on management, forcing them to increase efficiency and productivity (It is extremely dubious whether this would work. If it did it would more often be because firms reduced employment than because they raised the output and productivity of all the initial workforce. Thus unemployment would rise).

39. The image that many people have of the low wage/low productivity economy that might result from more pricing back into jobs tends to be inaccurate and misleading. It would not involve an actual decline in the level of technology in any existing occupation or process. The changes would take place at the margin: firms would choose new equipment that was slightly less labour-saving than they would have chosen at higher wages; they would delay new investment of a labour-saving nature a little longer; and, perhaps most important, there would be a shift in the structure of the economy towards activities that used a higher proportion of employees together with a general incentive for companies to increase the level of output. In none of these cases would Basnett's description of low status, insecure and inefficient workers be appropriate. Of course, such shifts at the margin would only be gradual, which is why real wages should grow more slowly for many years so that the impact cumulates to something substantial over time.

40. Even if everyone agreed that they wanted real wages to grow more slowly, they are powerless to achieve such an outcome. This is a point made in the Wass article. It is argued that when money wages grow more slowly (which can be achieved), firms react by passing the lower costs on in lower prices, and real wages are unchanged.

41. In principle this could be true but in practice is unlikely and experience does not support it. Upward pressure on nominal wages has increased real wages faster than productivity and reduced profits. Slower growth of wages would likely lead to lower real wages, although not to the full extent of the wages slowdown. Lower wages would not feed one for one through to prices because imported costs would probably not fall as much as wage costs, if at all, and there would be increased scope for firms to improve their margins without adversely affecting their competitiveness. In any case as explained earlier, a short-term reduction in inflation within a given financial framework would boost output and employment. So wage moderation would lead to a reduction in unemployment even if real wages were unchanged.

42. There is one situation in which this mechanism would be delayed and the growth of real wages would not slow down, at least not for a number of years. This would be if the Government tightened fiscal and monetary policy following the reduction in the growth of money wages. In this case all of the reduction in money wage growth could feed through into lower inflation: there would be no real wage deceleration. The reduction in inflation here would not have as much impact on output and employment in the short term as with the unchanged financial framework, mainly because interest rates may not fall, the exchange rate could rise and cash limits would be reduced.

43. But the Government has no intention of responding to lower wage growth in this way. Against this background a slower growth of wages would both help demand and by leading to lower real wages would improve employment opportunities.

44. Lower Real Wages are of no use without increased Demand. Some accept the argument that lower real wages would help to improve supply

conditions but fear that it will be of little use if the demand is not present. This point is made in the Christopher letter.

45. But we have argued that given the Government's financial policy lower real wages will benefit demand as well as supply conditions. A demand stimulus through a higher PSBR and lower interest rates can equally be obtained by lower wages and prices within a given financial policy. The extra benefit from wage moderation is lower inflation and business confidence. There is no shortage of demand. Money GDP is currently growing at around 8 per cent a year. The Government's financial policy is consistent with continued growth at about this rate this year followed by a slow decline. A lower growth of earnings and prices within the framework leaves room for a rapid growth of demand. It is sometimes asked what the Government's response would be to lower earnings growth. The answer is that the appropriate response is to ensure that nominal magnitudes continue to grow at the rate implied by the financial strategy. That may require interest rate reductions but it would be within the framework of existing policy.

46. Any benefits of improved competitiveness can more efficiently be achieved by a lower exchange rate. This argument is made by Neuburger. But it is often forgotten that a lower exchange rate will only improve competitiveness **providing** that it reduces real wages. Without an acceptance of lower real wages exchange rate depreciation will increase prices without any competitive gain. Why should employees be prepared to accept lower real wages by this route which increases inflation and not by wage moderation which helps inflation? By contrast wage moderation produces the same lower real wage but at a lower inflation rate. That must be a better outcome. It is sometimes argued that it is easier to accept lower real wages by exchange rate depreciation because everyone is affected equally at the same time. But in that case it is not the principle that is being disputed but the best mechanism for bringing it about. It is also argued by Neuburger that for a given improvement in competitiveness a lower exchange rate does less damage to the real incomes of workers than lower pay levels. It is difficult to see how this can be sustained if full allowance is made for both the impact of the exchange rate and wages on prices.

What is clear is that a refusal to accept a lower real wage combined with currency depreciation is a (well-known) recipe for an acceleration of inflation.

48. Simulations of the Treasury model show benefits to unemployment from lower pay settlements because the model has been adapted to reflect the views of its proprietors. Henry Neuburger has argued, in a recent Low Pay Unit pamphlet and elsewhere, that the Treasury model considerably overstates the effect of changes in pay on unemployment. The implication is that the Treasury has fixed the model to produce the results it wants by incorporating an arbitrary feedback from improved company liquidity to increased employment. However the motivation for this change to the model, implemented in early 1982, was quite different. Previous versions of the model had completely failed to track the experience of 1980 and 1981, when financial pressures on companies caused them to shed labour to a marked degree; and the introduction of a feedback from liquidity to employment in the model was designed to remedy this failure. Far from overstating the effects of pay on employment, our view is if anything that the effects will be understated due to the absence of any specific allowance for the impact of real pay on the labour intensity of output or the composition of demand.

49. Trade Unions are not to blame for unemployment; Government needs to work with a strong democratic trade union movement. This is an argument put forward by David Basnett in his FT article. Trade Unions can have both positive and negative effects upon national output and employment. The positive effects can occur through reductions in labour turnover, co-operation among workers and improved communications with management. The negative effects of unions occur through three well-known avenues. First, there are restrictive working practices which lower productivity, such as minimum manning requirements, demarcation rules etc. Second, there are the destructive effects of strikes. Third, there is the trade union mark-up on pay, where unions raise the level of pay of their members relative to other workers. If the union successfully raises the level of pay above the competitive level, more pay for employed members will be at the expense of reduced employment in that trade.

50. There is no empirical evidence in the UK on the positive effects of unions. On the negative side there are several estimates on the size of the wage mark-up due to trade union power from a 10 per cent mark up for manual workers in 1980 by Blanchflower(1983), 32 per cent in a study by Nickell and Andrews (1983) and an extremely high estimate by Minford (1983) of 74 per cent. Estimates of the effect on employment range from a reduction in employment by over 400,000 between the mid '50s and the mid'70s (Nickell and Andrews) to a reduction of over a million (Minford).

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to the supply side?

If that is how the Budget comes out, it could indicate that the Government is setting its course towards the ultimate objective of stable prices which the Chancellor has proclaimed. It could also be defended on the argument that maintainable growth in the economy comes not from fiscal or monetary stimuli to demand but from the supply side, and in particular through a lower relativity between wages and output per head. The importance of these things cannot be underestimated; we have stressed them at various points above. The question is whether they can work by themselves, and the demand side be left to follow along. The CBI in its Budget submission to the Chancellor appears to have been partially converted to the supply side view; it also calls for a somewhat higher PSBR, but in order to finance 'supply side' measures. The view can be traced way back into the history of economic thought, and is not necessarily the worse for that. And yet...

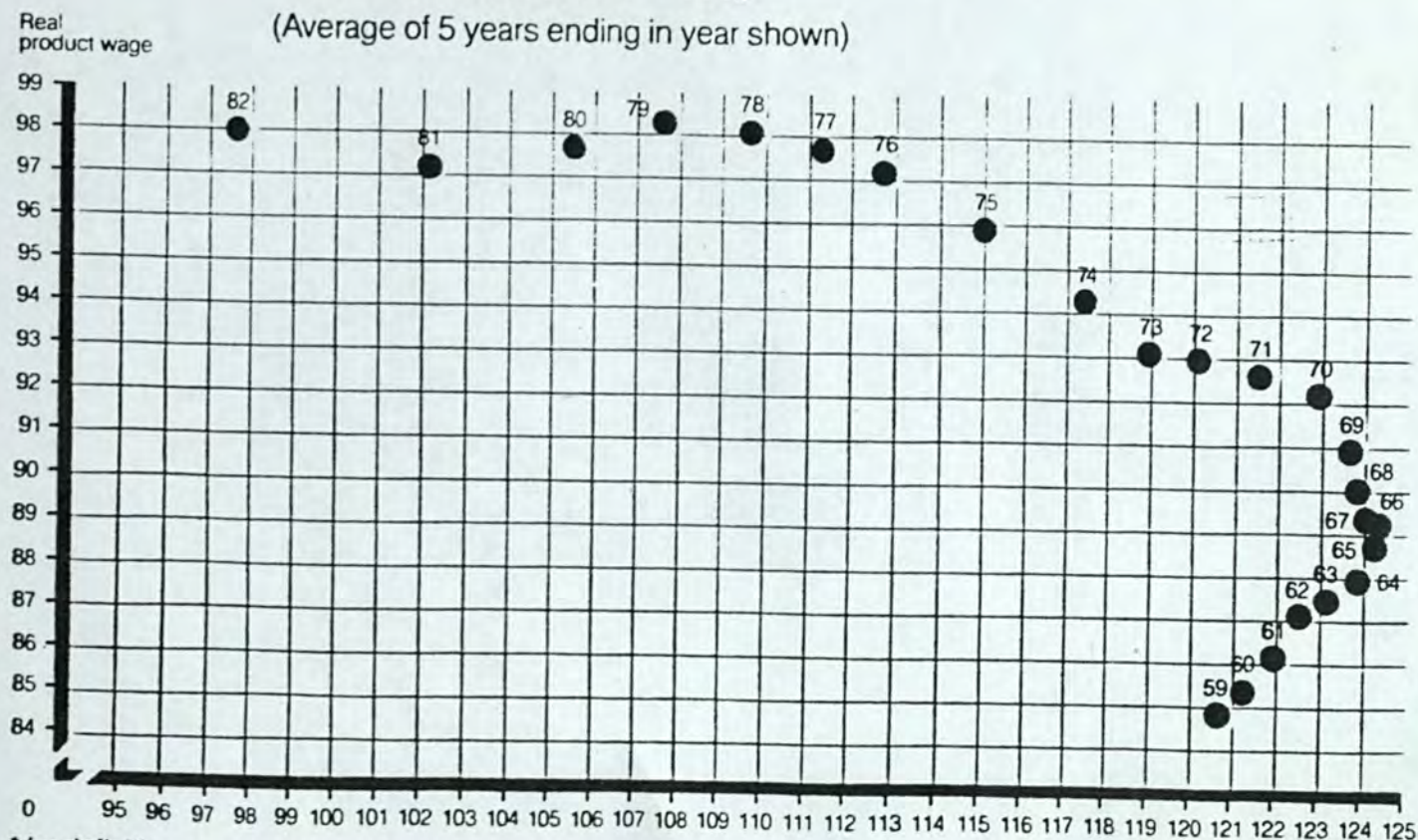
The idea that employment and output are related to the real cost of employing labour has been ventilated in these pages on a number of occasions. Chart 5 updates the relationship for UK manufacturing industry. The 'real product wage' is calculated from an index of wages and salaries per employee, plus the employers' contributions for National Insurance and superannuation, which is then divided by an index of output per employee and an index of (value-added) prices of manufactured products. The result is an approximation to the movement in the real effective cost of employing labour. It is akin to the share of labour costs in value-added, but it should be borne in mind that these are the costs of labour as seen by the employer rather than the rewards enjoyed by the employee. The latter would have to take account of income taxes and of retail prices in general rather than the prices of a particular product such as manufactures. It now appears that the post-war history of the relation between the 'real product wage' and employment has had three phases. Up to the late 1960s they rose together. From then to the late 1970s employment fell as the 'real product wage' rose. It

was this second phase which reawakened interest in the notion that unemployment was rising because real wages were too high. But the relationship now seems to have moved into a third phase, in which since the end of the 1970s employment has been dropping like a stone while the 'real product wage' has been stable or even slightly falling. (The figures plotted are five year averages. The annual data show a steep decline from 1975 to 1978, a rise in the two years to 1980 when wages rose sharply relative to prices and output per head fell in the recession, and since 1980 a decline resumed at a moderate pace. The annual data for employment show a continuous drop since 1978.)

What are we to make of this? The new experience from the end of the 1970s indicates that the 'real product wage', our proxy for the real effective cost of employing labour, may have lost its earlier influence on the level of employment—perhaps either way. Something else must have been at work. Is it perhaps declining demand? The figures plotted in Chart 5 relate only to manufacturing, and it is necessary to be cautious about drawing from them conclusions concerning the economy as a whole. Nevertheless, what has been happening in manufacturing since the late 1970s appears not to support the view that the key to higher levels of employment and output can be found in lower real labour costs alone. Lower labour costs may be necessary to ensure that any given level of demand can be profitably supplied, but if demand sags output may fall nevertheless. In other words, supply without demand may be as futile as demand without supply is dangerous. If we are right in thinking that this year will see the growth of demand diminishing in the UK economy, there is a case for some fiscal action to sustain it provided that it is balanced by at least some of the 'supply side' measures which the CBI and others have advocated, including the abolition of the National Insurance Surcharge. Equally, there is a case for the latter measures, provided that they are balanced by some stimulus to demand. To produce a balanced package some increase in the PSBR would probably be required. Perhaps the day for this has dawned; but will it be visible through the Treasury's blinds?

Chart 5 **Real product wage^a and employment in UK manufacturing (1980 = 100)**

(Average of 5 years ending in year shown)





C M O

G G

cc J R

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

10 September 1984

Dear Andrew

EMPLOYMENT SEMINAR ON 13 SEPTEMBER

The enclosed papers arise out of a remit given to my Secretary of State at the last seminar on 25 May. Colleagues will wish to consider, perhaps at the next seminar on 13 September, whether they wish to endorse the specific proposals for further action.

I am copying this letter to David Peretz (Treasury), Elizabeth Hodgkinson (Department of Education and Science), Michael Riedy (Department of Energy), Alex Galloway (Chancellor of the Duchy of Lancaster's Office), David Normington (Department of Employment), Callum McCarthy (Department of Trade and Industry), Steve Godber (Department of Health and Social Security), Richard Hatfield and Peter Gregson (Cabinet Office) and to the Chairman of the Manpower Services Commission.

Yours sincerely

John Ballard

JOHN BALLARD
Private Secretary

Andrew Turnbull Esq

C M O

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UNUSED LAND AND EMPTY HOUSING

I attach two papers on the separate but related topics of unused land and empty housing.

A good deal has been done over the past five years to deal with these problems. The two papers set out what has been achieved to date. But much remains to be done. It is essential that we ourselves, in the management of our Departments and sponsored bodies, should set a good example if we are to press local authorities hard to release their surplus land and empty housing. DHSS have set a good example of a vigorous assault on these problems and it is one which other Departments with large property holdings (including my own) will do well to follow. The two papers make a number of specific proposals for further action on both the Departmental and local authority fronts. I invite colleagues to endorse these.

PATRICK JENKIN



UNUSED LAND IN PUBLIC OWNERSHIP

Memorandum by the Department of the Environment

INTRODUCTION

1. Local authorities, government departments, nationalised industries and other public bodies own over 100,000 acres of unused and underused land on sites of one acre or more.

2. Although much has been done in the last five years to encourage the disposal of publicly owned land for housing and other developments, there is still a long way to go. Demand will ultimately determine the pace of disposal. But more can be done to secure the disposal of these unused assets. This note summarises what has been achieved since 1979 and sets out action now in hand and proposed.

ACHIEVEMENTS SINCE 1979

3. Since 1979 a wide range of initiatives has been taken to release publicly owned land suitable for housing and other development, to reclaim derelict land and recycle urban land. A large amount of land has been brought forward for development or for sale as a result of these measures. The recent circulars on Green Belt and Land for Housing both emphasise the importance of bringing neglected urban land into use for housing. Paragraphs 4-11 summarise what has been done to date. To give a sense of scale, the areas quoted can be compared with the annual rate of agricultural land used for urban development, which has been running at the rate of about 8,000 acres a year in England and Wales in recent years compared to over 20,000 acres a year between the wars.

Land for housing

4. Instead of requiring specific consent to dispose of land, local authorities have been given general consent to sell housing land at the best price reasonably obtainable. Authorities have



also been encouraged to use land with low historic cost for partnership schemes with developers building under license, including the offer of discounts on the houses built. Between April 1979 and December 1983 4,400 acres of housing land was sold by local authorities. This included 900 acres initially licensed to private contractors to build houses for sale. 9,000 houses were built in this way for owner-occupation between April 1981 to December 1983.

Land Registers

5. Since the Land Register system was introduced in 1981 registers have been established for all 365 districts in England. At the end of 1983 12,000 sites, comprising 112,000 acres, were on the Registers. By 1 July 1984 about 16,000 acres had been sold or brought into use. Meanwhile further sites have been added to the registers. The distribution of this land by ownership and by disposal performance is shown in the table attached. Just under half of all this land has been assessed as having medium to high potential for development, the rest little or none. About 30,000 acres are on offer for sale. Assuming that all or most of the land already sold, brought into use or on offer for sale is in the category of high or medium development potential, over two thirds of that category is already "on the move". The "direction to dispose" procedure under the 1980 Act has recently been initiated on nine sites owned by local authorities.

6. We have now initiated the statutory procedures to compel the sale of 9 sites owned by local authorities. Until now it has usually been sufficient to threaten to use this 'direction to dispose' procedure under the 1980 Act in order to stir an authority to action. We have now identified 9 sites where in our view the authority is unreasonably refusing to sell. These are of the nature of test cases, and if the directions are confirmed, this will both encourage other authorities to sell and will pave the way to further directions. We expect to have the results in these first nine cases later this week.

Derelict Land Reclamation

7. Between 1974 and 1982, the years of the last two national surveys, some 40,000 acres of derelict land were reclaimed, about two-thirds of which was done with grant aid. The average rate of reclamation is in round terms 5,000 acres a year. In spite of this progress, new sites becoming derelict have meant that the amount of dereliction justifying reclamation is the same now as it was in 1974. At present bids for schemes to be included in the programme are more than double the annual PES provision of around £75m. Priority is being given to land register sites with most potential for attracting private sector investment after reclamation.



Urban development grant

8. Since the UDG scheme was introduced in 1982, schemes completed in progress or subject to offer of grant involve 567 acres of urban land, of which 500 acres were in need of clearance or restoration. Nearly half of this has a housing end use. At present the funds available are sufficient to enable all schemes acceptable for grant to proceed. But this could change if more good schemes come forward and UDG funds were reduced.

New Towns

9. Since 1979 some £450m. of commercial and industrial property (including land) has been sold by the New Towns Commission and Development Corporations. The programme is continuing at about £70m. a year; land sales alone are running at over £10m. a year. Over 18,000 new town houses have been sold since May 1979. Sales are continuing at about 4,000 a year. Housing land sales are now running at about £25m. a year and are expected to rise to about £30m. a year over the next five years. About 500 acres were sold in 1982/83. This figure rose to over 800 acres in 1983-84 and a further 800 acres were sold in that year for other purposes.

Urban development corporations

10. The London Docklands Development Corporation was set up in 1981/82. Since then they have acquired nearly 1,000 acres of land, most of which was acquired by vesting from local authorities and other public bodies. Nearly half of this acreage has now been reclaimed and serviced. Of this, a total of 250 acres is being developed or is already in use. 172 acres have been released to 18 private housebuilders and 8 housing associations to provide over 4,000 new dwellings. By March 1984, 1,150 had been completed. On present policies, LDDC expect that by March 1989 about 10,000 units will have been completed on land provided by the Corporation.

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11. Merseyside Development Corporation was also set up in 1981/82 and has acquired 600 acres of land, primarily from other public bodies and again mostly by vesting. It has reclaimed 250 acres at Riverside and will begin phased release of land after the International Garden Festival, which occupies half the site, closes in October 1984. 75 acres is to be allocated for housing with provision for about 3,150 houses.

12. The release of serviced land is the UDC's prime method of promoting regeneration. As the UDCs have already committed most of their 1984/85 allocations the prospects for an increase in the rate of release are bleak unless further resources can be made available.

THE NEXT STEPS

General

13. First, we need to increase the pressure on local authorities, nationalised industries and other public bodies to market and capitalise on underused or surplus land assets. This requires action by several Departments, some of whom also have substantial holdings of surplus or unused land.

14. Secondly, action should be concentrated on the areas where demand for land is high or where the need for inner city regeneration is greatest. This calls for more selective use of UDG and DLG to encourage the recycling of unused and derelict land, to stimulate private sector redevelopment and to promote public sector/private sector partnership in reclamation and development.

15. Thirdly, many public bodies with land disposal programmes, would benefit from better co-ordinated estate management, systematic forward programming of land recycling, and better marketing arrangements drawing on the expertise of the private sector.

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Government Departments and Nationalised Industries

16. It is particularly important that the Government should set a good example of resource management and disposal of redundant assets. There is much room for improvement. The 1983 review by consultants of NHS land and property followed up by the DHSS Circular of the same year requiring a much more systematic approach by health authorities to estate management sets a good example of what can be done. Other Departments can benefit from DHSS experience and follow their example, both on their own land holdings and those of nationalised industries and sponsored bodies. Consultants can be employed to advise on prospects for vacant and underused land, to identify scope for marketing surplus assets, and to help overcome inertia and reluctance to part with land that may or may not be needed at some unspecified time in the future.

Local Authorities

17. So far the pressure has been brought to bear on local authorities across the board to release land for development. This has had some success (as described above) and will be maintained. Two new steps are being taken to facilitate access to land registers and to promote developer interest in land register sites (these relate to all land register sites but local authority holdings are the largest component):

- (1) Within the next two months all land register sites will be on the DOE computer with terminals in London and Regional Offices available to the public, estate agents, developers etc.
- (2) Before the end of the year a new "catalogue" of all land register sites will be published by the Estates Times from material provided by DOE. This is planned to be a periodic publication and the first edition will probably be a "free issue" supported by advertising. It will be widely distributed.

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18. In addition, it is proposed to concentrate attention on a short list of 20-30 local authorities in areas where there is a known demand for land, and who have substantial holdings of land register sites but have made little progress towards disposal. It is proposed to take action at two levels:

- (1) to require the local authorities to provide a statement of their present intentions as regards each of their sites on the register and the action they are taking to dispose of the land or bring it into use;
- (2) to commission estates consultants in several of these areas to identify the sites that appear to have the greatest development potential and marketability.

19. The results of the local authorities' statements on the one hand and the consultants views on the other will then be compared and action taken, using the statutory powers if necessary, to bring about the disposal of those sites for which the local authority appear to have no present need and which the consultants consider to be readily saleable.

Summary

20. Local authorities, Government Departments, sponsored bodies and nationalised industries have large holdings of unused or underused land. In the past five years effective action has been taken to secure the release of this land - both by the introduction of land registers and by the use of grant incentives and other means. In the past two years or so 16,000 acres of land register sites have been sold or brought into use and other 30,000 acres are on offer for sale. This represents over two thirds of the total land with high or medium development potential.

21. The rate of progress depends both on the readiness of public owners to release land and on market demand. Much of the other land on the registers is less readily developable due to site factors, location, contamination, dereliction,

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difficulties of access or other constraints. But there is still plenty of land on the registers that should be brought forward for development.

22. Government Departments should take firm action to bring this about, both as regards their own holdings and those of their sponsored bodies and nationalised industries. Pressure will be maintained on local authorities to release their surplus land and special action is now proposed to tackle a priority list of authorities in areas where demand for land is high and that hold substantial stocks of land and have been slow to offer it for sale. Finally, within the next two months or so access to, and publicity for, land registers will be greatly enhanced and this will provide the opportunity for publicising what has already been achieved, for new marketing initiatives and for renewed pressure on recalcitrant authorities.

Department of the Environment
7 September 1984

LAND REGISTERS: LAND HOLDINGS AT 1 JANUARY 1984 (ACRES) AND LAND REMOVED FROM REGISTERS FOLLOWING DISPOSAL OR BECAUSE BROUGHT INTO USE

	CURRENT HOLDING	Removed
	1/7/1984	1/7/1984
<u>Local authorities</u>	64,500	9,600
<u>Government departments and other Crown bodies</u>		
Environment	400	200
DHSS	4,300	100
Department of Energy	100	-
DTP	300	100
MOD	2,600	1,100
DTI	-	-
Other Crown bodies	-	-
<u>Total</u>	<u>7,700</u>	<u>1,500</u>
<u>Nationalised industries and statutory undertakers</u>		
British Rail	14,800	1,900
British Gas	1,800	200
National Coal Board	2,300	100
/Associated British Ports	400	- see Note 17
Other port authorities	2,800	200
British Waterways Board	200	-
Electricity Boards	3,600	500
Water authorities	2,500	600
British Steel	1,700	700
British Shipbuilders	100	-
Post Office	-	-
/British Telecom	400	100 - see Note 27
Other NIs and SUs	-	-
<u>Total</u>	<u>30,600</u>	<u>4,300</u>
<u>Other non-Crown public bodies</u>		
/New Towns	8,500	600 - see Note 37
/Urban development corporations	700	- - see Note 37
Housing Corporation	-	-
<u>Total</u>	<u>9,200</u>	<u>600</u>
<u>All owners</u>	<u>112,000</u>	<u>16,000</u>



NOTE

1. The land of Associated British Ports and British Telecom has been included only for the sake of completeness. ABP, the former British Transport Docks Board, have been privatised and it would be inconsistent with Government policy toward them to make use of land register powers in respect of their land. It has not, however, been removed from the registers in view of legal advice that to do so would be open to challenge: their land is still technically subject to registration because ABP are statutory undertakers, albeit in the private sector.

2. The land of British Telecom will shortly cease to be subject to registration once the relevant provision of the Telecommunications Act 1984 comes into force, and their land will then be removed.

3. New Town Development Corporations and UDC's have as one of their main functions the acquisition and servicing of land for development. All the land that they own is therefore held for their statutory purpose and the Corporations are selling large areas of land for development (see paragraphs 8-11 of main paper). In some cases, however, sites have been included on the land registers - e.g. where the land is not likely to be developed in the near future but where inclusion on the register may attract development interest.

PUBLIC SECTOR VACANT DWELLINGS

Introduction

1. From the outset, this Government has recognised the importance of reducing the numbers of empty dwellings owned by public sector landlords. Wherever possible, the emphasis has been on disposal to the private sector, but better management of the tenanted stock also has an important part to play. The Department has taken several initiatives to reduce the numbers of local authority empty dwellings, and has encouraged other Departments to reduce the levels of empty dwellings for which they are responsible. Much has been achieved, but the overall trend is still upwards. This paper considers progress so far, and looks to new solutions.

A. Local Authority vacant Dwellings

(i) Action since 1979

2. Initiatives by the Government since 1979, and particularly in the Housing Act 1980, to encourage the sale of local authority empty dwellings include:

- a. Homesteading - that is, the sale of unimproved properties to prospective owner-occupiers;
- b. the Improvement for Sale (IFS) Scheme;
- c. powers for local authorities to guarantee building society mortgages;
- d. consent to local authorities to sell vacant dwellings, with a discount of up to 30% for priority groups;
- e. consent to local authorities to sell empty properties to the private sector for improvement/conversion and resale;
- f. consent to certain local authorities to sell difficult-to-let properties to private sector trusts for improvement, conversion and management.

3. The Government has also taken the following initiatives to encourage local authorities to manage their tenanted stock with lower void levels:

- a. the 2% void limit in the housing subsidy system (3% in exceptional circumstances), above which a local authority's subsidy entitlement is reduced;
- b. provision for short-term lets to priority groups;

- c. the Priority Estates Project (PEP) which aims to assist local authorities to improve the management of problem estates;
- d. advice from the Housing Services Advisory Unit (HSAU) on good practice in the efficient management and use of public sector housing, including the Department's advisory publication "Reducing the Number of Empty Dwellings";
- e. the introduction in 1983 of Form HIP4 into local authorities' Housing Investment Programme (HIP) submissions inviting them to list their dwellings which have been empty for over one year, with bids for putting these dwellings back into use;
- f. in May this year, the Minister for Housing & Construction launched an intensive exercise to explore the difficulties of the 30 worst-affected authorities and to seek new solutions.

(ii) Results of initiatives

4. There has been substantial ^{but} ~~and~~ varied progress with privatisation:

- a. between April 1979 and March 1984, 18,600 vacant dwellings were sold by local authorities;
- b. at April 1983, 6,100 were programmed for sale;
- c. many authorities are making use of their powers to sell empty housing at attractive prices to private developers for renovation and resale for owner-occupation. Minster Court in Liverpool is the most often quoted example, but at least 50 such schemes are under consideration;
- d. the disposal of the Cantril Farm estate (now Stockbridge Village) on Merseyside to a private trust has brought in the private sector to manage and revitalise a severely rundown council estate. Four further projects are being planned on this model.

5. As far as better management of tenanted local authority housing is concerned, apart from the 2% subsidy limit for empty dwellings, the Department's initiatives detailed in para 3 have concentrated on advice and encouragement. The exercise with the 30 worst-affected

authorities is indicating that over the last few years many local authorities have taken the message to heart and have greatly tightened their procedures, although there is still considerable room for improvement with others. Although results could not have been expected overnight, it is reasonable to suppose that the Department's initiatives have had a useful impact in helping to contain the problem. It is also evident that although there is no quantified information about the number of empty dwellings which have been, and are being relet, the turnover is considerable as refurbishment work is completed on empty dwellings and other dwellings due for refurbishment are vacated for work to be done on them. Progress on refurbishment is inevitably limited by the availability of resources, both financially and in terms of staff effort to monitor and expedite work effectively. Although some local authorities are reluctant to consider any disposals of empty housing, and in some areas of the country housing remains empty simply because of lack of any demand, the overall impression gained from the exercise is that most authorities regard the problem as one of their top priorities, and are tackling it open-mindedly and imaginatively. 16 of the 30 authorities have told the Department that they brought down the number of their long-term empty dwellings and 19 of them have reduced their levels of total empties in 1983/84.

6. Nonetheless, the total number of local authority empty dwellings remains high - 107,000 at 31 March 1983 according to local authority returns and about the same number at 31 March 1984 according to preliminary indications from this year's returns. Although the overall number appears to be levelling out, and although at 2.3% of the stock overall the number empty is on average little more than the 2% normally considered acceptable for management purposes, some authorities continue to have much higher vacancy rates, including high levels of long-term empty dwellings.

(iii) Further options

7. Existing policies are being reinforced to promote further sales and better management. In particular:

- a. further development of the Stockbridge Village approach including the possibility of an agency to promote the establishment of such Trusts, both to improve rundown council estates, and to promote improvement of private housing in inner city areas;

- b. legislation to help local authorities to sell unpopular blocks of flats with vacant possession to developers for renovation and resale, on the lines of Minister Court;
- c. increasing the number of authorities participating in the Priority Estates Project, which has recently been extended for 3 years;
- d. consideration could also be given to extending the Community Refurbishment Scheme approach from Merseyside to other parts of the country. These schemes bring together the Department's Urban Programme and the MSC's Community Programme to fund unemployed people locally to refurbish rundown estates - invariably with high levels of vacant dwellings;
- e. more specific direction of housing capital allocations to bringing empty housing back into use;
- f. a Circular to bring home to local authorities at large the lessons on management good practice which have emerged from the current exercise with the 30 worst-affected authorities;
- g. the promotion of more short-life schemes to bring back into use empty property which cannot be brought up to the full standard.

8. In the last resort, Ministers might wish to consider selective use of the Land Register powers to compel local authorities to put their long-term empty dwellings on to the market. However, they would no doubt first want to assess the results of the current limited exercise to use the Land Register powers to secure the disposal of nine pieces of land (which is covered in a separate paper). It should also be noted that the number of dwellings which might be suitable for this approach would be relatively small - less than 10,000. Ministers would need to take a view of the likely knock-on benefits, and of the costs in terms of work for the Department and local authorities, and of the inevitable political controversy. If Ministers were minded to take firmer action to secure sales of empty housing a first step might be to use their general powers to require information in order to ask local authorities to give comprehensive details of long-term empty dwellings, in the expectation that this request would generate greater political pressure locally.

B. Dwellings owned by Government Departments, Public Corporations and New Town Development Corporations

(i) Action since 1979

9. In 1981, the Minister for Housing & Construction wrote to all Government Departments and other public bodies which owned housing in their own right. Departments were urged, on the basis of statistics for empties which they provided, to dispose of empty dwellings or put them back into effective use. The exercise was repeated in 1982 and 1984.

10. As far as the Department's direct responsibilities are concerned, levels of empty dwellings owned by PSA and the Regional Water Authorities come under close scrutiny, as do those of the New Town Development Corporations, to which many of the initiatives detailed in paras 2 and 3 apply in much the same way as they do to local authorities.

(ii) Results of Initiatives

11. Local authority returns in 1983 showed that Government Departments and other public bodies had the highest rate of empty dwellings of all sectors (23,000 vacant dwellings, 6.9% of total stock). The table at Annex 1, based on the Department's own statistics and information provided in response to the Minister's recent enquiry, shows that with the exception of the Department of Energy, no Department significantly reduced the number of empty dwellings between 1981 and 1984, and indeed that there were some major increases. As far as DOE itself is concerned, PSA numbers are small and steady. Vacancy rates in New Towns have gone down from 6.9% in May 1979 to 4.6% at the end of March 1984.

(iii) Further options

12. It is recognised that some Government Departments have special operational reasons for high levels of vacancies. However, the levels in nearly all cases seem unacceptably high, and make the Government vulnerable to criticism in its current efforts to put pressure on local authorities to improve their performance.

13. The initiative by the Minister for Housing & Construction to invite Departments to set targets and to monitor progress is intended to prompt sales and more intensive management practices.

14. DHSS has recently undertaken a Rayner Scrutiny into the use of residential accommodation and is now consulting about the results. Other Departments with significant holdings may wish to consider a similar approach.

Department of the Environment
September 1984.

	1	2	3	4		5		6		7		COMMENTS
	TOTAL EMPTY May 1981	TOTAL EMPTY March 1982	TOTAL EMPTY March 1984	BEING SOLD		REPAIR/ RELET		AWAITING DEMOLITION		AWAITING DECISION		
				1982	1984	1982	1984	1982	1984	1982	1984	
MOD MILITARY CIVILIAN	15100 -	13600 269	14316 518	0 0	0 0	5300 -	6410 25	0 0	0 0	- -	3986 -	
D ENERGY	2645	1845	1925	650	725	570	800	280	160	345	240	
DHSS	1620	2053		278		1542		80		153		
HOME OFFICE	1817	2479	3084	1600	1421	739	286	20	15	120	0	
MAFF	0	16	105	5	92	4	5	0	0	7	8	
D TRANSPORT	302	442	685	158	237	123	172	145	177	16	99	
FORESTRY COMMISSION	279	310	260	134	120	74	60	1	7	101	73	
BWB	63	76	77	45	45	225	19	5	2	1	11	
RWAS	-	-	331	-	152	-	167	-	5	-	7	
PSA MILITARY (DISPOSAL)	-	1766	1711	1696	1651	0	0	70	60	0	0	
PSA CIVIL ESTATE	-	187*	203	75*	134	22*	19	0*	0	90*	50	
NEW TOWNS	-	6331 ^Ø	4564 ⁺	-	-	3660	2155	-		-	-	
TOTAL / EXCLUDING RWAs & DHSS ⁷		27321	27448									

Ø Dec 1981

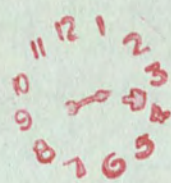
* Oct 1983

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+ June 1984

9 SEP 1984





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10 September 1984

Dear Andrew,

SEMINAR OF INDUSTRY AND EMPLOYMENT

I now attach my Secretary of State's note on "Passport for a Job", referred to in your letter of 6 September. This is to be taken under item 4 of your annotated agenda for the Seminar.

I am copying this letter to David Peretz (HM Treasury), Elizabeth Hodgkinson (Department of Education and Science), John Ballard (Department of the Environment), Michael Reidy (Department of Energy), Callum McCarthy (Department of Trade and Industry), Steve Godber (Department of Health and Social Security), Richard Hatfield and Peter Gregson (Cabinet Office).

Yours sincerely

David Normington

D J NORMINGTON
Principal Private
Secretary

INCREASING EMPLOYMENT THROUGH DEREGULATION

Note by the Secretary of State for Employment.

1 There is little doubt that many employers - especially many potential employers - are deterred from taking on extra people by their fear of the paperwork and legal obligations involved. This is particularly true where full-time employees are concerned and must be at least part of the explanation for the rapid growth in part-time employment at a time when full-time job opportunities are actually decreasing. It is also of course one of the reasons for the growth of the black economy. If the full benefits of economic regeneration are to be reflected in a reduction in the unemployment count it is vital that we should persuade employers and small businessmen who have not yet employed anyone that the "employment system" is neither bureaucratic nor burdensome. If we can do so, we may unlock a completely new area of job opportunities.

Passport for a Job - a possible scheme

2 As agreed at our last meeting, officials from the Departments concerned have therefore been examining the potential for an entirely new idea of a "Passport for a Job". This would be a scheme which exempted employers who employed people at below a certain wage from their obligations in respect of those employees for tax and national insurance and from the main requirements of employment protection legislation. The aim of such a scheme would be to demonstrate the potential benefits of deregulation, to encourage the employment of people at realistic wage rates and thereby to promote job opportunities.

3 Officials have now reported. It became clear during their studies that any proposal of this sort would involve several major departures from existing policy - exemption from both income tax and national insurance contributions balanced

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- benefit.

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by the removal of the individual employee's rights under existing arrangements for sick pay, employment protection and in some cases Wages Council awards. The officials' report shows that none of these changes presents overwhelming difficulties nor need they necessarily involve new primary legislation. But they would undoubtedly be controversial, involving, as they do, removal of individuals' employment rights, and they could be expensive. While I am attracted, therefore, by a scheme of this kind which would establish the principle of deregulation, before going any further I would appreciate colleagues' views on the practicability of such a scheme and on the coverage.

Focus of the Scheme

4 The main question is how to focus such a scheme. Officials looked at the possibility of a scheme for the under 18s. However, I now think they are the wrong target. For those entering working life at that age our proclaimed objective is proper training and our chosen instrument for the Government contribution is the Youth Training Scheme. We have only just begun to escape from the clash of aims between YTS and the Young Workers Scheme and it would be a mistake to resuscitate it. Furthermore it seems to me that the social security review of young people's benefits could open a preferable way to achieving the scheme's employment aims for under 18s.

5 I therefore believe we ought to consider targetting any scheme within the post YTS age group ie broadly within the range 18 to 25 year olds. The unemployment rate in this age group is more than double that of other adults and about one-third of them have been unemployed for a year or more. I

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have considered a number of options. The greatest impact would be achieved by a scheme which was open to all employers and covered the whole 18 to 25 age group. But initial assessments suggest that the costs of such a scheme would be too great to contemplate at present. I have also looked at the possibility of focussing on the long-term unemployed in the 18 to 25 age group. But again the costs of such a scheme would be considerable and I am anxious to avoid a scheme which seems to be treating the long-term unemployed as second class citizens.

Preferred Option

6 My preferred option, therefore, is a scheme which would run end on to YTS and be available to everyone up to the age of 20. Young people would become eligible for the scheme once they had exhausted the possibilities of youth training; and employers would be able to keep young people under 20 on the scheme perhaps for up to two years provided their pay did not exceed, say, £50 per week.

7 Such a scheme could be presented as an extension of the principle of the Young Workers Scheme. It would be easier to defend removing employment rights from this age group since it could be presented as a new and more effective way of helping young people into their first employment after the Youth Training Scheme. The impact of deregulation should also be proportionately greater on this age group than on older people. They are more likely to accept modest wages and flexible conditions than those with more responsibilities. A Scheme of this sort will be seen by many as a test of the principles of deregulation, so it is important that we should choose the group who are likely to benefit the most.

8 Our initial calculations suggest that the full cost of such a scheme might be around £120m and the net cost £86m. Some of the costs might be offset by savings on the Young

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Workers Scheme, which "Passport" would replace. The effect on the unemployment count, which depends on the popularity of the scheme and is inevitably speculative, might be around 40,000.

9 In my view such a scheme is the minimum necessary really to test whether the present system deters employers from taking people on. If we do anything less or do only part of the package we shall not make the major impact we are seeking nor establish the value of deregulation and realistic wage levels to employment creation.

10 I should appreciate colleagues' views on the feasibility of such an approach.

6/9/84

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Discussion Document

TOWARDS FULLER EMPLOYMENT

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DISCUSSION DOCUMENT

6 September 1984

TOWARDS FULLER EMPLOYMENT

1. We have weathered the world recession far better than many of our competitors. During the past year alone, Gross Domestic Product has risen by nearly 3%; industrial output has grown by 3.5%; investment has increased by 10% in real terms; industrial profits have improved by 25%; productivity is better by 5.25% and inflation has been kept at its lowest level for 15 years. And yet, unemployment has remained obstinately high. This worrying persistence of high unemployment during economic recovery is a matter of urgent concern, not only to the Government but also to every private individual, business and trade union.

THE GROWTH OF UNEMPLOYMENT

2. The problem of unemployment is not new to Britain. Since 1960, the number of people registered as unemployed has risen painfully through the lifetimes of different Parliaments and different governments. The trend has been steadily upward despite some oscillations. In 1962, there were 454,000 people on the register; in 1972, 855,000; and in 1982, 2,793,000. [Graph]

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3. Nor is the problem unique to Britain. [Comparison with Europe].

4. The pattern in many of the countries of the Pacific has been quite different. There are, of course, important historical and cultural differences between European and Pacific basin nations. But we should be willing to learn what we can from the dramatic successes of Japan, Hong Kong and South Korea. [Statistical comparisons from D/Emp]

5. We should also be willing to ask why the United States has avoided the sustained upward trend in unemployment that has occurred in Britain. Between 1962 and 1982, over 30 million additional jobs were created in the United States, even allowing for closures and dismissals. As a result, the proportion of the American civilian workforce registered as unemployed, instead of increasing steadily, has varied between 3.5% and 10% over the past twenty years. It was 5.5% in 1962, and was still only 5.6% in 1972. Indeed, even in the difficult years since 1972, the unemployment rate has risen and fallen by turns. It increased markedly in 1975, then gradually reduced until 1979. It rose again from 1979 to 1982, and is now falling once more.

6. Why has America been so successful at creating new jobs, not merely in recent years but continuously over the last

two decades? At first glance, it is tempting to suppose that the cause was buoyant demand stimulated by Government borrowing. But this argument is false.

7. Over the past 20 years, there has been no shortage of demand in Britain. The amount of money available for buying new goods and services in Britain increased seventeen times as fast as the increase in the volume of production between 1962 and 1982. In America, by contrast, demand - as measured by nominal GDP - rose half as fast as in England, and increased only five times as fast as production.

8. [Treasury passage dealing with Reaganomics, rebutting the argument that the Federal deficit is the main cause of increased employment, and distinguishing short cyclical fluctuation based on money stimulus etc from the long-term trend of job creation in an enterprise culture; also commenting on the 'natural' rate of unemployment in the US.]

9. [Rebuttal of other fallacious explanations of Britain's unemployment record (eg lack of investment), and examples of the lump of labour fallacy (eg high technology, growth in workforce)].

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THE NATURE OF THE OBSTACLES

Excessive Wage Rises

10. A more significant consideration is the high level of wage increases in Britain: between 1962 and 1982, average real wages in the United States rose by well under P%; over the same period in Britain, they rose by some Q%. The divergence has been even greater during the past 3 years: the Government's clearly articulated strategy has succeeded in bringing down the rate of inflation; but wage increases have not reflected this. Real wages [have not changed in the United States since 1981], whereas in Britain, they have risen by X%. If these British rises had been matched by corresponding increases in the amount of goods produced by each employee, they would have constituted a wholly welcome improvement to our standard of living. But without such increases in productivity, they have forced companies to reduce costs by shedding labour. These are the sad facts behind the assertion that people can price themselves into and out of jobs.

11. Many commentators are coming to understand that people in Britain have priced themselves out of jobs over the past 20 years. Some conclude, with a considerable weight of evidence on their side, that the very large wage increases have been the major cause of high unemployment.

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12. Why has the British economy experienced such high wage increases? It is sometimes suggested that the responsibility lies with governments that refuse to impose statutory limits on pay. But there is no evidence to support this view. [Paragraph by Treasury/DEmp making good, clear arguments against pay policies]

13. The true cause of excessive wage increases is the short-sighted attitude too often found in British industry. Unfortunately Trade Unions act on behalf of the bulk of their members who already have jobs without considering the fate of those others, usually not current Union members, who do not have and cannot find jobs. Such unions have pressed for high rates of pay, which suit those in work, heedless of the fate of those who are seeking work. Many negotiators still seem unaware that higher pay causes redundancies because companies cannot afford to employ as many people at the new rates.

14. This winner-takes-all approach has been particularly harmful in the case of youth wages. With a very few exceptions, young people beginning their first job can contribute much less to the success of any business than those who have acquired the skills and experience that come through a period at work. It is therefore sensible for any firm to hire older people unless the young are willing to accept lower wages commensurate with their lower contribution. In Germany, this is indeed the pattern;

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average youth wages are only 20% of adult wages. But in Britain, the average youth worker receives over 50% of the adult rate. As a result, young people have taken more than their share of the rising unemployment. Between 1962 and 1982, youth unemployment in Britain rose by 1200% - more than twice the rise for adults. This is an extremely painful and self-inflicted wound. [Paragraph to be expanded by DEMP].

15. The blame for this obstacle to youth employment is not easy to apportion. Trade Unions, certainly, must share some of it; but so, too, must those managers who have consistently failed to insist on levels of wages that would make it worthwhile to employ young people. All too often, management has taken the easy way out - agreeing to high youth wages, and then avoiding the consequences by refusing to employ young people. This is an example of the kindness that kills.

16. [Passage on 'Why work?' from D/EMP, DHSS, Treasury. Problem is the relationship between pay, tax and benefits, and the very low starting threshold for income tax: particularly acute for young people].

17. Some argue that Wages Councils are also a cause of the problem. The motives behind the creation of these councils were laudable: they were designed to protect wage-earners against rapacious employers. But they may have unfortunate

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consequences. [Passage from D/Emp on the Councils, examining the evidence about their impact on employment - including comparisons between wages council and non wages council industries, and providing figures for growth of jobs in the US in those industries that are covered by Wages Councils in the UK]

Failures of Management and Enterprise

18. But excessively high wage rises are not by any means the only cause of unemployment in Britain. We are also hampered by failures of management and enterprise.

19. Management in Britain frequently leaves much to be desired. The blame for this cannot, of course, be laid solely at the door of those known as 'managers'. Management depends not only on those who manage but also upon those who are managed. The interests of individual employees and their Trade Unions can be furthered only in a concern where they make a positive contribution. Without their cooperation, no person appointed as a manager can hope to design his products well, to control quality properly, or to market his goods with zeal. For a company to compete, all the individuals who work in it have to be willing to contribute to its success, by welcoming rather than rejecting the new technology, by striving everywhere for greater efficiency and productivity, and by treating the

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customer as a valued source of employment rather than as an unfortunate source of additional bother.

20. Those who are appointed as managers have particularly heavy responsibilities in all of these areas. Failures of design, quality control and marketing do not 'happen' to managers: they are caused. Cooperation by a workforce necessarily involves cooperation with that workforce. The introduction of new technology has to be explained if it is to be achieved smoothly; arrangements have to be made to safeguard the legitimate interests of all those working in the company when changes occur; even if innovations are essential to the long-term prospects for the company's capacity to employ, no set of employees can be expected to welcome them if they can see that their own lives will be adversely affected. Managerial imagination, sensitivity and respect for individuals are absolutely indispensable conditions for competitiveness and expansion. The absence of these qualities, and of reciprocal qualities on the part of employees and trade unions has all too often been an obstacle to employment in Britain.

21. We have much to learn, here, from nations such as Japan. Some large firms in Japan often come close to giving their employees guaranteed jobs for life. But in return, the employees are much more flexible than we often are: they willingly learn new skills and move to new jobs within the

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same firm. [Passage on internal labour markets to be drafted by DTI/DEmp].

22. Japanese firms also find it easier to offer permanent jobs for their employees because they distinguish between 'core' tasks for which they employ staff directly and peripheral activities which are frequently contracted to small businesses. This does, of course, occur in Britain - it is, indeed, happening increasingly. But there are still cases in which flexibility and competitiveness are impeded by excessive reluctance to make use of small, adaptable suppliers. [DTI passage on the importance of small business in Japan].

Inadequate Training

23. The level of employment in Britain is also decisively affected by the training that employees have received. In great part, this will depend on their basic education: it is to the schools that employers and the nation must principally look not only for training in literacy, numeracy and higher intellectual skills, but also for the inculcation of those attitudes that make a young person employable. [Expansion of passage by DES].

24. In addition, there is the more specialised - though almost equally important demand - for many young people to

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receive forms of vocational training that will make them immediately useful to the firms that employ them. In this respect, Britain has notably lagged behind her European partners. Roughly 65% of young people aged 14 - 19 currently undertake courses of vocational training in West Germany; in France, the figure is X%; but in Britain, only Y% of 14 - 19 year olds are enrolled in such courses.

Regulations and Restrictions

25. Jobs in Britain have also been destroyed by a large number of restrictions and regulations, which make it difficult for businesses to set up and expand. One form of restriction which has had a marked effect is planning. Many people in Britain are understandably concerned to protect the environment. In response to this wish, successive governments have encouraged local authorities to impose detailed planning constraints on businesses. These have restricted not only the building of new homes, but also the creation and expansion of businesses. They have, for example, frequently prevented new light industry, out-of-town retailing, fast-food shops and leisure centres from settling and expanding in those areas where there is most demand for them. These are industries that have generated [millions] of new jobs in the United States, where planning controls are less rigorous.

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26. Another important constraint is licensing. Nobody can deny that it is necessary to keep a check on the quality of goods and services, particularly where health and safety are at risk. But every attempt to impose such checks through licensing inevitably places additional financial burdens on businesses, which are reflected in lower profits, less expansion, and fewer jobs. These problems have been exacerbated by the widespread use of quantity (as opposed to quality) licensing. An example is quantity licensing of buses and taxis, which has - in many parts of Britain - purposefully reduced the number of vehicles in operation. This in turn has cut the number of jobs available.

27. The growth of new businesses and new jobs is also restricted by monopolies and cartels. Where such a monopoly or cartel operates, producers are able to make greater profits by charging a higher price than would otherwise be possible, thereby decreasing the volume of sales and the number of jobs. Moreover, like quantity licensing, monopolies and cartels restrict the number of new entrants in a large number of industries, trades and professions. Until recently, severe anti-competitive restrictions were imposed on the stock exchange, opticians, building societies and conveyancers; and there is still little scope for free competition in many areas, including notably air travel.

28. The creation of new jobs is further impeded by a large number of well-intentioned pieces of legislation. Most

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notable amongst these are employment protection and housing protection. There is, of course, a strong reason for retaining such protections: they safeguard the interests of those who presently possess jobs and those who presently live in rented accommodation. But these must be balanced against the interests of people who do not at present enjoy such advantages - people without homes or jobs. This rule has not always been observed. The obligations imposed on employers by the Protection of Employment Act in its original form were so complex, and the task of getting rid of an inefficient or unhelpful employee so daunting, that many companies now cite the employment legislation as their main reason for not wanting to take on more people. Although the government has made substantial modifications in the provisions of the Employment Protection Act, it probably remains a considerable psychological obstacle to employment.

29. The protections available to tenants also cause difficulties. Those tenants who are already in situ should have their rights respected. But because these same protections are also available to newcomers, there have been very few new tenancies under the terms of the legislation. Householders have been unwilling to rent out spare accommodation, and developers have been reluctant to build new rented housing. This has made it more difficult for people to move from places where work is unavailable for them to places where they would be able to find work. The

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degree of such mobility is one of the principal contrasts between Britain and the United States: the capacity to rent accommodation rapidly makes Americans far more willing to seek out work wherever it is to be found.

30. Admittedly, these restrictions and regulations sometimes transfer jobs from the more regulated to the less regulated sectors of the economy without having any effect on the total number of jobs. But in other cases, they affect all sectors of the economy, and contribute significantly to total unemployment. Too often, attention is focussed solely on the merits of regulation, and this economic and social cost is neglected. The merits are genuine; many of us do benefit from restrictions on planning, protection of employment and housing, and other forms of regulation. But we ought to consider the high price that the least fortunate members of our society are paying to give us these benefits.

Taxation and Subsidy

31. Another obstacle to the creation of new jobs - and one at least as important as restriction and regulation - is the system of taxation and subsidy that has been operated in Britain since the War.

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32. The effects of the various forms of taxation are well known:

- High local authority business-rates drive established firms into bankruptcy and deter new entrepreneurs from setting up. Such rates are now the prime form of business tax: they remove some 20 % of all gross business profits, and have a particularly bad effect on small businesses. They have risen dramatically over the last twenty years. The business rate rose roughly ten-fold between 1963 and 1983, while prices rose only six-fold.
- High national insurance contributions from employers have made it expensive for businesses to take on workers, and have provided an incentive to use machinery instead of labour. Between 1963/64 and 1984/85, the national insurance contributions payed by employers rose from X% to Y%.
- Over-generous tax allowances for capital investment have encouraged the substitution of machinery for labour where this would not otherwise be economically sensible.

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- High marginal rates of income tax have penalised success and have reduced the incentives for managers and entrepreneurs to work hard and generate expansion, with hardly any offsetting gain in public revenue.

33. One of the causes of high taxation has been the high level of subsidy given to businesses. Subsidies of this sort can be another example of the kindness that kills. [Passage by Treasury on high costs per job, effects on borrowing and interest rates, and hence on long-term employment rates].

34. Moreover, some of the subsidies have failed to protect jobs even in the short term. This is not surprising, since all government subsidies pose substantial administrative problems. Governments rarely have the information or the skills to take sensible decisions about industrial support; and such support encourages industrialists to look to Whitehall for funds rather than to their consumers - a recipe for industrial decline.

35. The problem is particularly acute in the case of some of the regional subsidies that have been given since the War. Expenditure on such subsidies rose from £24 million in 1962/3 to £917 million in 1982/3. This money has not, in many cases, been targetted to increase employment as much as possible. It has frequently been directed towards those projects that are capital-intensive rather than those that

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are job-intensive; it has been concentrated on the manufacturing sector (in which employment has been tending to decline since 1966) rather than upon the growing service sector; and very large amounts of it have been given for projects that would have occurred in the same location even without assistance.

REMOVING THE OBSTACLES

36. [Treasury passage on the cumulative effects of the various obstacles.] How many of these numerous obstacles to employment in Britain should we remove? What sacrifices are we prepared to make to do so? These questions need to be asked and answered fairly and squarely.

37. It is idle to pretend that we shall ever remove them all, or indeed that we shall ever wish to do so. The number of people finding employment in Britain might rise sharply if wages were to be dramatically reduced, if all restrictions, regulations and protections were to be abolished forthwith, and if all taxation were to be reduced to a bare minimum. But the consequences of taking such steps, the effects on the quality and character of life, would be unacceptable. We would be left without many of the protective regulations to which we have become accustomed over many years: more old buildings would be demolished; some tenants would lose their rights; employees could be

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subject to intolerable hazards at work; it would become impossible to fund an adequate social security system.

38. The problem for any government is to find ways of reducing the obstacles without bringing about these other undesirable results. And the present government has been tackling that problem.

The Record

39. The Government has taken action to reduce the number of regulations and restrictions that impede the creation of jobs:

- The planning system has been improved. Factories are now allowed to expand by up to 20% of their original size or 8,000 square feet without a planning application. The administration of development control has been placed entirely in the hands of local districts, so that new enterprises do not have to obtain permission from both county and district authorities. Circular 22/80 instructed all local councils to make expansion easier for small firms wherever possible; and a major research project has since shown that the Circular has considerably helped small firms in rural areas.

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- 24 special enterprise zones are being set up in particularly deprived areas. These enable new businesses to establish themselves and expand, unhindered by the normal planning routines and exempt from local authority rates. New firms opening in the first eight zones have already generated some 2,000 new jobs.

- In July 1984, the Department of Transport issued a major White Paper proposing radical deregulation of buses and taxis. Quality and safety standards are to be maintained and tightened. But quantity licensing for buses will be abolished (except, for the time being, in London); and there will also be a gradual relaxation of restrictions on numbers of taxis in those places where such restrictions apply. This is a classic example of the benefits of cautious deregulation: without reducing quality control, and without in any way threatening necessary subsidies for rural transport, the Government's proposals will allow new entrepreneurs to enter the market, providing the opportunity for more competition, cheaper fares, more travel and more jobs.

- Strenuous efforts have been made to decrease regulation and increase competition in the professions. The opticians' monopoly [has been]

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ended. The Government [has introduced] legislation to break the conveyancing monopoly which solicitors have held for 180 years, and to allow competitive advertising amongst solicitors. And the monopoly of patent agents is under review. These moves will make it easier for newcomers to offer such professional services, thereby generating both lower prices and new job opportunities.

- The Government has made it easier for people to move from one place to another in search of work by increasing the opportunities for those on the move to sell their homes, and to buy or rent new accommodation. The sale of some 600,000 council houses and flats has made it possible for the occupants to put their dwellings on the market, and for new purchasers to buy them. And a new drive has been launched to make more land available by [improving and] selling off public sector waste-land. [Passage from DoE on new initiative].

40. The government has also set about reducing the burden of taxation borne by business, so that firms can expand and offer new jobs more quickly. Rates of Corporation Tax are being progressively reduced from 53% to 35% for large companies, and have already been cut to 30% for smaller companies. Capital allowances are being phased out to remove the tax bias against employment. Investment in new

job-creating enterprise has been encouraged by eliminating the separate tax on investment income; this has reduced the top rate on such income from the absurd level of 98% to 60%. The very high business rates levied by the most irresponsible local authorities have been brought under control by the Rates Act (1984). And in six new experimental 'freeports', firms will be allowed to manufacture, process, store and export goods to other countries without paying any British customs dues.

41. Subsidies to loss-making nationalised industries, which do damage to other business through higher Government borrowing and increased interest-rates, have at last been brought under control. Between 1962 and 1979, such public finance rose from £X million to £Y million; since then, the Government has reduced it to £Z million. The plan is to reduce it still further.

42. In its White Paper on Regional Policy, the Government set out new proposals for reducing the job-destroying economic distortions that are caused by our present system of regional subsidies. In future, such subsidies are to be reduced in scale, targetted more closely on job-creation and directed towards service activities as much as towards manufacturing. They will be given only for projects that create new productive capacity, expand existing capacity, or bring about useful changes in a product, process or service. The new legislation will in addition ensure that the grants

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given to large firms can be kept below a set cost-per-job created. These changes will make the subsidies more cost-effective, and will also reduce the total amount spent on them, thereby enabling further control of the taxation and government borrowing that makes it difficult for businesses to expand and create jobs

43. Several steps have also been taken to make it more difficult for Trade Unions to prejudice economic expansion and the creation of new jobs. The restrictive practice of the 'closed shop' has been brought under control; legal remedies have been provided for employers affected either by secondary action or by strikes that take place without a proper vote; and unions have been compelled to elect their leaders by secret ballot. As a result of these measures, individual members now have more power to prevent their Unions from aggressively pursuing the unaffordably high wage rises that cause industrial dislocation and reduce the number of jobs.

44. The Government has, in addition, paid special attention to the wages and jobs of young people. It has launched a series of new schemes to help young people price themselves and train themselves into jobs. The Secretary of State for Education announced, at Sheffield in 1984, a dramatic programme to improve standards in schools. The Youth Training Scheme and the Technical and Vocational Education Initiative are together providing some 290,000 young people

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with useful vocational training that will make them far more attractive to employers, and far more able to contribute to the expansion of the firms in which they come to work.

Moreover, by setting the training allowance for 16 year-olds under the Youth Training Scheme at [£26] per week, and by offering incentives to employers to take on 17 year-olds at under [£50] per week, the Government has begun to induce a greater sense of realism about youth wages; indeed, between 1977 and 1983 youth wages have declined as a proportion of adult wages from 54.7% to 52.4%.

Thinking for the Future

45. These reductions in the amount of restriction, taxation and economic distortion, together with the moves towards more responsible Trade Unionism and the improvement of training will undoubtedly in the long term help to create many more new jobs in Britain. But the Government is aware that these measures may not be sufficient to bring about the lasting increase in employment that Britain sorely needs. We, as a nation, need to consider what further steps can be taken to enable businesses to expand and employ more people.

46. Planning restrictions clearly need further investigation. The Government does not, of course, wish to see such restrictions abandoned: they make so invaluable a

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contribution to the quality of life that, despite their adverse effects on jobs, they certainly need to be retained. But it may be possible to introduce liberalisation of various sorts without endangering the beautiful parts of our cities and countryside. One method of achieving such liberalisation might be for councils to draw up schemes easing control in certain 'simplified planning zones'. Within these zones, permission might automatically be given either for development of all kinds or for some specific variety such as small businesses, science parks or housing. The Government issued on 11 May 1984, a consultative paper describing this scheme. [Reactions to the paper have been generally favourable, and the Government is considering the various points that have been raised].

47. Further action might also sensibly be taken to remove needless restrictions and regulations other than those concerned with planning. In some cases, the government is not the appropriate body to take such action: certain professional groups, for example, have imposed restrictions on their own capacity to advertise, thereby impeding competition, lower prices, expansion and employment. It is for the governing bodies of these professions, rather than for the Government, to remove those restrictions; and the Government is therefore glad to see that groups such as the Royal College of Veterinary Surgeons and the bodies governing the accountancy profession have taken the matter in hand. In other cases, however, the Government does have

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a direct role, because the restrictions are statutory. In dealing with these cases, the advantages to business and employment arising from decreased regulation must be balanced against the social benefits of retaining certain limitations. The Government is aware of the legitimately strong feelings that are aroused by, for instance, alterations in shop hours. Wide consultation and prolonged reflection are needed before any such changes can be made. But the Government is acutely conscious of the extent to which these regulations impede expansion and job-creation in the retail trades - a sector of the economy that has provided huge numbers of new jobs in other countries such as the United States. [The Government therefore set up a public enquiry in 1983, which has recently reported, recommending far-reaching relaxation of the restrictions; the Government is now considering what changes, if any, can appropriately be made in the light of the report.]

48. The Government also wishes to encourage competition, low prices and expansion in those parts of the economy that are still affected by monopolies and cartels. It has for example been investigating the scope for increasing competition in the provision of local authority services, [and it is also considering the report of the Civil Aviation Authority on methods of preserving and increasing competition in domestic airline routes].

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49. The Government is further considering whether the balance between the protection of those who possess jobs and the interests of those who are jobless could be improved by further changes in the Employment Protection Acts. There can be little doubt that these Acts, even in their present amended form, constitute a serious disincentive for employers who would otherwise be willing to take on new employees. The Government therefore wishes to canvass popular opinion on the following possible changes:

- i.)
- ii.) [Options for change outlined]
- iii.)

The Government recognises, of course, that any of these changes would to some extent diminish the security of those in work. The question is whether this loss might be outweighed by the gain in new employment that could occur once the changes were made.

50. Such changes in employment legislation and the other steps discussed above, would stand more chance of giving rise to new jobs if they were accompanied by measures to increase geographical mobility, so that unemployed people could more easily move to places where suitable work was available for them. [Passage on mobility in the housing

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market, and particularly on the Private Rented Sector in the light of recent decisions at H Committee].

51. The Government also wishes to overcome another of the major causes of unemployment by providing opportunities for unemployed people to price themselves into jobs. In particular, the Government is concerned to provide such opportunities for young people. For these reasons, the Government believes that it is be advisable to consider changes in the present system of Wages Councils. [Extended passage on the Councils, putting forward various options for reform/abolition, recognising the possible disadvantages for those in work, but outlining the advantages for those out of work, and seeking comments from readers].

52. [Passage from DHSS on the Fowler reviews as a contribution to the elimination of the 'Why Work?' problem.]

Alleviating the Immediate Problem

53. The Government is also keen to play its part in increasing understanding between managers and employers. There are, of course, strict limits upon the extent to which Government can be involved without improperly interfering in the running of businesses. But it is determined to do whatever can be done within those limits. [Passage on (i) D/Emp scheme for improving employer/employee relations, (ii)

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DTI schemes for quality improvement, and (iii) (?) a new 'Year of the Customer': all phrased as possibilities worth investigating].

54. The Government is, however, conscious that the removal of the obstacles to employment described in this paper will inevitably be a gradual and lengthy process. In the meanwhile, it fully recognises the continued need for transitional measures that will enable people who have the misfortune to be unemployed for a long period to overcome the effects of that misfortune and to regain employment.

55. Undoubtedly, one of the most satisfactory methods of achieving this result is to provide unemployed people with help to start their own businesses. [Passage displaying the virtues of the Enterprise Allowance Scheme, and outlining the increases recently made in its scope.]

56. A contribution can also be made by encouraging employers to divide jobs. [D/Emp passage on JSS/JRS]

57. Unfortunately, however, not every unemployed person is able or willing to try his or her hand at starting a new business. The Government has therefore made efforts to ensure that those who remain unemployed for a long period and who do not take advantage of the Enterprise Allowance Scheme, nevertheless have available to them a period of useful work which can help to boost their morale, to provide

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them with new skills, and to improve their prospects of finding lasting employment. [Passage on the Community Programme and Voluntary Projects Programme, describing their advantages; but admitting the financial cost, and ending with a reminder to the reader that this will inevitably be translated into higher taxation or higher interest rates, thereby causing yet another obstacle to general employment].

58. The Government is willing to countenance these disadvantages because it is acutely aware of the degree of demoralisation that can affect those who are unable to find work for a prolonged period. But concern for the plight of those who are at present unemployed must never become an excuse for neglecting the measures that will in the long run do most to alleviate that plight; efforts to make the transition to full employment easier must never become an excuse for failing to make the transition itself. Britain suffers from a disastrous medley of obstacles to employment. Many of these serve the interests of the affluent working majority at the expense of the impoverished and unemployed minority. For the sake of the majority, they cannot all be swept away; but they can and - for the sake of the minority they should - be gradually and consistently reduced. In recognising this imperative, the Government declares itself firmly and unashamedly the champion of the 'have-nots'. It understands itself as their protector, and is determined to pursue their cause, not with false sentimentality, but with energy and perseverance.

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COPY 1 8
CC NO
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JR

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

6 September 1984

Dear David

EXPENDITURE PROGRAMMES RELEVANT TO EMPLOYMENT

Thank you for sending us a copy of your letter of 10 August to David Normington enclosing a copy of the report of the working group under Treasury chairmanship.

My Secretary of State has now seen the report. He agrees with the Chancellor that it is a useful piece of work which should provide background to the Chief Secretary's discussions with colleagues on public expenditure. He notes in particular the high cost-effectiveness of some of the DOE programmes relating to inner cities and the favourable comparisons with the average of public expenditure as a whole. He is attracted by the idea of evaluating more systematically the cost effectiveness, for employment purposes, of public expenditure programmes and of proposals aimed largely at cutting unemployment or increasing employment. For those purposes he agrees with the suggestion in paragraph 29(iv) of the report and, with some reservations about the possible bureaucracy involved, would be content with the procedural requirement suggested in paragraph 29(v). On the former suggestion, however, he wonders whether it might not be more appropriate for the Manpower Group, with its remit thus extended, to come under the aegis of the Cabinet Office?

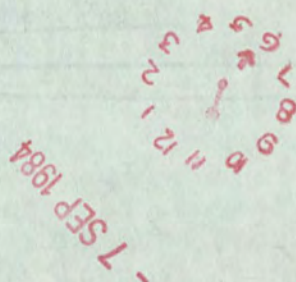
I assume, incidentally, that paragraph 9(ii) of the report should read "assistance to the inner cities, the heritage programme and major elements of DOE's housing programme". It would also be clearer to say in paragraph 28(i): ".... with the possible exception of Urban Development Corporations and Urban Development Grant." These two programmes are quite separate.

I am copying this letter to the recipients of yours.

Yours sincerely
Ala Davi

A H DAVIS
Private Secretary

Manpower PT 3
Cheques Seminar





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10 DOWNING STREET

From the Private Secretary

SECRET AND PERSONAL: CMO

6 September 1984

Dear David,

SEMINAR ON INDUSTRY AND EMPLOYMENT

I attach an annotated agenda for next Thursday's meeting. Also attached are the Policy Unit note to be considered under item 5 and the minute from Sir Keith Joseph which is relevant to item 3.

I understand the Chancellor will be circulating the other paper under item 3, that the Secretary of State for Employment will circulate a note under item 4 and the Secretary of State for the Environment the notes mentioned on item 6(iii).

While the papers do not themselves need to be restricted to Private Offices, the existence of the meeting should be restricted to those who strictly need to know and briefing on the papers to be commissioned without reference to it.

I am copying this letter to Elizabeth Hodgkinson (Department of Education and Science), John Ballard (Department of the Environment), Michael Reidy (Department of Energy), Alex Galloway (Chancellor of the Duchy of Lancaster's Office), David Normington (Department of Employment), Callum McCarthy (Department of Trade and Industry), Steve Godber (Department of Health and Social Security), Richard Hatfield and Peter Gregson (Cabinet Office) and to the Chairman of the Manpower Services Commission.

Your sincerely
Andrew Turnbull

ANDREW TURNBULL

David Peretz, Esq.,
H.M. Treasury.

SECRET AND PERSONAL: CMO

45T.

Industry and Employment Seminar: 13 September
Agenda

1. Report on recent developments in the labour market

To be raised orally by Secretary of State for Employment.

2. Expenditure Programmes Relevant to Employment

Papers

- Paper attached to David Peretz's letter of 10 August to David Normington
- Replies from DEmp (17/8) and DTI (30/8)

Issues

- (i) Does the Group agree with the analysis of the paper?
- (ii) What policy conclusions should be drawn?
- (iii) Are any adjustments between expenditure programmes called for?

3. Relationships between wages and unemployment

Papers

- Minute from Secretary of State for Education and Science to Prime Minister (8/8)
- Note from the Treasury discussing evidence on link between wages and employment. To be circulated next week.

Issues

- (i) How well is link established?
- (ii) What can Government do to improve understanding of it? (see also Item 5)
- (iii) How can Government avoid accusation that it seeks a low wage economy.

4. Passport for a Job

Papers

- Note to be circulated by Secretary of State for Employment

5. Getting Across the Government's Approach on Employment

Papers

Draft Discussion Paper by No.10 Policy Unit

Issues

- (i) Have the elements of the Government's approach to be creation of jobs been correctly identified?
- (ii) Should theme that removal of restrictions and protections will benefit the "have-nots" be stressed?
- (iii) Is a discussion document/Green Paper the best medium?
- (iv) If not how can Government's message be got across? A programme of speeches? Government publications?
- (v) What measures and policy initiatives should the

Government take over the next year?

6. Background Papers

- (i) Checklist and Conclusions from 25 May meeting - attached to Andrew Turnbull's letter of 29 May.
- (ii) Papers circulated by Secretary of State for Employment for 25 May meeting - attached to Andrew Turnbull's letter of 18 May.
- (iii) Notes to be circulated by Secretary of State for the Environment
 - (a) Public Sector Vacant Dwellings
 - (b) Vacant Under-used Land in the Public Sector.

SECRET AND PERSONAL: CMO

PRIME MINISTER

September Seminar : Paper on Jobs

The Policy Unit have suggested that the Government publish a discussion document or Green Paper to get across its message on the origins of unemployment and what needs to be done to tackle it. A draft could be tabled for next week's meeting on industry and employment. (In addition there will be the paper on the costs per job of different expenditure programmes commissioned at the last meeting plus a note from Department of Employment on the Passport For A Job idea and a Treasury note on recent papers by the IEA and the Low Pay Unit arguing for and against the link between wages and jobs).

Mr. King has seen the Policy Unit draft and is said to be attracted by the idea of a discussion document. I understand the Treasury have reservations. They accept that the Government's message needs to be got across that unemployment arises from a variety of factors, e.g. excessive real wages, inadequate productivity, rigidities in labour markets, well meaning but misguided regulation etc., but they doubt if a Green Paper is the best way to put this across. They feel the Government is not consulting on a specific proposition but expressing its own view and seeking a reaction. They feel that a better approach would be to use the material in the Policy Unit draft for a series of speeches. This was envisaged at the last Seminar but, apart from the Chancellor's Mais lecture, little seems to have happened.

I doubt if there would be very much discussion about the basic thesis on the origins of unemployment but there could be dispute about:

i) What measures are feasible to tackle the problem.

ii) What is the best way to get the Government's message across.

I suggest that the Policy Unit's draft be tabled at the meeting with the following questions:

i) Is the diagnosis agreed?

ii) Have the responses been correctly identified?

iii) Is a Green Paper the best way to get the message across?

iv) If not, how should this be done, e.g. by a programme of speeches, the Treasury's Economic Progress Report or other Government publications?

Agree this approach?

Yes

Duty Clerk
PP AT

3 September 1984



DEPARTMENT OF TRADE AND INDUSTRY

1-19 VICTORIA STREET

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Secretary of State for Trade and Industry

31 August 1984

David Peretz Esq
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Dear David

EXPENDITURE PROGRAMMES RELEVANT TO EMPLOYMENT

My Secretary of State has seen the Report enclosed with your letter of 10 August.

2 He considers that the heavy emphasis in the Report on the first-year employment effects is unhelpful. In the only area where this Department's support is specifically employment-related, which is that of regional policy, our objective relates to the medium and long-term. It surely would give a most misleading measure of relative attractiveness to compare once and for all outlays to achieve lasting employment with continuous injection of funds to sustain the employment benefit. While the Report mentions support to loss-making industries, our prime aim is a return to profitability at a realistic level of activity and assistance is not given primarily on short term employment/unemployment grounds. The best route to sustainable higher levels of employment is to increase efficiency and competitiveness.

3 My Secretary of State was therefore glad to see that the Report does recognise the different supply side merits of alternative approaches. Although most DTI industrial policies are aimed at long-term supply side improvements a number of them would in fact score well in terms of the net exchequer cost criterion developed in the Report. This is because subsidiaries are paid only when they secure much larger private sector expenditure.

4 I am copying this letter to Andrew Turnbull (No 10), Elizabeth Hodgkinson (DES), John Ballard (DOE), Michael Reidy (Energy), Alex Galloway (Chancellor of the Duchy of Lancaster's Office), David Young (Manpower Services Commission) and to Richard Hatfield (Cabinet Office).

Yours ever,

Cathleen McCarthy

M C MCCARTHY
Private Secretary

Manpower
Services



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pm saw at weekend

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PRIME MINISTER

31 August 1984

SEPTEMBER SEMINAR: PAPER ON JOBS

Unemployment remains the dominant long-term political issue.

There is a danger that, at the seminar on 13 September, there will be no agreement between those (like the Chancellor) who favour radical moves and those who are more cautious.

Unless the government shows concern about unemployment and tries to win the debate about its causes and cure, no advances can be made. Simply abolishing wages councils, for example, without first carrying the argument would be seen as a clumsy attack on the low-paid.

The attached document has been prepared by Oliver Letwin, David Willetts and myself, following your request. It makes the argument in a new way, showing that many of the most serious impediments to employment - such as high wages, lax management, regulation, taxation and subsidy - serve the interests of the 'haves' in our society at the expense of the 'have nots'. Some radical moves are therefore ways of helping those at the bottom of the pile to help themselves. Once described in this way, it is much more difficult to

E. R.
oppose them. Tom King liked the idea when he saw a preliminary draft, and we have also consulted Terry Burns.

If you still agree with the idea of such a paper, we recommend that:

- i. this paper should be confined to very limited circulation before the seminar;
- ii. if approved in principle at the seminar, it should be issued by Tom King in an amended form as a Department of Employment discussion document.

JOHN REDWOOD

TOWARDS FULLER EMPLOYMENT

1. We have weathered the world recession far better than many of our competitors. During the past year alone, gross domestic product has risen by nearly 3%; industrial output has grown by 3½%; investment has increased by 10% in real terms; industrial profits have improved by 25%; productivity is better by 5 1/4%; and inflation has been kept at its lowest level for fifteen years. And yet, unemployment has remained obstinately high. This worrying persistence of high unemployment during economic recovery is a matter of urgent concern, not only to the government but also to every private individual, business and trade union.

THE GROWTH OF UNEMPLOYMENT

2. The problem of unemployment is not new to Britain. Since 1960, the number of people registered as unemployed has risen painfully through the lifetimes of different Parliaments and different governments. The trend has been steadily upward despite some oscillations. In 1962, there were 454,000 people on the register; in 1972, 855,000; and in 1982, 2,793,000. [Graph].

3. Nor is the problem unique to Britain. [Comparison with Europe].

4. The pattern in many of the countries of the Pacific has been quite different. There are, of course, important historical and cultural differences between European and Pacific basin nations. But we should be willing to learn what we can from the dramatic success of Japan, Hong Kong and South Korea. [Statistical comparisons from D/Emp].

5. We should also be willing to ask why the United States has avoided the sustained upward trend in unemployment that has occurred in Britain. In Britain, there were fewer jobs in 1982 than in 1962, because not enough new jobs were created to offset the closures and dismissals; whereas between 1962 and 1982, over 30 million additional jobs were created in the United States, even allowing for closures and dismissals. As a result, the proportion of the American civilian workforce registered as unemployed instead of increasing steadily, has varied between 3.5% and 10% over the past twenty years. It was 5.5% in 1962, and was still only 5.6% in 1972. Indeed, even in the difficult years since 1972, the unemployment rate has risen and fallen by turns. It increased markedly in 1975, then gradually reduced until 1979; it rose again from 1979 to 1982, and is now falling once more.

6. Why has America been so successful at creating new jobs, not merely in recent years but continuously over the last two decades? At first glance, it is tempting to suppose

that the cause was buoyant demand stimulated by Government borrowing. But this argument is false.

7. Over the past twenty years, there has been no shortage of demand in Britain. The amount of money available for buying new goods and services in Britain increased seventeen times as fast as the increase in the volume of production between 1962 and 1982. In America, by contrast, demand - as measured by nominal GDP - rose half as fast as in England, and increased only five times as fast as production.

8. [Treasury passage dealing with Reaganomics, rebutting the argument that Federal deficit is the main cause of increased employment, and distinguishing short cyclical fluctuations based on money stimulus etc from the long-term trend of job creation in an enterprise culture; also commenting on the 'natural' rate of unemployment in the US.]

9. [Rebuttal of other fallacious explanations of Britain's unemployment record - eg lack of investment, and examples of the lump of labour fallacy - high technology, growth in workforce].

THE NATURE OF THE OBSTACLES

Excessive Wage Rises

10. A more significant consideration is the high level of wage increases in Britain: between 1962 and 1982, average real wages in the United States rose by well under P%; over the same period in Britain, they rose by some Q%. The divergence has been even greater during the past three years: the Government's clearly articulated strategy has succeeded in bringing down the rate of inflation; but wage increases have not reflected this. Real wages [have not changed in the United States since 1981], whereas in Britain, they have risen by X%. If these British rises had been matched by corresponding increases in the amount of goods produced by each employee, they would have constituted a wholly welcome improvement to our standard of living. But without such increases in productivity, they have forced companies to reduce costs by shedding labour. These are the sad facts behind the assertion that people can price themselves into and out of jobs.

11. Many commentators are coming to understand that people in Britain have priced themselves out of jobs over the past twenty years. Some conclude, with a considerable weight of evidence on their side, that the very large wage increases have been the major cause of high unemployment.

12. Why has the British economy experienced such high wage increases? It is sometimes suggested that the responsibility lies with governments that refuse to impose statutory limits on pay. But there is no evidence to support this view. [Paragraph by Treasury/DEmp making good, clear arguments against pay policies].

13. The true cause of excessive wage increases is the short-sighted attitude too often found in British industry. Unfortunately Trade Unions tend to act on behalf of the bulk of their members who already have jobs without considering the fate of those others, usually not current Union members, who do not have and cannot find jobs. Such unions have pressed for high rates of pay, which suit those in work, heedless of the fate of those who are seeking work. Many negotiators still seem unaware that higher pay causes redundancies because companies cannot afford to employ as many people at the new rates.

14. This winner-takes-all approach has been particularly harmful in the case of youth wages. With a very few exceptions, young people beginning their first job can contribute much less to the success of any business than those who have acquired the skills and experience that come through a period at work. It is therefore sensible for any firm to hire older people unless the young are willing to accept lower wages commensurate with their lower contribution. In Germany, this is indeed the pattern;

average youth wages are only 20% of adult wages. But in Britain, the average youth worker receives over 50% of the adult rate. As a result, young people have taken more than their share of the rising unemployment. Between 1962 and 1982, youth unemployment in Britain rose by 1200% - more than twice the rise for adults. This is an extremely painful and self inflicted wound. [Paragraph to be expanded by D/Emp].

15. The blame for this obstacle to youth employment is not easy to apportion. Trade Unions, certainly must share some of it; but so, too, must those managers who have consistently failed to insist on levels of wages that would make it worthwhile to employ young people. All too often, management has taken the easy way out - agreeing to high youth wages, and then avoiding the consequences by refusing to employ young people. This is an example of the kindness that kills.

16. [Passage on 'Why work?' from D/Emp, DHSS, Treasury. Problem is the relationship between pay, tax and benefits, and the very low starting threshold for income tax. Particularly acute for young people].

17. But there is at least one further cause of the problem: the Wages Councils. The motives behind their creation are laudable: they were designed to protect wage-earners against rapacious employers. But they have unfortunate

consequences. [Passage from D/Emp on the Councils, providing factual evidence that they can harm prospects for employment - comparisons between wage-council and non-wage-council industries. Provide figures for growth of jobs in the US in industries covered by Wages Councils in UK.]

Failures of Management and Enterprise

18. But excessively high wage rises are not by any means the only cause of unemployment in Britain. We are also hampered by failures of management and enterprise.

19. Management in Britain frequently leaves much to be desired. The blame for this cannot, of course, be laid solely at the door of those known as 'managers'. Management depends not only on those who manage but also upon those who are managed. The interests of individual employees and their Trade Unions can be furthered only in a concern where they make a positive contribution. Without their cooperation, no person appointed as a 'manager' can hope to design his products well, to control quality properly, or to market his goods with zeal. For a company to compete, all the individuals who work in it have to be willing to contribute to its success, by welcoming rather than rejecting the new technology, by striving everywhere for greater efficiency and productivity, and by treating the customer as a valued source of employment rather than as an unfortunate source of additional bother.

20. Those who are appointed as managers have particularly heavy responsibilities in all of these areas. Failures of design, quality control and marketing do not 'happen' to managers: they are caused. Cooperation by a workforce necessarily involves cooperation with that workforce. The introduction of new technology has to be explained if it is to be achieved smoothly; arrangements have to be made to safeguard the legitimate interests of all those working in the company when changes occur; even if innovations are essential to the long-term prospects for the company's capacity to employ, no set of employees can be expected to welcome them if they can see that their own lives will be adversely affected. Managerial imagination, sensitivity and respect for individuals are absolutely indispensable conditions for competitiveness and expansion. The absence of these qualities, and of reciprocal qualities on the part of employees and trade unions has all too often been an obstacle to employment in Britain.

21. We have much to learn here, from nations such as Japan. Some large firms in Japan often come close to giving their employees guaranteed jobs for life. But in return, the employees are much more flexible than we often are: they willingly learn new skills and move to new jobs within the same firm. [Passage on internal labour markets to be drafted by DTI/DEmp].

22. Japanese firms also find it easier to offer permanent jobs for their employees because they distinguish between 'core' tasks for which they employ staff directly and peripheral activities which are frequently contracted to small businesses. This does, of course, occur in Britain - it is, indeed, happening increasingly. But there are still cases in which flexibility and competitiveness are impeded by excessive reluctance to make use of small, adaptable suppliers. [DTI passage on the importance of small business in Japan].

Inadequate Training

23. The level of employment in Britain is also decisively affected by the training that employees have received. In great part, this will depend on their basic education: it is to the schools that employers and the nation must principally look not only for training in literacy, numeracy and higher intellectual skills, but also for the inculcation of those attitudes that make a young person employable.

[Expansion of passage by DES].

24. In addition, there is the more specialised - though almost equally important demand - for many young people to receive forms of vocational training that will make them immediately useful to the firms that employ them. In this respect, Britain has notably lagged behind her European partners. Roughly 65% of school leavers currently undertake

vocational training in West Germany; in France, the figure is X%; but in Britain, only Y% of school leavers are enrolled in such training.

Regulations and Restrictions

25. Jobs in Britain have also been destroyed by a large number of restrictions and regulations, which make it difficult for businesses to set up and expand. One form of restriction which has had a marked effect is planning. Many people in Britain are understandably concerned to protect the environment. In response to this wish, successive governments have encouraged local authorities to impose detailed planning constraints on businesses. These have restricted not only the building of new homes, but also the creation and expansion of businesses. They have, for example, frequently prevented new light industry, out-of-town retailing, fast food shops and leisure centres from settling and expanding in those areas where there is most demand for them. These are industries that have generated [millions] of new jobs in the United States, [where planning controls are less rigorous].

26. Another important constraint is licensing. Nobody can deny that it is necessary to keep a check on the quality of goods and services, particularly where health and safety are at risk. But every attempt to impose such checks through licensing inevitably places additional financial burdens on

businesses, which are reflected in lower profits, less expansion, and fewer jobs. These problems have been exacerbated by the widespread use of quantity (as opposed to quality) licensing. A notorious example is the licensing of buses and taxis, which has - in many parts of Britain - purposefully reduced the number of vehicles in operation. This in turn has cut the number of jobs available.

27. The growth of new businesses and new jobs is also restricted by monopolies and cartels. Where such a monopoly or cartel operates, producers are able to make greater profits by charging a higher price than would otherwise be possible, thereby decreasing the volume of sales and the number of jobs. Moreover, like quantity licensing, monopolies and cartels restrict the number of new entrants in a large number of industries, trades and professions. Until recently, severe anti-competitive restrictions were imposed on the stock exchange, opticians, building societies and conveyancers; and there is still little scope for free competition in many areas, including notably air travel.

28. The creation of new jobs is further impeded by a large number of well-intentioned pieces of legislation. Most notable amongst these are employment protection and housing protection. There is, of course, a strong reason for retaining such protections: they safeguard the interests of those who presently possess jobs and those who presently live in rented accommodation. But these must be balanced

against the interests of people who do not at present enjoy such advantages - people without homes or jobs. This rule has not always been observed. The obligations imposed on employers by the Protection of Employment Act, in its original form were so complex and the task of getting rid of an inefficient or unhelpful employee so daunting that many companies now cite the employment legislation as their main reason for not wanting to take on more people. Although the government has made substantial modifications in the provisions of the Employment Protection Act, there is no doubt that psychologically it remains a considerable obstacle to employment.

29. Equally, the protections available to tenants - though advantageous to the present holders - have without doubt contributed both to the unwillingness of many householders to rent out spare accommodation and to the unwillingness of developers to build new rented accommodation. This has made it more difficult for people to move from places where work is unavailable for them to places where they would be able to find work. The degree of such mobility is one of the principal contrasts between Britain and the United States: the capacity to rent accommodation rapidly makes Americans far more willing to seek out work wherever it is to be found.

30. Admittedly, these restrictions and regulations sometimes transfer jobs from the more regulated to the less

regulated sectors of the economy without having any effect on the total number of jobs. But in other cases, they affect all sectors of the economy, and contribute significantly to total unemployment. Too often, attention is focussed solely on the merits of regulation, and this economic and social cost is neglected. The merits are genuine; many of us do benefit from restrictions on planning, protection of employment and housing, and other forms of regulations. But we ought to consider the high price that the least fortunate members of our society are paying to give us these benefits.

Taxation and Subsidy

31. Another obstacle to the creation of new jobs - and one at least as important as restriction and regulation - is the system of taxation and subsidy that has been operated in Britain since the War.

32. The effects of the various forms of taxation are well known:

- High local authority business-rates drive established firms into bankruptcy and deter new entrepreneurs from setting up. Such rates are now the prime form of business tax: they remove some 20% of all gross business profits, and have a particularly bad effect on small businesses.

They have risen dramatically in over the last twenty years. The business rate rose roughly ten-fold between 1963 and 1983, while prices rose only six-fold.

- High national insurance contributions from employers have made it expensive for businesses to take on workers, and have provided an incentive to use machinery instead of labour. Between 1963/64 and 1984/85, the national insurance contributions payed by employers rose from X% to Y%.
- Over-generous tax allowances for capital investment have encouraged the substitution of machinery for labour where this would not otherwise be economically sensible.
- High marginal rates of income tax have penalised success and have reduced the incentives for managers and entrepreneurs to work hard and generate expansion, with hardly any offsetting gain in public revenue.

33. One of the causes of high taxation has been the high level of subsidy given to businesses. Subsidies of this sort can be another example of the kindness that kills. [Passage

by Treasury on high costs per job, effects on borrowing and interest rates, and hence on long-term employment rates].

34. Moreover, some of the subsidies have failed to protect jobs even in the short term. This is not surprising, since all government subsidies pose substantial administrative problems. Governments rarely have the information or the skills to take sensible decisions about industrial support; and such support encourages industrialists to look to Whitehall for funds rather than to their consumers - a recipe for industrial decline.

35. The problem is particularly acute in the case of some of the regional subsidies that have been given since the War. Expenditure on such subsidies rose from £24 million in 1962/3 to £917 million in 1982/3. This money has not, in many cases, been targetted to increase employment as much as possible. It has frequently been directed towards those projects that are capital-intensive rather than those that are job-intensive; it has been concentrated on the manufacturing sector (in which employment has been tending to decline since 1966) rather than upon the growing service sector; and very large amounts of it have been given for projects that would have occurred in the same location even without assistance.

REMOVING THE OBSTACLES

36. [Treasury passage on cumulative effects of the various obstacles.] How are we to remove these numerous obstacles to employment in Britain? At what cost are we prepared to do so? These questions need to be asked and answered fairly and squarely.

37. It is idle to pretend that we shall ever remove them all, or indeed that we shall ever wish to do so. The number of people finding employment in Britain might indeed rise sharply if wages were to be dramatically reduced, if all restrictions regulations and protections were to be abolished forthwith, and if all taxation were to be reduced to a bare minimum. But the consequences of taking such steps, the effects on the quality and character of life, would be unacceptable. We would be left without many of the protective regulations to which we have become accustomed over many years: more old buildings would be demolished; some tenants would lose their rights; employees could be subject to intolerable hazards at work; it would become impossible to fund an adequate social security system.

38. The problem for any government is to find ways of reducing the obstacles without bringing about these other undesirable results. And the present government has been tackling that problem.

The Record

39. The Government has taken action to reduce the number of regulations and restrictions that impede the creation of jobs:

- The planning system has been improved. Factories are now allowed to expand by up to 20% of their original size or 8,000 square feet without a planning application. The administration of development control has been placed entirely in the hands of local districts, so that new enterprises do not have to obtain permission from both county and district authorities. Circular 22/80 instructed all local councils to make expansion easier for small firms wherever possible; and a major research project has since shown that the Circular has considerably helped small firms in rural areas.
- 24 special enterprise zones are being set up in particularly deprived areas. These enable new businesses to establish themselves and expand, unhindered by the normal planning routines and exempt from local authority rates. New firms opening in the first eight zones have already generated some 2,000 new jobs.

- In July 1984, the Department of Transport issued a major White Paper proposing radical deregulation of buses and taxis. Quality and safety standards are to be maintained and tightened. But quantity licensing for buses will be abolished (except, for the time being, in London); and there will also be a gradual relaxation of restrictions on numbers of taxis in those places where such restrictions apply. This is a classic example of the benefits of cautious deregulation: without reducing quality control, and without in any way threatening necessary subsidies for rural transport, the Government's proposals will allow new entrepreneurs to enter the market, providing the opportunity for more competition, cheaper fares, more travel and more jobs.

- Strenuous efforts have been made to decrease regulation and increase competition in the professions. The opticians' monopoly [has been] ended. The Government [has introduced] legislation to break the conveyancing monopoly which solicitors have held for 180 years, and to allow competitive advertising amongst solicitors; (this, in turn, has led the Law Society to call for an end to the Barristers' monopoly on presenting cases in higher courts). And the monopoly of patent agents is under review. These moves will make it easier for

newcomers to offer such professional services, thereby generating both lower prices and new job opportunities.

- The Government has made it easier for people to move from one place to another in search of work by increasing the opportunities for those on the move to sell their homes, and to buy or rent new accommodation. The sale of some 600,000 council houses and flats has made it possible for the occupants to put their dwellings on the market, and for new purchasers to buy them. And a new drive had been launched to make more land available by [improving and] selling off public sector waste-land. [Passage from DoE on new initiative].

40. The government has also set about reducing the burden of taxation borne by business, so that firms can expand and offer new jobs more quickly. Rates of Corporation Tax are being progressively reduced from 53% to 35% for large companies, and have already been cut to 30% for smaller companies. Capital allowances are being phased out to remove the tax bias against employment. Investment in new job-creating enterprise has been encouraged by eliminating the separate tax on investment income, to reduce the top rate on such income from the absurd level of 98% to 60%. The very high business rates levied by the most irresponsible local authorities have been brought under

control by the Rates Act (1984). And in six new experimental 'freeports', firms will be allowed to manufacture, process, store and export goods to other countries without paying any British customs dues.

41. Subsidies to loss-making nationalised industries, which do damage to other business through higher Government borrowing and increased interest-rates, have at last been brought under control. Between 1962 and 1979, such public finance rose from £X million to £Y million; since then, the Government has reduced it to £Z million. The plan is to reduce it still further.

42. In its White Paper on Regional Policy, the Government set out new proposals for reducing the job-destroying economic distortions that are caused by our present system of regional subsidies. In future, such subsidies are to be reduced in scale, targetted more closely on job-creation and directed towards service activities as much as towards manufacturing. They will be given only for projects that create new productive capacity, expand existing capacity, or bring about useful changes in a product, process or service. The new legislation will in addition ensure that the grants given to large firms can be kept below a set cost-per-job created. These changes will make the subsidies more cost-effective, and will also reduce the total amount spent on them, thereby enabling further control of the taxation

and government borrowing that makes it difficult for businesses to expand and create jobs.

43. Several steps have also been taken to make it more difficult for Trade Unions to prejudice economic expansion and the creation of new jobs. The restrictive practice of the 'closed shop' has been brought under control; legal remedies have been provided for employers affected either by secondary action or by strikes that take place without a vote; and unions have been compelled to elect their leaders by secret ballot. As a result of these measures, individual members now have more power to prevent their Unions from aggressively pursuing the unaffordably high wage rises that cause industrial dislocation and reduce the number of jobs.

44. The Government has, in addition, paid special attention to the wages and jobs of young people. It has launched a series of new schemes to help young people price themselves and train themselves into jobs. The Secretary of State for Education announced, at Sheffield in 1984, a dramatic programme to improve standards in schools. The Youth Training Scheme and the Technical and Vocational Education Initiative are together providing some 290,000 young people with useful vocational training that will make them far more attractive to employers, and far more able to contribute to the expansion of the firms in which they come to work. Moreover, by setting the training allowance for 16 year-olds under the Youth Training Scheme at (£26) per week, and by

offering incentives to employers to take on 17 year-olds at under [£50] per week, the Government has begun to induce a greater sense of realism about youth wages; indeed, between 1977 and 1983 youth wages have declined as a proportion of adult wages from 54.7% to 52.4%.

Thinking for the Future

45. These reductions in the amount of restriction, taxation and economic distortion, together with the advent of more responsible Trade Unionism and the improvement of training will undoubtedly in the long term help to create many more new jobs in Britain. But the Government is aware that these moves may not be sufficient to bring about the lasting increase in employment that Britain sorely needs. We, as a nation, need to consider what further steps can be taken to enable businesses to expand and employ more people.

46. Planning restrictions clearly need further investigation. The Government does not, of course, wish to see such restrictions abandoned: they make so invaluable a contribution to the quality of life that, despite their adverse effects on jobs, they certainly need to be retained. But it may be possible to introduce liberalisation of various sorts without endangering the beautiful parts of our cities and countryside. One method of achieving such liberalisation might be for councils to draw up schemes easing control in certain 'simplified planning zones'.

Within these zones, permission might automatically be given either for development of all kinds or for some specific variety such as small businesses, science parks or housing. The Government issued on 11 May 1984, a consultative paper describing this scheme. [Reactions to the paper have been generally favourable, and the Government is considering the various points that have been raised].

47. Further action might also sensibly be taken to remove needless restrictions and regulations other than those concerned with planning. In some cases, the government is not the appropriate body to take such action: certain professional groups, for example, have imposed restrictions on their own capacity to advertise, thereby impeding competition, lower prices, expansion and employment. It is for the governing bodies of these professions, rather than for the Government, to remove those restrictions; and the Government is therefore glad to see that groups such as the Royal College of Veterinary Surgeons and the bodies governing the accountancy profession have taken the matter in hand. In other cases, however, the Government does have a direct role, because the restrictions are statutory. In dealing with these cases, the advantages to business and employment arising from decreased regulation must be balanced against the social benefits of retaining certain limitations. The Government is aware of the legitimately strong feelings that are aroused by, for instance, alterations in shop hours. Wide consultation and prolonged

reflection are needed before any such changes can be made. But the Government is also acutely conscious of the extent to which these regulations impede expansion and job-creation in the retail trades - a sector of the economy that has provided huge numbers of new jobs in other countries such as the United States. [The Government therefore set up a public enquiry in 1983, which has recently reported, recommending far-reaching relaxation of the restrictions; the Government is now considering what changes can appropriately be made in the light of the report.]

48. The Government also wishes to encourage competition, low prices and expansion in those parts of the economy that are still affected by monopolies and cartels. It has for example been investigating the scope for increasing competition in the provision of local authority services, [and it is also considering the report of the Civil Aviation Authority on methods of preserving and increasing competition in domestic airline routes].

49. The Government is further considering whether the balance between the protection of those who possess jobs and the interests of those who are jobless could be improved by further changes in the Employment Protection Acts. There can be little doubt that these Acts, even in their present amended form, constitute a serious disincentive for employers who would otherwise be willing to take on new employees. The Government therefore wishes to canvass

popular opinion on the following possible changes:

- i.)
- ii.) [Options for change outlined]
- iii.)

The Government recognises, of course, that any of these changes would to some extent diminish the security of those in work. The question is whether this loss might be outweighed by the gain in new employment that could occur once the changes were made.

50. Such changes in employment legislation and the other steps discussed above, would stand more chance of giving rise to new jobs if they were accompanied by measures to increase geographical mobility, so that unemployed people could more easily move to places where suitable work was available for them. [Passage on mobility in the housing market, and particularly on the Private Rented Sector in the light of recent decisions at H Committee].

51. The Government also wishes to overcome another of the major causes of unemployment by providing opportunities for unemployed people to price themselves into jobs. In particular, the Government is concerned to provide such opportunities for young people. For these reasons, the Government believes that it is be advisable to consider changes in the present system of Wages Councils. [Extended

passage on the Councils, putting forward various options for reform/abolition, recognising the possible disadvantages for those in work, but outlining the advantages for those out of work, and seeking comments from readers].

52. [Passage from DHSS on the Fowler Reviews as a contribution to the elimination of the 'Why Work' problem.]

Alleviating the Immediate Problem

53. The Government is also keen to play its part in increasing understanding between managers and employers. There are, of course, strict limits upon the extent to which Government can be involved without improperly interfering in the running of businesses. But, it is determined to do whatever can be done within those limits. [Passage on (i) D/Emp scheme for improving employer/employee relations, (ii) DTI schemes for quality improvement, and (iii) (?) a new 'Year of the Customer': all phrased as possibilities worth investigating].

54. The Government is, however, conscious that the removal of the obstacles to employment described in this paper will inevitably be a gradual and lengthy process. In the meanwhile, it fully recognises the continued need for transitional measures that will enable people who have the misfortune to be unemployed for a long period to overcome the effects of that misfortune and to regain employment.

55. Undoubtedly, one of the most satisfactory methods of achieving this result is to provide unemployed people with help to start their own businesses. [D/Emp passage displaying the virtues of the Enterprise Allowance Scheme, and outlining the increases recently made in its scope.]

56. A contribution can also be made by encouraging employers to divide jobs. [D/Emp passage on JSS/JRS.]

57. Unfortunately, however, not every unemployed person is able or willing to try his or her hand at starting a new business. The Government has therefore made efforts to ensure that those who remain unemployed for a long period and who do not take advantage of the Enterprise Allowance Scheme, nevertheless have available to them a period of useful work which can help to boost their morale, to provide them with new skills, and to improve their prospects of finding lasting employment. [D/Emp passage on the Community Programme and Voluntary Projects Programme, describing their advantages; but admitting the financial cost, and ending with a reminder to the reader that this will inevitably be translated into higher taxation or higher interest rates, thereby causing yet another obstacle to general employment].

58. The Government is willing to countenance these disadvantages because it is acutely aware of the degree of demoralisation that can affect those who are unable to find

work for a prolonged period. But concern for the plight of those who are at present unemployed must never become an excuse for neglecting the measures that will in the long run do most to alleviate that plight; efforts to make the transition to full employment easier must never become an excuse for failing to make the transition itself. Britain suffers from a disastrous medley of obstacles to employment. Many of them serve the interests of the affluent working majority at the expense of the impoverished and unemployed minority. For the sake of the majority, they cannot all be swept away; but they can and - for the sake of the minority they should - be gradually and consistently reduced. In recognising this imperative, the Government declares itself firmly and unashamedly the champion of the 'have-nots'. It understands itself as their protector, and is determined to pursue their cause, not with false sentimentality, but with energy and perseverance.

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*nbpm
Sub
17/8*

17 August 1984

Dear David,

EXPENDITURE PROGRAMMES RELEVANT TO EMPLOYMENT

My Secretary of State has now seen the report enclosed with your letter of 10 August. He considers it valuable that this study has been undertaken and is generally content with its main findings.

On the particular point the Chancellor raises, the Secretary of State thinks it is positively desirable that the cost effectiveness of different public expenditure programmes which have similar aims of reducing unemployment or creating jobs should be evaluated on a consistent basis.

I am sending a copy of this letter to Andrew Turnbull (No 10), Callum McCarthy (DTI), Elizabeth Hodgkinson (DES), John Ballard (DOE), Michael Reidy (Energy), Alex Galloway (Chancellor of the Duchy of Lancaster's Office), David Young (Manpower Services Commission) and to Richard Hatfield (Cabinet Office).

Yours sincerely

David Normington

D J NORMINGTON
Principal Private Secretary

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JR

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

10 August 1984

David Normington Esq
Private Secretary to the
Secretary of State for Employment
Caxton House
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NBM
D

Dear David

EXPENDITURE PROGRAMMES RELEVANT TO EMPLOYMENT

- - - I am circulating with this letter a copy of a report that has been prepared by an interdepartmental group, including officials from your department and the Department of Environment, under Treasury chairmanship.

The Chancellor sees this as a useful piece of work, which should provide helpful background to the Chief Secretary's continuing discussions with colleagues on public expenditure. Of the implications for policy choices, set out in paragraph 29 of the paper, he is attracted by the procedural suggestion in paragraph 29(v), and would be interested in any comments on it from your Secretary of State and other colleagues.

I am sending copies also, for information, to Andrew Turnbull (No 10), Callum McCarthy (DTI), Elizabeth Hodgkinson (DES), John Ballard (DOE), Michael Reidy (Energy), Alex Galloway (Chancellor of the Duchy of Lancaster's Office), David Young (Manpower Services Commission) and to Richard Hatfield (Cabinet Office).

Yours ever
David

D L C PERETZ
Principal Private Secretary

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EXPENDITURE PROGRAMMES RELEVANT TO EMPLOYMENT

Report by Officials

This report presents the conclusions of an inter-departmental group* which has reviewed the comparative cost-effectiveness of selected public expenditure programmes aimed explicitly at reducing unemployment, or having an important impact on it. The remit was to examine the effects of altering the balance between different programmes within existing public expenditure policies and totals.

2. As such, the review picks up one of the recommendations of the PAC Report on Special Employment Measures (SEMs) (Fourth Report 1983-84):

"As SEMs are a preferred use of a given amount of public funds, alternative uses of those funds which might achieve the same or very similar objectives should be fully examined and evaluated. There should be renewed efforts both to devise ways of comparing alternative forms of public expenditure, and to assess - even if only on a broad basis - the second round economic effects of SEMs."

3. The group has sought to:

- (i) assemble broadly comparable data for the relevant programmes;
- (ii) evaluate their cost-effectiveness by using the methodology conventionally applied to SEMs;
- (iii) assess their longer term macro-economic effects.

* The group was set up at the request of the Chancellor. It was chaired by the Treasury and included representatives from the Departments of Employment and Environment and from the No.10 Policy Unit.

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Coverage

4. To keep the report manageable and in line with the remit, the Group has taken as a base the short term effects of the main special employment measures (SEMs) run by the Department of Employment and the MSC, for which agreed estimates of costs are already available as a result of the work of the DE's Manpower Group. Taking SEMS as a base, this report makes comparisons of two broad kinds:

(i) with some specific labour intensive programmes financed by the Department of Environment which are broadly comparable in scale with the SEMs (paragraphs 9-20 and table 1); and,

(ii) with estimates of the short-term effects of certain broad categories of public expenditure produced on the Treasury model (paragraphs 22-24 and table 2).

5. A final section looks at the longer term impact of the measures, including second round effects (paragraphs 25-27). The main findings and policy implications are set out in paragraphs 28-29.

6. It has not been possible to cover all the specific expenditure programmes relevant to employment, or even all those in which labour content is above average. The coverage of the report is nonetheless effectively quite wide as it spans significant differences in cost-effectiveness.

Objectives

7. Even within the range covered here there is a problem in ascribing a common objective - reducing unemployment - to all the programmes. The SEMs are themselves not homogeneous. Although all aim to cut unemployment in

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in the short term, many have other and longer term objectives such as lowering wage expectations and improved employability.

In addition some add to employment as well as reducing unemployment, either in the normal labour market or outside it. And many are targeted on particular groups, rather than the unemployed generally.

8. The DoE programmes under review can all be said to have explicit employment or unemployment objectives. But in many cases these are incidental to other aims such as easing the problems of inner cities and encouraging home ownership. Unlike SEMs, these programmes are not designed with the primary aim of reducing unemployment.

The specific programmes

9. Detailed description of the programmes is in the Annex. In summary, they are:

(i) all the SEMs, including the Youth Training Scheme; and,

(ii) assistance to the inner cities, and the heritage programme, which are major elements of the DOE's housing programme.

10. SEMs currently cover 620,000 people with an estimated direct short term effect on the unemployment count of about 450,000. Expenditure on the measures grew in real terms by 60 per cent between 1978-79 and 1983-84 (faster than any other programme apart from energy), a period when unemployment more than doubled. Of the £2 billion provision for 1984-85, around half is on schemes for young people, 30 per cent on temporary employment outside the labour market, 15 per cent on early retirement schemes, and 5 per cent on the creation or maintenance of jobs within the labour market.

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11. Provision for the selected DOE programmes is nearly £3 billion in 1984-85. In recent years a large reduction in housing expenditure has been accompanied by a much smaller rise in inner cities spending. Employment supported by the current level of expenditure is around 300,000 and the direct short-term effect on the unemployment count is 200,000 or so. Much of this employment is in construction, which has spare capacity and a predominantly male workforce.

Cost effectiveness

12. This can be measured in a number of ways. For the purpose of assessing DE and MSC Schemes the main measure used by the DE Manpower Group is net exchequer cost (NEC) per person removed from the unemployment count. This measures short term cost-effectiveness in relation to a single aim. It takes no account of second round effects; nor should it be considered in isolation from other more qualitative criteria which seek to capture the wider impact of SEMs. The same short term measure has been applied to the DOE programmes though this causes some difficulties.

13. NEC is the gross per capita public expenditure cost of a programme minus savings in benefit payments and any increased tax revenue and national insurance contributions. The impact of a measure on the count is typically lower than the number of people it covers because of four factors: deadweight (paying for something that would have happened anyway); substitution (where those covered by a scheme take jobs which would otherwise have been filled by people outside it); displacement (where the output of subsidised activities is at the expense of output and employment elsewhere); and non-claimants (where a person recruited under a particular scheme did not previously claim unemployment or supplementary benefit).

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14. The group's assumptions about these factors for all the specific programmes are set out in the technical note at the Annex. The evidence underlying the assumptions varies considerably. In the case of SEMs they are based largely on survey evidence, and estimates of NEC can therefore be regarded as reasonably well founded. The assumptions for the DOE programmes rely almost entirely on informed judgement. And estimates for the broad public expenditure packages take the form of standard ready reckoners.

15. In the time available the Group has had to take some short cuts, as the Manpower Group figures are not addressed to the effects of substituting expenditure on SEMs for other public expenditure within a given total. The figures for Net Exchequer Cost are for an increase in expenditure on each scheme with no explicit assumption about total public expenditure. All the figures in table 1 are on this basis. Similarly the figures in Table 2 are for additional public expenditure within the categories it covers, though in this case the model requires an explicit assumption viz that this adds to total public expenditure. This yields figures for first year PSBR costs per person off the count etc which can be broadly compared with the figures in table 1.

16. In principle a ranking based on NEC or PSBR costs may not be the same as the ranking in terms of public expenditure costs because the former allows for the flowbacks of tax and national insurance contributions. The variation between programmes in these flowbacks is unlikely to be large enough to invalidate the broad ranking of the SEMs, the DoE measures, and the broad categories of expenditure, in terms of relative cost effectiveness which is suggested by the figures in the tables. The large differences shown in table 2 for these different groups of measures taken together supports this view. Paragraphs 14 and 15 give further reasons against focusing

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too closely on the precise numbers in the tables, as opposed to their broad ranking.

17. There are difficulties in extending the SEMs concept of NEC per person off the count to the DOE measures because:

(i) the concept is appropriate to the objective of reducing unemployment (ie the primary aim of SEMS), but not completely so to one concerned with employment creation (some of the DOE measures). In the latter case net cost per net job created might be more suitable;

(ii) the assessment of NEC for the SEMs concentrates mainly on first year effects, whereas DOE programmes (and some SEMs) have some direct effects extending into the second year and beyond, though displacement effects will rise.

18. To deal with these difficulties table 1 below provides estimates of net exchequer cost per net job where possible as well as per person off the unemployment count. It also indicates the effects of extending the calculations into the second year.

19. A further limitation of the NEC measure is that it does not capture second round or indirect effects of the programmes. These are illustrated by means of qualitative statements about:

(i) short run GDP effects;

(ii) supply side effects, such as more flexible working patterns, training and impact on wage-expectations;

(iii) redistributive effects on unemployment - ie targetting on particular disadvantaged groups;

(iv) social benefits.

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20. The following table summarises the findings on net costs and second round effects of SEMs and the DOE measures. The programmes are dealt with in aggregate terms, even though particular parts of some schemes (eg shared ownership or YTS for the unemployed) may be more (or less) cost effective than the average for the whole scheme.

21. The short term effects of broad categories of public expenditure are discussed in paragraphs 22-24 below and longer term macro-economic effects in paragraphs 25-27.

TABLE 1 - EMPLOYMENT AND OTHER EFFECTS OF EXPENDITURE PROGRAMMES RELEVANT TO EMPLOYMENT

	Average net cost per person off count /net cost per net job/ YEAR 1 £'000	YEAR 2	Short run GDP effect/	Supply side effects	Redistribution of unemployment in favour of specially disadvantaged groups	Social benefits
A. DEPARTMENT OF EMPLOYMENT						
Enterprise Allowance	2.6 /n.a./	0.65	Some	Additional entrepreneurial activity and associated employment and increased competitiveness		
Young Workers	2.4 /2.4/	Lower	Some, perhaps small	Reduced wage expectations	Younger people but some substitution	Occupation for young people
Community Programme	1.9 /1.5/		Some	Improved employability for long-term unemployed, some reduction in income expectations through more flexible working e.g. part-time	Long term unemployed and younger people	Occupation for young and disadvantaged. Enhancement of community assets
Job Release	1.6 /n.a./		None	Flexible working; reduction in labour supply may exercise upward pressure on real wages but replacements tend to get paid less		Opportunity for voluntary early or phased retirement
Youth Training	1.4 /n.a./		Some, perhaps small	Increased productivity & training; reduced wage expectations	Younger people but some substitution	Occupation and development of young people
Community Industry	1.4 /1.3/		Small	Improved motivation; small training benefit	Younger people	Work for community service work for disadvantaged young
Job Splitting	-0.2 /-0.2/	Lower	None	Flexible working patterns; labour reserve against future demand expansion		
B. DEPARTMENT OF ENVIRONMENT						
Private Housing Grant aided improvement	21.8* /13.1/	Same	Some	Flexible, small scale working		Better housing conditions; improved fixed asset stock
LA/HA Housing New Build	19.1 /11.6/	"	"	Negligible		"
Renovation	15.8 /9.4/	"	"	Negligible		"

TABLE 1 (Continued)

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	Average net cost per person off count /net cost per net job/ YEAR 1 YEAR 2 £'000		Short run GDP effect ⁴	Supply side effects	Redistribution of unemployment in favour of specially disadvantaged groups	Social benefits
<u>Inner Cities</u>						
Heritage	14.4* /8.6/	Same	Some	Flexible, small scale working		Better preservation, pre- sentation and display of heritage
Urban Programmes	10.4 /6.3/	Lower	"	Entrepreneurial/voluntary flexible working	Inner city unemployment	Reduction of inner city stress; regeneration of inner city economic confidence
Derelict Land Grant	6.5-10.7** /3.9-6.3/	Lower perhaps negative	0.6	Negligible		Benefits to surrounding communities, higher surround- ing land values
Urban Development Grant	0.5-3.1** /0.3-1.0/		1.5	"	Inner city male employment	Reduction of inner city stress; regeneration of inner city economic confidence
Urban Development Corporations	-0.6-1.6** /-0.3-1.0/		2.0	"	"	"

NOTES:

- Marginal costs anticipated to be lower than average
- ** Marginal costs anticipated to be higher than average

⁴ The evaluation of GDP effects of these programmes is confined to the first year; no allowance is made for the possible economic implications of financing the measures nor of the wider economic effects arising from any short run increase in economic activity, e.g. on inflation. Where figures appear in the column they are intended to reflect the ratio of private expenditure additionally induced by the programme relative to the public expenditure required.

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Comparison with broad categories of expenditure

22. It is natural to compare the NEC figures for SEMs and the DoE programmes with the first year PSBR costs associated with certain broad economic categories of public expenditure. The estimates of the latter, given in the table below, are not precisely comparable with the figures given earlier since they make allowance for second round effects*. They also make an allowance for the fact that employment does not always adjust immediately to changes in output, in contrast to the estimates in table 1; this tends to raise the estimated costs. Nevertheless they provide a rough yardstick for comparing orders of magnitude.

Table 2: First year PSBR costs of broad public expenditure categories**

	(£thousand)	
	Per person off the unemployment count	per net person employed
Central Government employment	8-10	5-7
Central Government current expenditure on goods and services (including direct employment)	<u>5-20</u>	10-15
Local Authority investment	<u>25-35</u>	15-25
Central Government investment	<u>35-45</u>	20-30

* These go in both directions. For example, multiplier effects on activity tend to reduce costs and increase employment effects whilst interest rate effects operate in the opposite direction.

** All figures relate employment/unemployment effects in the fourth quarter of the year to PSBR effects for the year as a whole. They are based on the assumption that monetary growth is unaffected; that interest rates adjust to ensure this; and that the expenditure constitutes a net addition to total public expenditure, and hence an increase in the PSBR

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23. It is clear that the first year NEC per person off the count and per net job for SEMs and for those DoE programmes with high gearing of induced private expenditure compare favourably even with direct employment by central government, for which costs are significantly smaller than average. Table 1 suggests that the costs associated with DoE housing programmes are significantly higher than for SEMs. But they are probably still somewhat less than the average for public expenditure as a whole, though not much less than for average LA investment after allowance is made for lagged adjustment in the figures in Table 2.

24. On the basis of these numbers it is clear that a switch towards SEMs and some DoE programmes, with pro-rata cuts in other areas of public expenditure, would lead to significant first year reductions in unemployment. For the DoE measures and a majority of the SEMs, there would also be some short term increase in employment, in which case there may be some reduction in the PSBR associated with a given total of public expenditure. In the case of a switch to housing programmes and highly geared DoE programmes there may also be a net increase in GDP, since such expenditure also has a relatively high domestic output content. For a switch to SEMs, however, this is less likely to be so, and in some cases a reduction is quite possible.

Second Round and Longer Term Effects

25. The estimates given in tables 1 and 2 relate to the first year effects of the expenditure considered. However, it is important to look beyond the first year for programmes that last for a significant run of years or are virtually permanent. The question naturally arises to what extent, if at all, the programmes considered in this report are different from other forms of expenditure; and hence what scope exists for increasing employment

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and reducing unemployment in the long run by increasing the relative importance of these programmes within the overall constraints on public expenditure and the PSBR.

26. There are good reasons for thinking that costs per job for the DoE programmes and the majority of SEMs will tend to be higher in the longer term if second round effects are allowed for. In some cases, for example the Youth Training Scheme and DoE's UDG programme, this will reflect rising deadweight or displacement in addition to the normal macroeconomic mechanisms. For those programmes which do not have structural effects on the labour market, including those which involve high labour intensity and a high gearing of private expenditure, much the same type of macroeconomic crowding out can be expected as with general forms of expenditure, as a consequence of higher inflation and interest rates. In spite of possible significant net gains in the short run one would expect little net gain to output and employment in the long run from increasing the scale of the Housing and Inner City programmes, for example, relative to other programmes. The same probably applies to some of the SEMs. Estimates based on the Treasury model suggest that by the end of the fourth year the proportion of any initial net gain remaining could be less than a quarter.

27. With measures which have beneficial structural effects in the labour market, or are directed to particular parts which function very imperfectly (eg youths), there is a greater chance that some effect on employment and unemployment can be sustained in the longer term. But it is necessary to distinguish measures which yield structural benefits in the labour market from those which do not. The Job Release Scheme is probably an example of the latter category. In effect it reduces the labour supply, causes a tightening of the labour market, and reduces potential output. For this reason JRS is designed to be temporary. Other programmes have beneficial structural

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effects. This may well be true with the Youth Training and Young Workers programmes insofar as they encourage participants to lower permanently their expectations about future real wages or maintain their employability, and also the Community Programme to the extent that it encourages more part-time working. But even in these cases, with the possible exception of the Young Workers Scheme, the long run effects of a switch to these programmes on employment and unemployment may well be significantly less than the short run effects.

Main Findings

28. The main findings of the review are that:

- (i) SEMs are a better short run buy in terms of NEC per person removed from the count than all the DoE measures, with the possible exception of Urban Development Corporations and the associated grants;
- (ii) SEMs are also more cost-effective on this criterion than the broad public expenditure packages analysed in paragraphs 22 to 24;
- (iii) SEMs are heterogeneous and this is reflected in a range of net costs extending from around zero (Job Splitting Scheme) to almost £2,700 (Enterprise Allowance in the first year). The weighted average is £1,600 or so. Measures with the highest net costs tend to be those which do not aim for purely short term impact;
- (iv) SEMs have more pronounced supply side effects than the DoE programmes. In some cases these are beneficial (training, reduction of labour market rigidities, wages). But the effects are potentially adverse in the case of the job release scheme with its associated reduction in the labour force;

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(v) all the DoE programmes offer more than most of the SEMs by way of short-term additions to output, and asset creation;

(vi) to the extent that a switch to SEMs or DoE programmes leads to a temporary increase in output or tightening of the labour market, there will be some cost in terms of higher inflation and interest rates for a period;

(vii) The net exchequer costs per person off the count or per net job given in table 1 for the first year do not take account of second round effects. Allowing for these, the proportion of any initial net gain to employment remaining by the end of the fourth year from measures which do not bring structural benefits could well be very small; and their longer term net exchequer cost will therefore be higher. There is a better chance of some lasting gain to employment and unemployment from measures with beneficial structural effects (eg lower wage expectations) which tend to offset the inflationary impact of tightening the labour market. But even so these last gains may well be significantly less than the short terms gains in most cases.

Implications for Policy Choices

29. These points suggest the following policy conclusions :

(i) if Ministers wished the sole objective of SEMs to be the maximum short term reduction in unemployment for the minimum public expenditure cost, this would imply reallocation between the various measures. But there are practical (ii below) and political limitation to such a move. It would involve sacrificing a number of beneficial supply-

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side effects. For example less would have to be spent on schemes which encourage positive adjustment (YWS and Enterprise Allowance) and more on others. (It might, however, be noted in passing that beneficial supply side effects could also be achieved if legislative and other institutional action, such as the abolition of wages councils, changes in employment protection, and revised social security arrangements were taken.);

(ii) if Ministers wished to increase the impact of public spending on unemployment, SEMs would remain a better bet than the generality of other programmes. But a major qualification is that extending the coverage of some SEMs would require changes in their rules, eg in order to attract more people, which would increase deadweight and reduce their cost-effectiveness; further work would be needed on any specific proposal to see if marginal cuts differed for average costs;

(iii) if Ministers wished to redistribute unemployment to help particular groups (eg the young or the long term unemployed), SEM-type measures are designed to do that. Such measures also achieve some geographical redistribution of unemployment since target groups (eg long term unemployed) are concentrated in high unemployment areas. However, if geographical distribution is a prime objective, DoE measures are designed for this purpose;

(vi) if Ministers thought it desirable to evaluate programmes with related unemployment aims on a regular basis, the task might be given to the interdepartmental Manpower Group. That Group

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has hitherto concentrated on priorities within the field of SEMs. But it could extend its work to other programmes, some parts of which, as the review has indicated, might have net costs fairly close to those of SEMs. Departments which believed they had a programme which could compete in cost effective terms with SEMs, and were able to demonstrate a convincing prima facie case, could put proposals to that Group which would then test them according to its standard criteria;

(v) in view of the short run cost-effectiveness of SEMs Ministers might consider the possibility of adopting a new requirement when public expenditure proposals are put forward primarily or largely on grounds of cutting unemployment or increasing employment, notably support for industries where current levels of output and employment are unprofitable. The requirement would be that such proposals should be supported by figures for net exchequer cost per person off the unemployment count or when appropriate per net job. These figures should preferably be calculated on a basis consistent with that adopted in this review and should in any case be cleared with the Treasury;

(vi) the possibility that the long term benefits of SEMs, DoE programmes and any other measures relevant to employment may be significantly smaller than the short term benefits should be borne in mind when Ministers consider their relative priority each year.

HM TREASURY

3 August 1984

COMPARISONS OF COST-EFFECTIVENESS : SOME TECHNICAL ISSUES

PURPOSE AND METHODOLOGY

1. This note sets out
 - to consider the technical problems of comparing the employment and other effects of the expenditure programmes of the Department of Employment, MSC and Department of Environment, and
 - to present the comparisons in as useful and simple a way as possible, consistent with demonstrating the uncertainties and assumptions lying behind the estimates.

Table 1 sets out the objectives and expenditures associated with each of the programmes considered.

2. It was recognised that there would be difficulties in squeezing a comparison of DEm and DoE programmes into an evaluation framework concerned with a single objective (namely reducing unemployment) when this might not be the primary objective of all the programmes considered. Nevertheless, an evaluation framework of this kind has been developed for the assessment of special employment measures (SEMs) and in the first instance it was decided to see how useful this was for a wider range of comparisons.

3. The SEM's evaluation framework includes the following criteria against which we attempted to assess the DEm and DoE programmes:-

- (a) Net cost per person off the unemployment count; this measure seeks to estimate the net cost (including Exchequer flow-backs in tax revenue and benefit savings from those employed by the programme) per additional person taken off the unemployment count allowing for
 - 'deadweight' (paying for something that would have happened anyway);
 - 'substitution' (where those covered by a scheme take jobs which would otherwise have been filled by people outside it);

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- 'displacement' (where output of subsidised activity is directly at the expense of output and employment elsewhere); and
 - 'non-registration' (where a person recruited under a particular programme did not previously claim unemployment or supplementary benefit).
- (b) Short-run GDP effects; these are only qualitatively stated but indicate where they are likely to be small or non-existent.
- (c) Supply-side effects; these embrace a range of effects which are likely to have longer term consequences for the economy's adaptability and growth potential; they include more flexible working patterns, entrepreneurship, training, and the implications for real wage pressure and productivity growth.
- (d) Redistributive effects on employment, i.e. by targetting particularly disadvantaged groups such as the long-term unemployed.
- (e) Social benefits such as improved community service, regeneration of the inner-city environment.

4. Two points should be noted about this evaluation framework particularly with regard to the calculation of net costs and short-term GDP effects. The first is that they are the average costs and effects estimated to be associated with an increase in public expenditure on each programme. But, for the purpose of the current exercise concerned with the consequences of a shift in the balance of programmes the absolute magnitude of the figuring on net costs is less relevant than the ranking of the programmes. The second point is that the framework does not include assessment of the differential longer-term macro-economic effects arising from the different changes in output levels or prices to which the various programmes might give rise. These are discussed in the main report.

RESULTS

5. The work of estimating costs and summarising effects of programmes was expedited by the existing evaluations of DEM measures carried out by the Manpower Group and by the speed and thoroughness with which DEM and DoE supplied additional material. The results of the work completed to date are summarised in the Tables.

A summary of the critical assumptions underlying the estimates of net cost is presented in Table 2. In the case of DEM these are primarily assumptions and estimates of deadweight, displacement, substitution and the register effect. For the DoE programmes there are additional and prior assumptions which are critical, namely the public/private expenditure gearing ratio, the labour content of expenditure, the level of labour costs and the secondary, off-site employment effect. All these underlying assumptions and estimates are subject to uncertainties. Whilst some are more soundly based (e.g. DEM's estimates from survey work of deadweight etc) than others, it nevertheless remains the case that the resultant estimates of net costs can only give broad orders of magnitude.

Table 1 in the main report summarises the net costs per person off the count and net costs per job where appropriate and the wider employment and economic effects of each programme according to the criteria set out above in para 3.

6. Three particular difficulties were encountered in using the SEMs' framework for this comparative purpose. All were concerned with the estimate of net cost per person off the count.

- (a) Whilst this measure is appropriate for the SEMs objective of reducing unemployment it is less relevant for programmes whose prime or secondary purpose is to create employment whether from the count or not. Where net job creation is an objective it is more appropriate to use a net cost per net job measure. Where this seems relevant (e.g. in some DEM as well as DoE programmes) an estimate is included in Table 1 of the main report.
- (b) The period chosen for estimating net costs in the SEMs' framework is the 12 months within which expenditure is incurred. SEMs' costs can be calculated on a longer term basis but to do that further information is needed and for most programmes is not currently available and only crude guesses can be made. For example, to evaluate JSS and YWS over longer than one year would require an estimate of the jobs split or induced after the subsidy ceases. Insofar as some induced jobs remain the net cost per person off the count will be reduced. Only in the case of EA has there been estimation of second and third year effects.

For some DoE programmes the second year effects will be important because the gearing effect on private expenditure is expected to operate with a lag longer than 12 months.

Indication of the direction and magnitude of these second year effects is presented in Table 1 of the main report.

- (c) The SEMs' convention has been to present the average net costs for purposes of comparison. But marginal costs are important when considering expansion or contraction of schemes. In the case of SEMs such an expansion can change the nature of the schemes and thus change the whole basis on which both average and marginal costs are estimated. This is less likely to be the case in DoE programmes and Table 1 of the main report indicates the direction in which marginal costs will differ from average.

CONCLUSIONS

7. In drawing conclusions from this work it is necessary to bear in mind that it has proceeded with haste and for convenience has used an evaluation framework designed for another purpose (the assessment of SEMs). Moreover, because of time constraints the DoE assumptions and estimates have not been subject to the same detailed scrutiny as the DEM figuring. Despite the survey work that has been done for the assessment of SEMs there remain uncertainties about the figuring; this must be even more the case with the DoE estimates. Thus, the net cost measures should be taken only to give broad orders of magnitude and should not be emphasised in isolation from the other effects considered in the main report. The main findings of this work are presented in Table 1 and paragraph 26 of the main report.

PMA

ANNEX

**TABLE 1 - DESCRIPTION OF DE_m AND DoE EXPENDITURE PROGRAMMES RELATED TO
EMPLOYMENT : OBJECTIVES AND EXPENDITURES**

<u>PROGRAMMES AND OBJECTIVES</u>	<u>EXPENDITURES f_m</u>	
	1984/5 Estimate	1985/6 PES 1983
<u>A. DEPARTMENT OF EMPLOYMENT</u>		
<u>Youth Training</u> :- To provide training and planned work experience to enable school-leavers to compete more effectively in the labour market.	820	993
<u>Young Workers' Scheme</u> :- To encourage employers to take on more young people into permanent full-time jobs at realistic rates of pay.	56	45
<u>Community Industry</u> :- To provide temporary jobs for disadvantaged young people who find particular difficulty in finding and keeping jobs.	26	27
<u>Enterprise Allowance</u> :- To help unemployed people who wish to start up in business.	66	39
<u>Job-Splitting Scheme</u> :- To encourage employers to provide more part-time jobs for the unemployed.	5	3
<u>Community Programme</u> :- To provide temporary jobs for the long-term unemployed of community benefit.	561	588
<u>Full-time and Part-time Job Release</u> :- To encourage employed people approaching state pension age to give up work early and release jobs for the unemployed.	315	266
TOTAL	1849	1961
<u>B. DEPARTMENT OF THE ENVIRONMENT*</u>	1984/5	1985/6 PES 1983
<u>Housing Programme</u> :- To increase home ownership, to maintain and improve the existing stock, to give priority to special housing needs.		
<u>Local Authority (including New Towns)</u>		
New Build (includes land acquisition)	708	588
Renovation (own stock)	1005	1005

Annex
TABLE 1 (continued)

	1984/5	1985/6 PES 1983
<u>Housing Corporation</u> (not split)	687	655
<u>Private</u>		
Grant-aided renovation	450	450
<u>Inner Cities:-</u> To assist in dealing with the special concentration of social need associated with the decline of the inner cities.		
Urban Programme	255)	280
	)	
UDG	48)	
UDC	75	80
Derelict Land Grant	74	70
<u>Heritage:-</u> To maintain and present historic buildings, monuments and parks in a cost-effective way and to enable the public and overseas visitors to appreciate them.		
	96	90
TOTAL	3398	3218

- * In addition to the DoE programmes listed here and analysed later, there are also a number of projects and minor programmes which also have relevance for employment. There is shared home ownership in which, typically, the resident buys a half share of the property and the public sector retains the other half. A gearing factor of 2.0 applied to shared ownership new build will induce extra economic activity and employment in the short run. The Development Commission also contributes to economic activity in less prosperous rural areas in ways whose effects are likely to be similar to those for Derelict Land Grant.

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ANNEX

**TABLE 2 - ASSUMPTIONS IN THE ESTIMATION OF NET COST PER PERSON OFF THE
UNEMPLOYMENT COUNT**

<u>A. DEm Programmes</u>	Deadweight, displacement and substitution	Propensity to claim
Youth Training		
Adults	0	0.79
Youths Mode A	25%*	1.00
Mode B1	0	1.00
Mode B2	10%	1.00
Youth Workers Scheme	82%	1.00
Community Industry		
Adults	0	0.79
Youths	0	1.00
Enterprise Allowance	75%	1.00
Job Splitting Scheme	0	1.00
Community Programme	3%	0.78
Job Release		
Full-time	5%	0.97
Part-time	10%	0.90

* This estimate is an average for the last several months. Mode A deadweight are calculated by the formula which varies monthly depending on the type of intake.

<u>B. DoE Programmes</u>	Gearing	Labour content & cost	Deadweight/ Displacement etc	Propensity to register
Local Authority/Housing Association				
New Build	-	45%:£9Kpa	0 deadweight etc	0.6
Renovation	-	60%:£9.5Kpa	" "	"
Grant Aided Renovation	1.54	" "	50% "	"
Urban Programme	1.10	70%:£7.5Kpa	15% "	"
UDG	5.00	50%:£9Kpa	30-50% "	"
UDC	6.00	" "	" "	"
Derelict Land Grant	2.00	60%: "	20-40% "	"
Heritage	1.15	60%:£9.5Kpa	10% "	"



CC HMT *de*
(duplicate)

10 DOWNING STREET

From the Private Secretary

9 August 1984

BF
The Prime Minister has received the attached minute from Sir Keith Joseph commenting on a theme that he will be raising at the meeting on employment proposed for 13 September. Sir Keith comments particularly on a number of recent articles about the relationship between pay and unemployment and suggests that further work should be done on the arguments put forward in these articles. The Prime Minister has asked me to commission such work in time for the meeting on 13 September and I should be grateful if you could arrange for this to be done.

I am sending a copy of this letter and Sir Keith's minute to David Normington (Department of Employment).

Timothy Flesher

David Peretz, Esq.,
HM Treasury.

From: The Rt.Hon. Sir Keith Joseph, Bt., M.P.



CC HMT

8th August 1984.

The Rt.Hon. Mrs. Margaret Thatcher, M.P.,
Prime Minister.

PERSONAL & URGENT.

Dear Margaret,

Thank you for lunch today, and for the chance to discuss several issues. On one of them you bade me deliver my suggestion today, so that work might be initiated on it, if thought fit, while you are away.

I attach a minute.

Yours,

Keith

8th August 1984.

PRIME MINISTER.

At the meeting to which I have been called on September 13th I shall be proposing that, whatever else Government does, we should seek to increase understanding of the causes of unemployment - particularly the link between jobs and the price of labour.

You have often referred to this. Nigel Lawson, in his winding up speech last week, laid great, and I believe healthy, emphasis on it. But the message has not yet been widely hoisted in.

It so happens that very recently the argument on it has at last been joined - Sam Brittan, on July 19th, 23rd and 26th in Financial Times; Sarah Hogg reporting Nigel Lawson in the Times last week; and Hayek in the Times on August 7th have presented the case. David Basnett (Financial Times today) has rebutted it.

X In parallel the IEA has within the last fortnight published "Low Pay - or No Pay", which Chris Pond of the Low Pay Unit has sought to refute, though his views have been criticised in yesterday's Daily Telegraph by Professor Denison.

We have thus been presented by Mr. Basnett and Mr. Pond with presumably the best case that can be made against our analysis. May I suggest that prior to our meeting their arguments be analysed and that, if our views are validated and their arguments shown to be flawed, we should embark upon a systematic and sustained explanation of one of the main causes - and cures - of unemployment.

Our aim should be both to encourage sensible wage and productivity behaviour and to spread an understanding of the causes of unemployment.

There will be difficulties :

- (a) We shall be accused of wanting to lower pay, when in fact an acceptable alternative would be to lower wage costs by increased productivity.

- (b) We shall be told that a higher productivity actually decreases jobs, and will have to explain
 - (i) that this may indeed be a necessary stage on the way to more jobs, and
 - (ii) that projects now aborted by expected pay demands may become profitable enough to be implemented.
- (c) We shall be told how low paid are British wage-earners compared to those in competitor countries - but of course we know this, and we know that it reflects low productivity.
- (d) We shall be told that some managements are not very clever and that the crucial skills of marketing are not as widespread as desirable. That we know too. Our message will be addressed to managements that give way to damaging pressures almost as much as to unions.
- (e) We shall be told that some industries are virtually free of trade union restrictions - and we are thankful for that.

I hope that some preparatory work on the lines suggested could be done for our meeting.

I am copying this to Nigel Lawson.

KJ.

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Coming Secret
C

PRIME MINISTER

3 August 1984

GOVERNMENT POLICY

The Government, according to issue polls, is still doing well on inflation, law and order, defence and the Common Market. It is doing badly on unemployment, the National Health Service, education and local government.

Education

The themes of parental choice, parent power and higher standards are popular. The response to Keith's speeches has been magnificent.

The proposals on exams and parent-governors are an important first step. But in order to give parents some real choice, we need to move on to tackle direct-grant schools and technical colleges, and to think again how to handle the closure of village schools.

People believe that the education service is being cut severely, largely because of the school closures, and from the response of the educational establishment.

I attach the paper we wrote on direct-grant schools and technical colleges for your consideration this summer.

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(Annex A). Something like this middle way would give meaning to our belief in choice.

Health and Welfare

In health, the Government is still very unpopular - again because people believe the Government wants cuts and does not care about public health provision. Many speeches and many words have not succeeded in changing these public perceptions.

Concentrating on efficiency does not help: it is a cold and prickly word, and people are not sure that they want to be looked after by an "efficient" GP or hospital.

However, association with the cause, needs and aspirations of the patient is a more powerful tool both in managing the Health Service and in winning back the ground we have lost. It can lead on to making the necessary savings on the drugs bill, supplies, administration etc, rechanneling this money to reduce the waiting lists, provide the new treatments and the better standard of service which the public definitely wants.

A necessary first step remains the appointment of the Chairman of the NHS Board, and his development of a vigorous action programme for improving the quality of services, whilst saving on resource waste. We also need to motivate

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the new Regional Managers. Health Maintenance Organisations could be a small but important step in making the GP service more friendly to the customer. Norman Fowler is preparing an annual NHS Report which should be ready for Conference.

In the welfare field, the Government has come a long way. Setting up the Inquiries has taken the sting out of what could have been a very dangerous debate, and has opened up the chance for more radical reform. Your Seminar in the autumn will be important in bringing together some of the threads of policy: focussing the assault on poverty, the encouragement of self-help, the importance of insurance and the contributory principle, and the relationship between tax, benefits and the unemployment and poverty traps. David Willetts and I will produce some thoughts for September.

In pensions, the public's imagination has been captured by the action taken to help the early leaver and the consultative document on portable pensions.

The next question is how the cost and customer responsiveness of the State Earnings-Related Pension Scheme can be controlled and improved. I attach a recent paper written for Norman Fowler, which may elucidate some of the points.
(Annex B)

Economic Policy

In economic policy, the last couple of months have seen bad setbacks. The major increase in interest rates was a disappointment, and the early news on the public expenditure round is as bad as always. The autumn will see a painful battle again in an effort to curb public spending. Improving market confidence and a good PESC would reinforce each other and allow interest rates to fall.

I attach a note setting out some of the areas where savings have been identified as a result of policy reviews, or where further policy reviews might lead to substantial savings as a contribution towards the PESC debate. (Annex C)

Jobs

The Government's critics will make out that this Parliament shall be judged by whether or not more jobs are generated. This is not good ground and should not be ground of the Government's choosing. Nonetheless, the Government has to show that it has a positive contribution to make, going beyond the argument that if inflation is brought down and sound economic management instituted, the jobs will follow naturally. The best way is to seek more flexible labour markets, and to show the way in which wider wealth-ownership and competition policy can also have their favourable effect on jobs. The lesson is percolating through: recent coverage

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in the Economist, Telegraph, Times and FT has all stressed this argument, as did the Chancellor's Mail lecture; and all agree that putting more money into markets that don't work is a recipe for disaster. I attach a paper which sets out the case for a new Green Paper on the labour market as the first stage in introducing policies that will make labour more flexible. (Annex D)

DoE

The private rented housing market remains a regulated nightmare. H Committee has a strong majority in favour of deregulating, and many people of common sense accept that the artificial scarcity created by the current housing legislation is the prime cause of high rents and the difficulties, particularly for young people, in gaining access to the rented property they need. Meanwhile, very expensive benefits are given to people to live in unattractive and inadequate bed and breakfast accommodation. Yet the proposals from the DoE were timid and restrictive, and were rejected overwhelmingly by H Committee on political and financial grounds. Time is running out to come forward with suitable proposals, and to make use of the legislative slot in the 1985/86 Programme, which is the last conceivable date for law that can have any impact this Parliament. Sensible proposals are needed for the autumn.

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The paper on the water industry, reviewing one of our most important and under-researched nationalised concerns, did not lead to any imaginative strategy for the water industry itself. That too will have to come back in the autumn, when there will be an opportunity both to lower the high costs of the provision of water and disposal services, and to do something about the inadequacy of supply in relation to demand - particularly in the Western areas of this country.

In environmental policy, a robust statement of the Government's concern and intent is needed to prevent the green lobby becoming an acute embarrassment without incurring undue and unnecessary expense.

In the local authority area, the Government will face a serious challenge, as we have argued in recent weeks, from the Left-wing authorities subject to rate-capping. The best thing that has happened recently was the legal action taken to stop Ken Livingstone getting away with his expenditure proposals.

In the autumn the Government should turn its attention to the longer-term issues of local government finance and expenditure control, and prepare to make an authoritative statement on local government which can win back some of the lost ground. We would like to send you some thoughts on this subject in September.

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There is an opportunity to do something about cleaning up and rebuilding our inner cities and our wasteland. Through its sponsorship of the PSA, DoE can do something to facelift the tatty public sector estate.

At the Department of Employment, the passage of the Trade Union Bill, although not without accident, has improved the statutory armoury available to moderate trade unionists and to managers. It will now be important to demonstrate how the new legislation can work against the background of strikes.

The next question is strikes in essential services, and whether any further progress can be made in strengthening the moderate voice in the trade unions.

Industrial Policy

There is plenty of vigour in pursuit of the British Telecom privatisation, and the sale of INMOS has largely completed the task of cleaning up the old NEB. BL is a curate's egg - good in parts with the sale of Jaguar and the possible sale of Unipart, but bad with respect to the delay on trucks, bus and 4-wheel drive vehicles. Similar progress could be made in rebuilding morale, market share and profits in 4-wheel drive and bus as was made at Jaguar, if the will was there. British Shipbuilders at last has a clear and sensible plan.

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This autumn a good mean look can be taken at Regional Aid, and some life be put into the deregulation and competition initiatives, where there has been considerable foot-dragging.

At the Department of Energy, progress has been very slow. I attach one of our gas notes to remind you of the issues in establishing a more competitive gas market. (Annex E)

At the Department of Agriculture, a good review has been written by the multi-disciplinary team who investigated aid and subsidy. It should now lead to decisions in the PESC round.

At the Department of Transport, the bus policy has gone down well, and the next phase is to move on to the British Airports Authority. Privatisation of British Airways could be a great success.

At BR, more progress is going to be needed on productivity, cash husbandry, service improvement and investment in those things nearest to the customer's heart, in order to deliver the Chairman's pledges.

New Directions

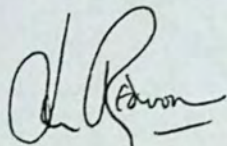
To liven up some of the old themes and to assert the importance of some of the newer ones, it might be possible

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to bring together in a colourful and human way the themes of clearing the wasteland, rebuilding the inner cities, using private enterprise to clean up Britain, creating a better labour market and going for jobs in a way which affects every local community.

If we were to work towards a British Enterprise Week for a date, say, in July 1986, we might be able to encourage a combination of municipal pride, the involvement of business in the community, the people involved in the urban programme, and voluntary groups to work towards a week of enterprise, technology and community improvements. The aims would be to provide motivation to get some things done, to provide a sense of challenge and then a sense of achievement, and to have a pleasant week in the summer.

Most of the money, enterprise and initiative should come from business and the local community itself. Some money from the Urban Programme and the DTI R&D and technology budget that is being spent anyway, could be related to the events. It could be an exhibition of the best of British technology and achievement, a trade fair, village fêtes, street parties and a drive for self-help and improvement of local communities, all rolled up into one. It could put the challenge back into the Enterprise Culture.



JOHN REDWOOD

PRIME MINISTERPRIVATE MONEY AND PARENTAL CHOICE

Keith Joseph's new proposals to increase the number and power of parent-governors are excellent. But we can increase parental power and choice further by providing a middle way between maintained and independent education in which parents pay the school directly for part of the cost. They would then gain more responsibility and more influence over the quality of their children's education.

Two ways of widening choice are the Assisted Places Scheme and Vouchers. But Assisted Places help only bright children, and Vouchers were abandoned last year after long debate. To find a genuine via media we need some version of the "grant-aided" principle, under which the state partially subsidises schools, and leaves them to raise the rest of their funds by charging modest fees, related to parents' capacity to pay.

We present three schemes for consideration, which Oliver Letwin has prepared with help from Stuart Sexton:

- (1) a proposal for new direct-grant technical schools;
- (2) a proposal enabling existing county schools to transfer from maintained to grant-aided status; and
- (3) a proposal to allow parents of children in a school under threat of closure access to limited grant to keep the school open.
(In response to your earlier criticism of this idea, we provide - in Annex B - evidence to show that this scheme would not cost more than closures.)

(1) Direct-Grant Technical Schools

Under Section 100(1)(b) of the 1944 Education Act, the Secretary of State has the power to "pay grants in respect of expenditure incurred or to be incurred for the purposes of educational services". This power could be used to establish one or more new direct-grant technical schools, without any need for further primary legislation.

These schools would be managed by independent charitable trusts, with governor-trustees. The governors would appoint the staff, have financial responsibility, and run the schools. A proportion of governors should be elected by parents, and the remainder would be appointed by the body founding the school.

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Having set a maximum number of pupils for each school, the Government would make a per capita grant. The rate of grant would be fixed at half the cost of providing a pupil with technical education under the TVEI. The schools would find the bulk of their remaining funds from fees and donations. The Government could add a subsidiary grant to give low-income parents some fee remission. There could be a sliding scale; at the bottom end, parents with incomes below £6,000 might pay only £300 p.a. of fees or even less. No child should receive an entirely free education.

The schools would select pupils according to their ability to benefit from technical education. It would be traditional to fix the age of selection at 11. But it might be politically astute to select instead at 14, since this would enable us to describe the scheme as an extension of the TVEI; it would also be easier to determine a child's suitability for technical education at this age.

The cost of creating such schools would be an addition to public expenditure as, in the short-term, LEAs would not be able to make matching savings. To keep the additional expenditure very low, it would be necessary to restrict the scheme to a few model establishments, which might serve as showpieces of technical education. David Young has suggested that one obvious location for such a model school would be London. Applications from LEAs wishing to participate in the TVEI have now been received by the MSC. The ILEA is one of the few LEAs to have made no application. The Government could announce that Londoners should not be left out, and that it proposed to reopen the direct-grant list. Applications from new or established charitable bodies wishing to set up a new technical school in inner London would be invited.

Setting up such a school might involve public capital expenditure up to a maximum of £7 million. (This capital cost would have to be written off, though the Government would retain ownership of the assets.) The Exchequer would have to find a further £1 million in running expenses once the school was fully established. A parent whose income exceeded £10,000 might expect to pay about £900 p.a. in fees. The capital cost could be lowered substantially if (a) the specification of building and equipment was less lavish and the land given free from public land banks; or (b) if an existing school subject to closure was adapted. (A table of the likely costs and

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(2) Transfers from Maintained to Grant-Aided Status

If the direct-grant list were reopened, it could be used for other purposes besides setting up technical schools.

The most radical option would be to offer grant-aid to any foundation wishing to set up an academically respectable school. But this would involve subsidising new independent schools that would have been created in any case, and also existing independent schools which could "abolish themselves" and reopen with a grant. This would lead to needlessly increased public expenditure. As our aim is not to subsidise independent schools, we should not pursue this option. But we could open the direct-grant list for those schools that are at present maintained. (To avoid difficulties with the Churches, it might be prudent to restrict the opportunity still further, allowing only county schools to join the list.)

In some places, such as Liverpool, the parents at a given school may almost unanimously agree that the policies of the LEA are disastrous, and may well be willing to pay fees in exchange for greater freedom of action. At present, these views are unlikely to be reflected by the governing body, since the governors of county schools are generally the creatures of the LEAs. Keith Joseph's new proposals will change this: a majority of the governors will be chosen by the parents.

Under this new regime, it would be practicable to give the governing bodies of county schools the right to apply to the Secretary of State for transfer to the direct-grant list. Before approving any such transfer, the Secretary of State would have to take into account:

1. Objections from the LEA.
2. Objections from parents at the school.
3. The likelihood that the governors could manage the school properly once the umbrella of the LEA was removed.
4. The effect on public expenditure.

Since such a transfer would cause the school to start charging fees, where none had been charged before, some parents might feel that they were being robbed. They would, of course, have the right to move

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object, as they do when closures are proposed. To minimise such problems, it might be wise to stipulate that no transfer to direct-grant status should be permitted if more than 5 per cent of the parents at the school objected in writing.

Where a transfer was approved, the school's position would be roughly the same as that of a direct-grant technical school. The governors would be reconstituted as trustees of an independent charitable trust who would appoint staff, take financial responsibility, and in every way run the school. The LEA would have to lease the buildings to the governing body at a peppercorn rent. The Government would make a per capita basic grant to the school, fixed at half of the national average cost for pupils of the relevant age; and this would be supplemented by a fee-remission grant for poor parents, arranged on a sliding scale, as in the case of the technical schools.

The position would be different from that of the technical schools in three ways:

1. Legislation would be required, setting out the Government's relation to the LEA in the case of a transfer.
2. Instead of increasing public expenditure, the scheme would certainly contain, and might possibly reduce it. (The Secretary of State would not approve a transfer unless he was satisfied that (i) the grant paid would be less than the funds provided by the LEA for the school; and (ii) the LEA would reduce its expenditure sufficiently to offset at least the net increase in Exchequer funding.)
3. The likelihood of some parents objecting, and of the transfer being baulked, would be very high: this option is therefore, in our view, much less likely to work than the direct-grant technical school.

(3) School Closures

When a school is scheduled for closure, particularly in a village community, many parents would like to find a way of preserving it. The Secretary of State has the power to accept or reject any LEA proposal to close a school. He could therefore make such approval conditional upon the LEA's willingness to grant-aid the school, if parents wished to reopen it as a charitable trust.

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We should ensure that this saved as much or more money than closure, by inserting the further condition that the Secretary of State would disallow any grant-aid where either the DES or the LEA could show that it would cost more than closure.

Where the LEA did offer grant-aid and this offer was taken up by the parents, the position of the school would be in most respects the same as that of non-technical direct-grant schools: the same status as a charitable trust, the same gubernatorial control of staff and educational policy, the same leasing of the school buildings from the LEA at a peppercorn rent, and the same need for primary legislation. The differences would be that:

1. The basic grant and supplementary fee-remission grant would come from the LEA, rather than the Government.
2. The Secretary of State would not have to worry about objections from parents since the scheme would be offering relief from closure, and would therefore constitute a pure gain for the parents - an offer that they could take or leave.
3. The basic grant paid would be fixed not at half the national average cost, but at half of the average cost of educating a pupil in the area covered by the LEA.
4. The school could be allowed to set its own fees, subject only to the approval of the Secretary of State.

I attach, in Annex B, examples which show that schools of this sort could both be viable for the parents and as cheap as closure for the LEA.

The examples overstate likely costs and understate likely revenues, and have been checked with DES officials and by the more numerate members of the Policy Unit.

The political advantages of a scheme of this sort are obvious: parents, particularly in rural areas, would be offered a way of avoiding school closures by taking a significant proportion of the cost of the school upon themselves. There is a reservoir of goodwill and willingness to volunteer and help in our village communities that should be tapped, and that could result in both

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We recommend that these three options be sent to the DES to further the policy of finding private money and a middle way of educational change. Schemes (1) and (3) are strong contenders. Scheme (2) may be more problematic, as the hurdles parents would have to leap to succeed could be too high.

John Rowood

DIRECT GRANT TECHNICAL SCHOOL: COSTS AND REVENUES

The Tables below set out the likely costs of establishing a direct grant technical school, and show how these costs might be met from grants and fees. The amounts given here are necessarily more speculative than they would be in the case of a non-technical school, since we have had only limited experience with technical education in recent years.

Table I is based on the assumption that all places in the school are taken up, and that parental incomes are distributed roughly as we have found them to be when operating the Assisted Places Scheme.

Table II is based on the pessimistic assumption that 20 per cent of the school places are not taken up, that all those who fail to take up places have well-off parents, (leaving the school with large numbers of parents entitled to fee-remission), and that the pupil/teacher ratio is only 15:1.

As the Tables show, the school would be comfortably viable after the first year of operation, and would need only modest increases in grant in the first year.

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PROJECT GRANT TECHNICAL SCHOOL: COSTS AND REVENUES

TABLE I: Assuming full take-up of places and expected distribution of parental incomes

1. Costs

	No. of Places	No. of Pupils	No. of Teachers	Cost of ⁽¹⁾ Teachers £	Non-Teaching Salaries ⁽²⁾ £	Other Running Costs £	Total Running Costs £	Capital Costs (Purchase of Bldg, + Equipment) (3) £		
								Lavish	Economy	Refurbishment
Yr.1								[5,000,000	4,000,000	3,000,000]
Yr.2	1,000	250	15	200,000	55,000	200,000	455,000	[500,000	250,000	187,500]
Yr.3	1,000	500	25	300,000	55,000	350,000	705,000	[500,000	250,000	187,500]
Yr.4	1,000	750	40	480,000	100,000	500,000	1,080,000	[500,000	250,000	187,500]
Yr.5	1,000	1,000	50	600,000	100,000	650,000	1,350,000	[500,000	250,000	187,500]

2. Revenues

	No. of Places	No. of Pupils	Basic Grant per capita ⁽⁴⁾ £	Total Basic Grant £	Fee Remission Grant ⁽⁵⁾ £	Total Exchequer Grant £	Full Fee Charged £	Fee at Income £8,000 £	Fee at Income £6,000 £	Total Fee Income £	Total Revenue £	Surplus/Defic- on Running Costs £
Yr.1												
Yr.2	1,000	250	850	212,500	37,500	250,000	900	600	300	180,000	430,000	(25,000)
Yr.3	1,000	500	850	425,000	75,000	500,000	900	600	300	360,000	860,000	155,000
Yr.4	1,000	750	850	637,500	112,500	750,000	900	600	300	540,000	1,290,000	210,000
Yr.5	1,000	1,000	850	850,000	150,000	1,000,000	900	600	300	720,000	1,720,000	370,000

(See explanatory notes overleaf)

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ANNEX A (cont.)

NOTES TO TABLE I

- (1) This assumes that the average teacher costs £12,000, but that the senior teachers are recruited in the first years.
- (2) The figure for non-teaching salaries assumes: (i) in the first 2 years, 3 cleaners @ £5,000 each plus 4 technicians @ £10,000 each; and (ii) in the next 2 years, 3 cleaners @ £5,000 each plus 8 technicians @ £10,500 each.
- (3) We estimate that each pupil will need 55 sq.ft. of space (40 sq.ft. for teacher, 7.5 for dining, staff rooms etc, and 7.5 for assembly hall etc). This estimate is based on figures from a major public school in the London area which does not make a habit of overcrowding its classrooms.

The cost of a site in a residential area of London should be roughly £100,000. (For a school of 55,000 sq.ft. on five floors, we would need 11,000 sq.ft. and another 10,000 sq.ft. for the grounds - amounting to 21,000 sq.ft., or half an acre - and land in residential areas of central London costs about £200,000 per acre.)

We are told that the building itself would cost c.£3 million. This includes the cost of architects, engineer, quantity surveyors and interest charges. (Costs of refurbishing an old building are typically 20% to 30% lower.)

The total cost of land and buildings should therefore be c.£3.1 million. To this, we might add something under £2 million for initial technical equipment - a generous allowance by any standards. And we assume that a further £0.5 million will be spent each year on additional equipment, as the number of pupils rises.

We estimate that a school on somewhat less lavish lines could be constructed as follows:

Site + Building	£3.0 million
Initial Equipment	£1.0 million
Additional Equipment	£1.0 million
Total	<u>£5.0 million</u>

and we believe that a school could be constructed by refurbishing existing property outside the expensive part of central London at something like the following costs:

Site + Building	£2.5 million
Initial Equipment	£0.5 million
Additional Equipment	£0.75 million
Total	<u>£3.75 million</u>

- (4) The basic grant per capita = 50% of the average cost of TVEI. (The average full recoupment cost for normal 14-18 education is c.£1,200 per pupil; the TVEI costs an average of £500 more than this.)
- (5) The sum allocated for fee remission grant assumes that 20% of parents earn £8,000, for each of whom the school receives an additional grant of £250; and that a further 20% earn £6,000, for each of whom the school receives an additional £500. (These assumptions are based on our experience of the Assisted Places Scheme.)

DIPLOMA GRANT TECHNICAL SCHOOL: COSTS AND REVENUES

TABLE II: Assuming only 80% take-up of places, a high proportion of poorer parents, and pupil/teacher ratio of 15:1 (1)

1. Costs

	No. of Places	No. of Pupils ⁽²⁾	No. of Teachers ⁽³⁾	Cost of Teachers £	Non-Teaching Salaries £	Other Running Costs ⁽⁴⁾ £	Total Running Costs £	Capital Costs (Purchase of Bldg, + Equipment) £		
								Lavish	Economy	Refurbishment
Yr.1								[5,000,000	4,000,000	3,000,000]
Yr.2	1,000	200	13	180,000	55,000	150,000	385,000	[500,000	250,000	187,500]
Yr.3	1,000	400	26	312,000	55,000	300,000	667,000	[500,000	250,000	187,500]
Yr.4	1,000	600	40	480,000	100,000	400,000	980,000	[500,000	250,000	187,500]
Yr.5	1,000	800	53	636,000	100,000	500,000	1,236,000	[500,000	250,000	187,500]

2. Revenues

	No. of Places	No. of Pupils	Basic Grant per capita £	Total Basic Grant £	Fee Remission Grant (5) £	Total Exchequer Grant £	Full Fee Charged £	Fee at Income £8,000 £	Fee at Income £6,000 £	Total Fee Income ⁽⁶⁾ £	Total Revenue £	Running Surplus (or Deficit) £
Yr.1												
Yr.2	1,000	200	850	170,000	37,500	207,500	900	600	300	135,000	342,500	(42,500)
Yr.3	1,000	400	850	340,000	75,000	415,000	900	600	300	270,000	685,000	18,000
Yr.4	1,000	600	850	510,000	112,000	622,500	900	600	300	405,000	1,027,500	47,500
Yr.5	1,000	800	850	680,000	150,000	830,000	900	600	300	540,000	1,370,000	134,000

(See explanatory notes overleaf)

NOTES TO TABLE II

- (1) All other assumptions are as in Table I, except where stated otherwise.
- (2) Number of pupils is reduced by 20%.
- (3) Pupil/teacher ratio is c.15:1.
- (4) These costs are considerably reduced, since the smaller number of pupils will use less electricity, spare parts, materials, etc.
- (5) The Fee Remission Grant remains as in Table I, because the number of poor pupils remains as high.
- (6) Total fees are considerably reduced because (i) the number of pupils has decreased; and (ii) the proportion of pupils paying reduced fees has increased.

COMPARISON OF SAVINGS FROM SCHOOL CLOSURES AND GRANT-AID

Area X: Country District with 4 Primary Schools

Present situation: As a result of falling rolls, the district's 4 primary schools have, between them, 250 surplus places; the average cost of educating a pupil in this area has consequently risen to £814 p.a., compared with an average cost of £700 p.a. in the LEA as a whole. The position is:

School	No.of Pupils	No.of Teachers	Pupil: Teacher Ratio	No.of Places	No.of Surplus Places	Cost per Pupil £	Total cost £
A	250	12	20.8:1	300	50	725	181,250
B	150	7	21.4:1	200	50	900	135,000
C	25	1.5	16.7:1	100	75	1,000	25,000
D	25	1.5	16.7:1	50	25	1,000	25,000
	<u>450</u>	<u>22</u>	Av.20.5:1	<u>650</u>	<u>200</u>	Av.814	<u>366,250</u>

LEA proposal: The LEA is alarmed by the number of surplus places, and believes that small village schools are educationally damaging. It therefore proposes to close schools C and D, which have a small number of pupils, large numbers of surplus places, and high unit costs. The proposal is to move the 25 children in school C to school A, and the 25 in school D to school B. The two part-time teachers in C and D are to be made redundant; the full-timers are to be transferred to A and B respectively: this minimises redundancy costs, which can in any case be set against receipts from sale or lease of the redundant premises. The result of the move is to eliminate 150 surplus places and to reduce average unit costs by £41 p.a. There are, however, considerable additional transport costs - another 25p per child per day: this amounts to £50.00 per child per school year, or a total extra cost for the 50 displaced children of £2,500p.a. The total saving brought about by the closures is therefore only £15,500 p.a. The LEA's costs will be:

School	No.of Pupils	No.of Teachers	Pupil: Teacher Ratio	No.of Places	No.of Surplus Places	Cost per Pupil £	Additional Tspt.Costs £	Total Cost £
A	275	13	21.2:1	300	25	725	1,250	200,625
B	175	8	21.9:1	200	25	850	1,250	150,000
C								
D								
	<u>450</u>	<u>21</u>	Av.21.4:1	<u>500</u>	<u>50</u>	Av.774	<u>2,500</u>	<u>350,625</u>

Grant-aided option:

School D is not particularly popular; most parents do not object to closure. But 20 of the parents at C do like their school, and are happy to pay something to keep it open. Ten of the parents from D decide to join them. Under the new grant-aided scheme, they could set up as an independent trust, and receive half the LEA's average cost per child as a basic grant, together with a fee-remission grant for poor children, and lease of the buildings at a peppercorn rent. But the LEA is not obliged, or indeed allowed, to offer this grant unless it is clear that the savings will at least equal those accruing from closure.

In the present case, the LEA's average cost per child is £700; the basic grant is therefore fixed at £350 per child. To this must be added a fee-remission grant of, say, £100 per child for the 5 children whose parents have incomes of between £10,000 and £8,000, and £200 per child for those 5 whose parents have incomes below £8,000. [These figures are based upon reasonable assumptions about the level of parental income, which are derived from our experience of the Assisted Places Scheme.] The LEA also loses unit savings from failing to fill some surplus places in A and B. But there are compensating savings on transport. The LEA would, in the short term, lose from its failure to lease or sell C's premises at commercial rates; but it would retain title to the assets. And the LEA would gain from the absence of redundancy payments, due to C's remaining open. It should also be remembered that the continued existence of school C under the scheme covers the LEA should there be any expansion of the village in future years.

The LEA's running costs might be as follows:

School	No. of Pupils	No. of Teachers	Pupil: Teacher Ratio	No. of Places	No. of Surplus Places	Cost to LEA per Pupil (£)	Additional Tspt. Costs (£)	Total Cost (£)
A	255	12	21:1	300	45	725	250 (4)	185,125
B	165	8	21:1	200	35	850	750 (4)	141,000
C	30 ⁽¹⁾	2 ⁽²⁾	15:1	100	70	400 ⁽³⁾		12,000
D								
	450	22	Av. 20.5:1	600	150	Av. 749	1,000	338,125

Notes:

- (1) = 20 from C + 10 from D.
 (2) = 1 full-time from C + 1 part-time from C + 1 part-time from D.
 (3) = £350 per child basic grant + £50 average of remission grant spread over 30 pupils. (The remission grant figure assumes that 5 parents have incomes of £8,000 and qualify for £100 remission; while 5 have incomes of £6,000 or below, and qualify for £200 remission.
 (4) = £50.00 per child for 5 remaining children from C, going to A; and for 15 remaining children from D, going to B.

As the table shows, the total cost to the LEA of the district's schools will be £12,500 less under the grant-aided scheme than under the closure scheme.

But will the new grant-aided school be financially viable? Its annual costs might be:

	£
1 full-time teacher (salary and employment costs)	10,000
2 half-time teachers	10,000
1 half-time caretaker	3,000
Heat, lights, repairs, books, equipment	5,000
	<u>£28,000</u>

The receipts might be:

Basic grant from LEA, @ £350 per capita	10,500
Fee remission grant for 10 poor people @ £100 for those with incomes bet. £6,000 & £10,000 and £200 for those with incomes under £6,000	1,500
Fees of £700 from 20 pupils whose parents have over £10,000 p.a.	14,000
Fees of £500 from 5 pupils whose parents have £8,000 p.a.	2,500
Fees of £300 from 5 pupils whose parents have under £6,000 p.a.	1,500
	<u>£30,000</u>

In other words, by charging its richer parents fees of under £15 per week, and by remitting over half of this for its poorest parents, the school could comfortably cover all its expenses.

Indeed, as the following table shows, the school could cover its costs even if half of its pupils' parents had incomes below £10,000, and even if two-thirds of these had incomes below £6,000. (The table also shows that such a school would cost the LEA a total of only £1,000 p.a. more in fee remission grant, and would therefore still be cheaper than the closure option.) The revenue of the school would be:

	£
Basic grant	10,500
Fee remission grant	2,500 (vs. £1,500 above)
Fees of £700 from 15 pupils (income £10,000)	10,500
Fees of £500 from 5 pupils (income of £8,000)	2,500
Fees of £300 for 10 pupils (income under £6,000)	3,000
	<u>£29,000</u>

This example is not arbitrary or wildly optimistic. It is based upon plausible assumptions about costs. It shows not that life would be easy for such a school, but that some schools in this position could very probably be grant-aided, and could survive, whilst both saving the LEA as much as closure, and charging extremely reasonable fees.

SECRETARY OF STATE

17 July 1984

PENSIONS

The Committee is beginning to worry about the implications of funding more pensions in the private sector as opposed to a pay-as-you-go public sector state earnings-related pension.

The fears seem to be:

1. The economy could not absorb the extra burden of savings which funding would represent.
2. People would object to having to pay more to fund their own pension scheme, rather than making modest contributions now for a pay-as-you-go scheme which will become very expensive at some point in the future.
3. Concern that the private sector could not deliver the level of benefit at reasonable cost which the public sector is thought to be able to deliver.

Savings Flows

The current yield on an index-linked government security, maturing in 22 years' time, is 3.8 per cent real; and for

one maturing in 35 years' time, is 3.6 per cent. A 6-year stock has a real return of 5.5 per cent. Given this, how can we believe either that the economy is awash with savings it cannot use, or that all the private sector pension funding calculations should be based on the assumption of 2.5 per cent real return? By taking no risks at all, private individuals could immediately pocket a real return substantially greater than that set out in the Government Actuary's calculations. Our slogan should be "Better savings now than taxes later".

All the evidence is that the economy is short of savings; there are numerous profitable investment opportunities which could absorb the money, and the savings ratio has fallen dramatically. Much of the savings generated in the economy over the last 40 years has been successfully channelled into a major extension of home-ownership. If we want a big increase in individual ownership of industrial and commercial activity in this country, then it requires substantial savings to be channelled into share-ownership. Productive assets will be transferred from the public sector into private hands.

The very same people who are arguing that they cannot see how the extra savings flow would be absorbed in the economy, often urge that the financial markets cannot withstand the rigours of a large privatisation programme which will

include major chunks of the telecommunications and energy industries - which, by any standards, are large concerns!

The financial markets are now international. If we ever did become stuck for profitable investments here, we can add to our substantial overseas holdings.

The argument that these policies could lead to too great a concentration of wealth in institutional hands is a more serious one. However, to keep the liabilities in public ownership seems even less desirable than aggregating them in the institutions. At least people and companies have some power over the institutions: they can take their business elsewhere - and frequently do if they are unhappy with the service and returns being generated.

The main assault on institutional power will come from a growing personalisation of investment, pensions and other financial activity. The introduction of personal pensions, the move towards fairer tax treatment between institutional and private saving, and the encouragement of a revolution in the City which will lead to a better and cheaper service for the small investor, should encourage the growth of private control of commercial and industrial wealth. Institutional ownership is an unsatisfactory halfway house. It leaves open the possibility of major nationalisation through the back door if a strong Left-wing government is ever elected, whilst not delivering enough personal choice. Pensions and

investment policy should therefore march onwards towards more individuals owning their own assets for retirement.

The Political Problem of the Cost of Funding

It is claimed that the individual's contributions will rise on transfer from SERPS to a private scheme. This, where true, shows how the state pension scheme is based on unsound foundations. Everyone accepts that by 2010, SERPS will cost an extra £10,000 million or thereabouts of gross public spending, at 1981-82 earning levels. Contribution rates will have to rise quite sharply in order to meet this, and at that point there will be a strong political temptation to water down the payments out of the Scheme as well as to increase taxation.

SERPS is like North Sea oil in reverse. The discovery of North Sea oil gave us another £7,000 million or £8,000 million a year to spend from taxes which we did not have before. SERPS means in 20 years' time either cutting other public spending programmes by a similar amount, or an increase in taxation.

As that happens so far into the future, is it any concern of present-day politicians? Why do anything difficult now? Something should be done as the present political situation requires it. Conservatives believe that claims on future

resources are better met by private freely chosen contracts than by taxes and administrative fiat.

The welfare Inquiries were set up because of the growing restlessness of individuals with the present system. People believe that the current system is messy, untidy and too expensive. They see that it does not fit with the general objectives of this Government, and regard the way in which this Government scythes and sidles its way through the welfare jungle as an important test of its purpose and its political skills. There is a willingness to be told that the overall welfare system is explosively expensive in 15 or 20 years' time, and a willingness to be guided in new directions.

Pensions offers one of the best hopes for setting out fully the importance of the contributory principle, and persuading people that they will be better off choosing the kind of scheme they want for their future, with the insurance and pension clauses tailored to their own requirements. They can shop around for the cheapest and best way of buying it. In an era of very high real returns on investments, and against the background of private sector occupational schemes usually offering a better range of benefits than state schemes, it should be possible to make private pension provision an attractive and enticing opportunity for people.

The question of cost will be confused by different levels of benefit and by the creation of tangible savings. Some employers will want to ease the transition by making a contribution, and this will be part of the normal bargaining process. The contracted-out rebate should be available. Many workers will or do see the movement into a pension scheme as a status symbol, a sign that they are making advances at their place of work. The Government's task should be to open up the opportunity for the 11.35 million unfunded people to find an approachable, clear and relatively cheap scheme which they will start to build up. If it can be a personal one, so much the better, as it will come nearer to meeting the requirements outlined above.

The evidence of the US is that private schemes can deliver more for less. They can do so here if the economy performs well and investment returns are good. If all goes badly, then the level of pensions will adjust automatically as investment values fail to live up to all expectations. The Government escapes having to make difficult and unpopular decisions in such circumstances.

What can the Government do?

There are two ways of tackling the problem, and both may be needed in whole or part. As SERPS involves paying too little now for something which will prove to be too expensive in the future, the terms of the existing State

Earnings-Related Scheme could be worsened. The abolition of the best 20-year rule would be one obvious way of doing it. The best option would be complete abolition; this could be coupled with a compulsory private sector pension contribution to ease worried hearts a little.

If the Government perseveres with some kind of reduced State Earnings-Related Pension Scheme, the terms relating to contracting-out need to be made much more attractive and much simpler. People should be able to contract-out on a money purchase basis for an institutional as well as a personal pension plan. The paperwork has to be simplified to qualify for contracting-out rebates. The differential contribution between contracted-in and contracted-out has to be increased, and the calculation worked out in such a way that more provision is being made against future liabilities under SERPS - a kind of notional future funding. Above all, we should be very suspicious of GAD calculations which, whilst accurately reflecting the current rules and regulations for the computations in the scheme, represent a major skewing of the costs and benefits between generations and different types of people.

SERPS is the best example of fool's gold the Government has yet devised, bringing in enough money at the moment, leading people to believe they are paying enough for their future pension, when no provision is being made for major future liabilities, as it is a pay-as-you-go system.

Conclusion

We should not be worried about:

- (a) the alleged difficulty of the market absorbing the money;
- (b) the possibility of the institutions strangling it all - the drift of policy is to reduce their power in the market place;
- (c) owning up to the lack of arithmetical common sense in the current financing system.

To fail to do any of these three things will be to invite the strong criticism that the Pensions Inquiry was, after all, a very damp firework let off in a particularly bad year, and the Government will stand condemned for failing to give a display of pyrotechnics that would enliven its whole show.

JOHN REDWOOD

CONFIDENTIAL

Annex D.

C

3 August 1984

PRIME MINISTER

JOBS: SEPTEMBER SEMINAR

Unemployment is still the most important political issue. We need to win the argument about its causes and do something about it. The September Seminar should be a vehicle for carrying forward both the argument and the action.

Making the argument

The first step should be a Green Paper on the labour market. This paper should range widely, covering employment legislation, National Insurance and tax matters, health and safety, local authority licensing and regulation, and social benefits. It should compare Britain's performance with that of other countries, and reiterate the point that our difficulties are an expanding labour force and a constrained labour market.

The paper should also knock down the argument that lasting jobs will be created by a new expansion of capital investment. Last year's White Paper attempted to show that the Government had not cut capital heavily, but scepticism was expressed by those reviewing the evidence, and little was made of the argument. People still see all capital

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investment as good, regardless of its usefulness, and wrongly believe it always generates many jobs. The Treasury model can show that additional public investment in the long run destroys many more jobs than it creates. Years of heavy investment in BSC, BL, British Shipbuilders and NCB have not protected jobs in those industries, and have damaged other sections of the economy through taxation.

The Department of Employment could be asked to produce a draft of such a paper for consideration at the Seminar.

Taking steps to improve matters

The Green Paper has to be followed up with action to tackle the worst features of our labour market. Tom King could bring forward a package of measures to amend or abolish Employment Protection legislation. The Chancellor's proposals on tax thresholds can be taken much further to lift a large number of new lower-paid jobs out of the tax net altogether, thereby simplifying the life of the employer. The DoE should be asked to repeal a series of local authority licensing and regulatory powers.

As an immediate measure, Passport for a Job should be carried into effect and should be as wide-ranging as possible.

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Finally, the Government needs to take a tough look at its efforts to create jobs. Recent work which is still under wraps in the Treasury, using their model, shows that Special Employment Measures, Regional Aid etc can, after very few years, destroy jobs rather than create them. In each case, the effect in the first year is to create a few jobs. But the effect tails off very quickly, especially for dear schemes like Regional Aid, because the expenditure drives up interest and/or inflation rates. Within 3 or 4 years, the economy has fewer jobs as a result of these "employment-creating" measures than it would have done if no action had been taken.

The Treasury figures point to a time bomb ticking away under this Government. The more these measures are heaped upon the economy, the more drugged and unresponsive the economy will become, and the more jobs will be lost in the run-up to the next Election.

The regional grants position illustrates the point vividly. If the policy was working, you would by now expect to see a renaissance on Merseyside, Teeside and Tyneside at the expense of the South East, but all the evidence points in the opposite direction. The winning strategy is to lower public expenditure, thereby lowering pressure on the borrowing requirement and on financial markets, and on individuals through the tax system. This can be done in a bold and imaginative way by further reducing Regional Aid,

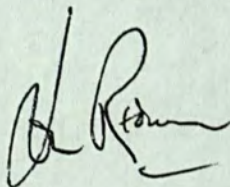
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slashing capital grants to agriculture, and concentrating the Department of Employment monies on the cheapest and least objectionable schemes - like VPP, Community Programme, Enterprise Allowance, etc. - A Green Paper on the lines suggested would prepare the public for such moves.

We recommend that:

1. Department of Employment should be asked to produce a draft Green Paper on Jobs for the September Seminar. Policy Unit could lend a hand.
2. The Seminar should also consider:
 - moves to repeal/amend Employment Protection legislation;
 - a deregulation action plan;
 - a "Passport for a Job" scheme;
 - a plan to reallocate monies on cheaper "job-creation" measures;
 - reduction of Regional Aid.



JOHN REDWOOD

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PRIME MINISTER

13 June 1984

GAS INDUSTRY PRIVATISATION

Peter Walker's latest paper sets out a range of options in addition to his preferred course of denationalising BGC lock, stock and barrel.

The meeting on Thursday should decide whether you wish to proceed with Peter Walker's preferred scheme of denationalising a monopoly, or whether you should proceed with splitting up the different functions of BGC and privatising them, starting with gas production, retail and servicing where competition is already strong.

Having seen the arguments between the Treasury and the Department of Energy, we still recommend the latter course.

Peter Walker's four points

We would not be opening up a "second front" with BGC for some time. A decision now would require several weeks of preliminary work on splitting the Corporation and obtaining the agreement of E(A). The miners' strike will not go on indefinitely. We should also remember that the unions may well oppose the Peter Walker scheme of complete denationalisation, even though the existing management would be happier.

There should be gas servicing and safety cover available to customers. However, a decision to denationalise retailing and customer servicing does not mean that this cover would be withdrawn or unavailable. Private providers, as in the water industry for maintaining the domestic water system, would emerge and compete with the denationalised business. BGC could retain responsibility for safety of mains and trunks.

We should not worry about the alleged difficulty of finding takers for the peripheral parts of the business. Several major energy companies and a large number of individual and corporate investors would be interested in taking a stake in offshore gas assets. The only specialised feature which limits their current appeal is the price-rigging which goes on in the marketplace. As one of the main aims of the gas-pricing policy is to establish a market price in gas, this particular problem will disappear. Gas servicing as well could be attractive. Companies like Dynorod and Hat Group (plastering and other building trades) have solved the problems of running labour-intensive service businesses, and make good money out of them.

LAUABJ

There is a risk that unions, management, and even customer interests could combine to resist change, and mobilise opinion against it. However, we should - with the piecemeal denationalisation approach - be able to win over the customer interests. If customer retailing and servicing is tackled first, there will be a better and more wide-ranging service at a lower price, with more choice. Consumer groups won't oppose this; I have even heard representatives from the National Consumer Council argue in favour of such changes. The unions will resist it, but they will probably resist any type of denationalisation. The management may well be unhappy about this suggested route, but that would argue for making selected changes to the Board so that it contains people who are enthusiastic about the policy.

Conclusion

It is recommended that the meeting agree to:

- (a) privatisation by splitting the functions off;
- (b) a tight timetable for bringing the first proposals to E(A) which should include sale of the retail business and the gas production interests.
- (c) The pipeline system and regional distribution companies could be considered later, once a market in gas has been established, and other companies are using the pipeline as a common carrier.

JOHN REDWOOD

SECRET

- 3 -

ANNEX

1. The detailed businesses reviewed in Peter Walker's paper

Appliance retailing. Peter Walker suggests that any buyer will be an asset-stripper. He is worried about the comprehensive nature of the service being jeopardised by the change of ownership; yet his paper indicates that BGC Board policy is to close down a large number of marginal outlets, and to concentrate on the larger outlets, where the prime activity is appliance retailing.

A private sector takeover and new senior management in BGC's retail business could transform it. The showroom chain could be dramatically improved, with the goods being better displayed. It could be made profitable whilst the price of goods could be reduced, for BGC retail at the moment manages to combine quite high prices with low profitability. BGC service could retain counters and facilities in the former BGC retail outlets, but it would also be free to negotiate similar arrangements with other retailers. For example, leading department stores and the Post Office are looking for more franchisees, and might be very interested in a BGC customer service point. Similarly, the Post Office is interested in expanding its counter business.

We recommend requiring BGC to end retailing and to sell its existing assets to the private sector. Of the other options, the least objectionable is the requirement to form retailing into separate companies and sell a majority interest to the private sector. Even with this scheme, there is the potential for cross-subsidy between the businesses in BGC and for some abuse of monopoly power. The idea that BGC should only sell a minority interest in retailing would achieve practically nothing, and leaving it for BGC to sort out their business under option (d) begs the question about why they haven't improved it years ago, both to give their customers a better deal, and to make some profit.

2. Installation and contracting. The private sector can handle installation, servicing and contracting work. It does so in many other areas - eg electrical installation and contracting, and in the water industry.

It is desirable to transfer this work to a greater extent to the private sector, where the work force is likely to be better motivated and better organised, and where the quality of customer service is likely to rise. Customers find it annoying that when they wish to have their facilities maintained or repaired, they can't even be told roughly what time of day the fitter is likely to call; and often when the fitter arrives, he is only able to do one part of the work - needing to call on a private sector plumber, for example, when fixing a central heating system.

Concern about safety could be dealt with by:

- (a) leaving it to BGC to tackle the safety of anything on the street side of the customer's meter; and
- (b) considering registration of qualified fitters who would be capable of doing the work in the private sector.

The strategic options set out are not exciting. There are two that are worth pursuing. One is option (a), to include it with appliance retailing. Another option - which we recommend - would be the creation of a separate company or companies to handle servicing, and the sale of these companies to the private sector.

3. Petroleum exploration and production. In the context of a policy to have a market in gas, the sale of the gas assets would be both easy and desirable. It helps competition by breaking BGC's stranglehold over gas from the North Sea to the customer. It helps the general policy of disengagement by the Department of Energy and BGC and it would raise substantial money for the Treasury. It might also assist in encouraging separate routing of gas by mechanisms other than the BGC pipelines, to develop more competition in the gas supply business which, to date, has failed to appear.

Option (a), a requirement to dispose of all its licence interests, would arouse antagonism from the existing management. BGC could get a realistic price for the gas. There is a lively market in gas and oil interests, and a fair market price could be arrived at through an offer for sale or an auction. The best price of all would probably be realised by selling the assets to more than one party.

There is little attraction in putting the assets into a company in which a majority of shares was retained by BGC. There would still be the same close linkage between the policy on exploitation of gas and the sale to customers, and there would still be the same cross-subsidisation. It would still be difficult to get accurate figures about the cost-effectiveness and value for money provided by the different elements of BGC's business, which is the core of the current problem.

Merging the assets with an existing oil company or oil companies is a variant of sale, and this should be left open if the general route to selling the oil assets is agreed, to be decided at a later stage when the bidding becomes clearer, and approaches can be made to potentially interested parties.

SECRET

- 5 -

The asset valuation of £1.1 billion seems to be a distinct under-estimate of their worth. The true answer could well be nearer to £2 billion. However, it is no bad thing to start off with a low estimate valuation, as the BGC style of resisting these changes is always to hold out the prospect of a very large figure and then claim, when a smaller figure is realised, that the public has been cheated.

JOHN REDWOOD

LAUABJ

SECRET

ANNEX C

THE PESC ROUND

The Report of the Public Expenditure Survey Committee reveals additional bids of some £2.3 billion, offset by only £0.5 billion of identified savings.

Many of the additional bids should be resisted on policy grounds, or offsetting savings should be sought elsewhere.

Eg:

MOD - £137 million for expensive pay awards.

DTI - £100 million extra for Rolls Royce and the aviation projects.

DTI - £30 million for the shipbuilding industry.

DTI - £37 million for regional grants and selective assistance.

Employment - £15 million for administration and salaries.

DoE - £200 million for additional improvement and repair of houses.

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SECRET

PSA - an additional £55 million for major new works, computerisation and maintenance.

DoE - £50 million for local environmental services.

DES - £30 million for additional local authority capital spending.

DHSS - £320 million additional money, largely for increases in demand-led benefits.

These can be disallowed or paid for by offsetting efficiency savings.

Once the larger and easier additional bids have been resisted, it is then necessary to seek to identify policy and efficiency savings. One of the most staggering figures in the Report of Survey is that the total provision for departmental running costs (largely administrative overhead) is £15.7 billion. This has risen by 63.4 per cent between 1979/80 and 1984/5, compared with only 54 per cent for price inflation. If the MOD - where the figures are distorted by the Falklands - is excluded, the overhead has risen by 66.9 per cent. This is against the background of reductions in Civil Service manpower and a concerted drive to contain and reduce the costs of administration. There should be a concerted onslaught, using FMI management techniques, to deliver some decent savings in the forthcoming year.

SECRET

There are several major policy areas where the review work that has been undertaken should be followed up, and savings delivered.

An acceptable package of reductions in domestic support for agriculture could deliver £280 million.

Sorting out the defence procurement operation could deliver savings of, say, £400 million in the first full year, which is only 5 per cent of the total purchases during the year - a relatively modest target, given the present bad buying.

At the DHSS, improved control over spare land, accommodation and the drug bill, could deliver up a further £300 million of savings.

It should be possible to reduce the territorial programmes by around £100 million with a little cheese-paring, given the generous over-provision in Scotland compared with anywhere else, and the expensive industrial aid programmes in both Northern Ireland and Wales.

The DTI programmes could be reduced by £300 million through a forthright attack on Regional Aid, and special assistance to industry could be reduced by an additional £100 million.

SECRET

Re-emphasising the cheap and effective employment-creation programmes at the expense of the dearer ones between the Department of Employment and DTI budgets, could also reduce expenditure by another £200 million.

The nationalised industries will be using the miners' strike as an excuse for upping their EFLs. This should be resisted strenuously, and they should be forced to have a renewed attack upon their working capital requirements, upon the search for new areas of profitable activity, and a further increase in the sales programme of parts of the business. We might be able to pencil in an additional £300 million of savings and extra asset sales from the total nationalised industry area.

(Total: £2 billion)

This shopping list provides examples of targets where policy work over the last year, and the known intentions of this Government, could lead to reduced expenditure levels. It is vital in this round that some of these policy initiatives are followed up and the savings delivered, in order to produce the lower interest rates and lower borrowing and lower taxes we need.

SECRET



FILE

4

(LAMABU)

10 DOWNING STREET

From the Private Secretary

27 July, 1984

The Prime Minister would like the Secretary of State for Social Services to join the meeting on Industry and Employment which has been scheduled for the afternoon of 13 September. As I explained on the telephone, there have been a number of such seminars where issues are discussed freely outside the normal run of Government business. The style of the meetings has been similar to that of the seminars on Health and Social Security. The last meeting in May, concentrated heavily on the prospect for jobs as will the one in September. Your Secretary of State will have an interest reflecting the impact of his policies on the poverty and unemployment traps. To bring him into the picture he might like to look at the papers prepared by the Secretary of State for Employment for the May meeting plus my letter of 29 May to which was attached a check-list of conclusions and points for further action. I draw your attention to the handling instructions in that letter.

The agenda for 13 September is not yet finalised though it will certainly include the paper referred to at (x) of the check-list.

I am copying this letter to Richard Hatfield (Cabinet Office).

(A. Turnbull)

S. Godber, Esq.,
Department of Health and Social Security.



B/C: Mr. Redwood

3

10 DOWNING STREET

From the Private Secretary

9 July, 1984

INDUSTRY AND EMPLOYMENT SEMINAR

The Prime Minister wishes to hold a meeting to discuss industrial and employment questions on the afternoon of 13 September, starting at 1430 hours. The agenda at this stage is provisional but the Prime Minister wishes to concentrate the discussion on the prospects for jobs. This will involve picking up the discussion of the papers tabled at the May meeting plus examination of the papers commissioned at that meeting, in particular that on the cost-effectiveness of various forms of Government spending to promote employment. She may also wish to discuss de-regulation, depending on how much progress is made at the meeting on the administrative and legislative burdens on small firms fixed for 24 July, and at the meeting of E(CP) which is scheduled to take place before the Recess to discuss ways of strengthening the forces of competition in the economy.

The Prime Minister would very much welcome any papers which Ministers wish to table putting forward ideas and suggestions on ways in which more jobs can be created.

I am copying this letter to Callum McCarthy (Department of Trade and Industry), Elizabeth Hodgkinson (Department of Education and Science), David Normington (Department of Employment), John Ballard (Department of the Environment), Michael Reidy (Department of Energy), Alex Galloway (Chancellor of the Duchy of Lancaster's Office), David Young (Manpower Services Commission) and to Richard Hatfield (Cabinet Office). I would be grateful if this letter could be retained within the Private Offices and any work in connection with the meeting be commissioned without reference to it.

(A. Turnbull)

D. Peretz, Esq.,
HM Treasury.

(2)

PRIME MINISTERINDUSTRIAL SPONSORSHIP OF INDIVIDUAL STUDENTS

You may remember that at the meeting on Industry and Employment last December, Sir Keith Joseph raised the need to increase the extent of industrial sponsorship of students in universities and polytechnics. He was worried that the level of the disregard, i.e. the amount of money a student can receive from other sources before his grant is abated, would be a disincentive. You will be pleased to know that he has reached agreement with the Chief Secretary to raise this from £980 to £1,600.

Sir Keith has also proposed an extension of the rules on tax relief so that a company can set against tax the costs of any students it sponsors. At present only those of course relating directly to the company's trade are eligible. The Chief Secretary is resisting this because it would allow the cost of sponsorship to be offset not simply sponsorship of students in subjects where there are shortages such as electrical engineering and computer science but anywhere including sponsorship for sport or the arts. The Chief Secretary believes that there are already adequate reliefs and that the solution lies in encouraging companies to take full advantage of them and in increasing their contribution to the training of engineers.

Sir Keith may return to the charge on this. I will report on progress.

21 June, 1984



Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Sir Keith Joseph Bt MP
Secretary of State for Education & Science
Department of Education & Science
Elizabeth House
York Road
LONDON
SE1 7PH

13 June 1984

Dear Secretary of State,

INDUSTRIAL SPONSORSHIP OF INDIVIDUAL STUDENTS

Thank you for your letter of 17 May to Nigel Lawson.

You make two proposals for increasing industrial sponsorship of students. The first is for an increase in the level of disregard. I am generally content with this, but I think it would be worth double-checking the cost implications: my officials will be in touch with yours about the details. I understand that your student awards vote is already under pressure in future years and it will be important to do nothing which adds to this.

Your second proposal is for an extension of the rules on tax relief so that a company can set against tax the costs of a student sponsored to do virtually any course. At present only those courses relating directly to the company's trade are eligible. For three reasons, I cannot accept this idea. First, I have seen no evidence of a shortage of graduates trained in finance, marketing, or other more general disciplines. Secondly, if only 10,000 students are sponsored at present, then it seems likely that companies are not making use of the relief already available to them. And if they are not sponsoring students on courses directly related to the trade, I can see no reason why they should want to sponsor students on courses which are not. Thirdly the purpose of the existing rules is to help productive industry by stimulating technical education and training. If we widen the rules on the basis that industrial support for education of any kind is a good thing, then pressure would mount for relief on industrial support of, say, arts, heritage or sport. There is no obvious stopping point.

A better approach might be to encourage industry to take advantage of the tax reliefs which are already available.

As you probably know, these cover:

(a) sponsorship of students by means of payments for technical education related to the trade at universities or approved institutions (in practice the payment may take the form of donations of equipment manufactured by the donor company).

(b) secondment of staff. Relief is available for companies seconding employees to charities. Universities should be able to qualify as bodies or trusts set up for charitable purposes.

(c) A charitable covenant. Relief is available for payments under covenant where the university etc. has charitable status.

I hope that Norman Tebbit will bear these provisions in mind when he sets about the task of encouraging industry to contribute more to the training of engineers, as he has undertaken to do in the context of the "switch to engineering". I attach great importance to this effort. It seems clear from the paper presented to this month's NEDC meeting that industry contributes far less to training and education in the UK than it does in the US, Japan and Germany, despite the complaints of UK firms about current and prospective shortages. If we could bring about a change in this pattern, it would of course increase total expenditure on training etc. in this country. That would be useful in itself especially as it would avoid adding to the problems of public expenditure control. But, more important, it would help to strengthen the influence of market forces, which is badly needed in this field.

I am copying this letter to the recipients of yours, and also to Dr Robin Nicholson.

James Liversley
Paul Rees
PETER REES

*Approved by the Chief Secretary
and signed in his absence*



NBPM 2
BT
12/6

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

11 June 1984

The Rt Hon Sir Keith Joseph MP
Secretary of State for Education
and Science

A handwritten signature in dark ink, appearing to read "Sir Keith".

SEMINAR ON INDUSTRY AND EMPLOYMENT

Thank you for your letter of 5 June.

I look forward to seeing Christopher Lawson's proposals, when they are ready, and would be happy then to hold a meeting to discuss them, as you suggest.

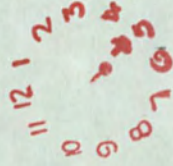
I am copying this letter to the Prime Minister and to Norman Tebbit and Tom King.

A handwritten signature in dark ink, appearing to read "Nigel".

NIGEL LAWSON

2
Manpower Pt. 3
Strategy for Industry and Employment

1984



- 11/6
- mf 11/6
1. MR FAULKNER
 2. CHIEF SECRETARY - 36A/2.
- 1/2 m x 1/2 m*
Copy 1/2 m

FROM: MRS E THOMS
DATE: 8 June 1984

cc. PPS
FST
MST
EST
Sir Peter Middleton
Mr Bailey
Mr Anson
Mr Monck
Mr Gordon
Miss Kelley
Mr Lovell
Mr R I G Allen
Mr Lord
Ms Dyall (IR)

INDUSTRIAL SPONSORSHIP OF INDIVIDUAL STUDENTS

Sir Keith Joseph wrote to Mr Lawson on 17 May with two proposals for improving the attractions of industrial sponsorship. We suggest you accept one, but reject the other.

Background

2. As you know there is evidence (mostly anecdotal, but still a lot of it) that the higher education system is producing too few engineers and technologists. The most acute shortages are in electronic engineering and computer science. The universities and polytechnics could increase their output, but at a cost. Having failed to convince the other departments concerned (DTI, DE, SO) to contribute to this cost, we now know that Sir Keith Joseph will be submitting a bid in this year's Survey to cover it. Whatever is eventually decided about the number of engineering graduates which are needed (and can be afforded), two problems remain:

- how to coerce industry into playing its part in their training;
- how to provide incentives for bright young people to apply for all the extra places.

Sir Keith Joseph's proposals would not solve these problems, but in his view, they would help.

Sir Keith's proposals

3. These are:

- (a) that the amount of money which a student can earn before his grant is abated (known as the "disregard") should be increased from £980 to £1600;
- (b) that the rules on tax relief should be extended so that a company can claim relief for a student sponsored to do virtually any course. At present, only those courses which are directly related to the trade which the company is engaged on attract relief.

4. The first of these looks acceptable but it would be worth asking DES to double check the cost implications. Sir Keith says these would be negligible since almost all sponsorship payments are below the current level of disregard (i.e. most sponsored students already get student grant at the unabated rate). But DES have already put in a PES bid to meet unforeseen expenditure on the student awards vote in future years, and they should do nothing to add to this pressure.

5. This proposal could also have implications for tax revenue. If it did have the effect (which Sir Keith presumably hopes it will have) of increasing sponsorship payments, and these payments attracted tax relief, then revenue would decrease. But the cost is likely to be ^{well} under £1 million, and FP Division advise that there is no need to reject the proposal on these grounds.

6. The second proposal is much less attractive. It would provide tax relief for sponsorship of virtually any form of education which might conceivably be useful in future employment. It would therefore represent a complete break with the aims of the current scheme which are to help productive industry by stimulating technical training. It would also create pressure for tax relief for industrial sponsorship of other worthy causes. The arts is the obvious candidate.

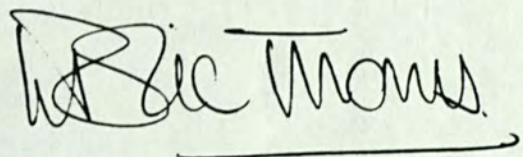
7. It is not clear either why such a change is necessary. We have seen no evidence of a shortage of graduates with financial or marketing qualifications (the two examples Sir Keith quotes). And if, as he says, only 10,000 students are sponsored now, then it is likely that companies are not making use of relief already available to them, despite their reports about current shortages and anxieties about the future.

Line to take

8. We suggest that you:

- (a) accept Sir Keith's proposal on the disregard (subject to reassurances on the cost);
- (b) reject his proposal for widening the scope of tax relief; ~~but~~
- (c) remind him of the other sorts of tax relief which are available;
- (d) stress the need for industry to start contributing on a much bigger scale than tax reliefs on sponsorship will ever encourage them to do.

9. I attach a draft reply.

A handwritten signature in dark ink, appearing to read 'Mrs E Thoms', with a horizontal line drawn underneath the name.

MRS E THOMS

A type
~~DRAFT~~ LETTER TO SIR KEITH JOSEPH

INDUSTRIAL SPONSORSHIP OF INDIVIDUAL STUDENTS

Thank you for your letter of 17 May to Nigel Lawson.

2. You make two proposals for increasing industrial sponsorship of students. The first is for an increase in the level of disregard. I am generally content with this, but I think it would be worth double-checking the cost implications: *my officials will be in touch with yours about the details* I understand that your student awards vote is already under pressure in future years and it will be important to do nothing which adds to this.

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engineers, as he has undertaken to do in the context of the "switch to engineering". I attach great importance to this effort. It seems clear from the paper presented to this month's NEDC meeting that industry contributes far less to training and education in the UK than it does in the US, Japan and Germany, despite the complaints of UK firms about current and prospective shortages. If we could bring about a change in this pattern, it would of course increase total expenditure on training etc. in this country. That would be useful in itself especially as it would avoid adding to the problems of public expenditure control. But, more important, it would help to strengthen the influence of market forces, which is badly needed in this field.

6. I am copying this letter to the recipients of yours, and also to Dr Robin Nicholson.

CMO

SECRET and
PERSONAL.



NBPM
AT 5/6

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury
Parliament Street
London SW1P 3AG

5 June 1984

Dear Nigel

SEMINAR ON INDUSTRY AND EMPLOYMENT

At the meeting on 29 May it was agreed that you and I, with Norman Tebbit and Tom King, should consider how best to carry forward Christopher Lawson's ideas on improving public understanding of the economic facts of life.

I have now spoken to Christopher Lawson. He will submit a proposal within one month which will suggest how this objective is best approached and will cover in particular the possible financing and timetable for any initiative. When we have his proposals, you may like to call a meeting to discuss them.

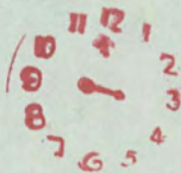
I am copying this letter to the Prime Minister and to Norman Tebbit and Tom King.

Ever,

Kevin

MANPOWER: Seminar
pt 2

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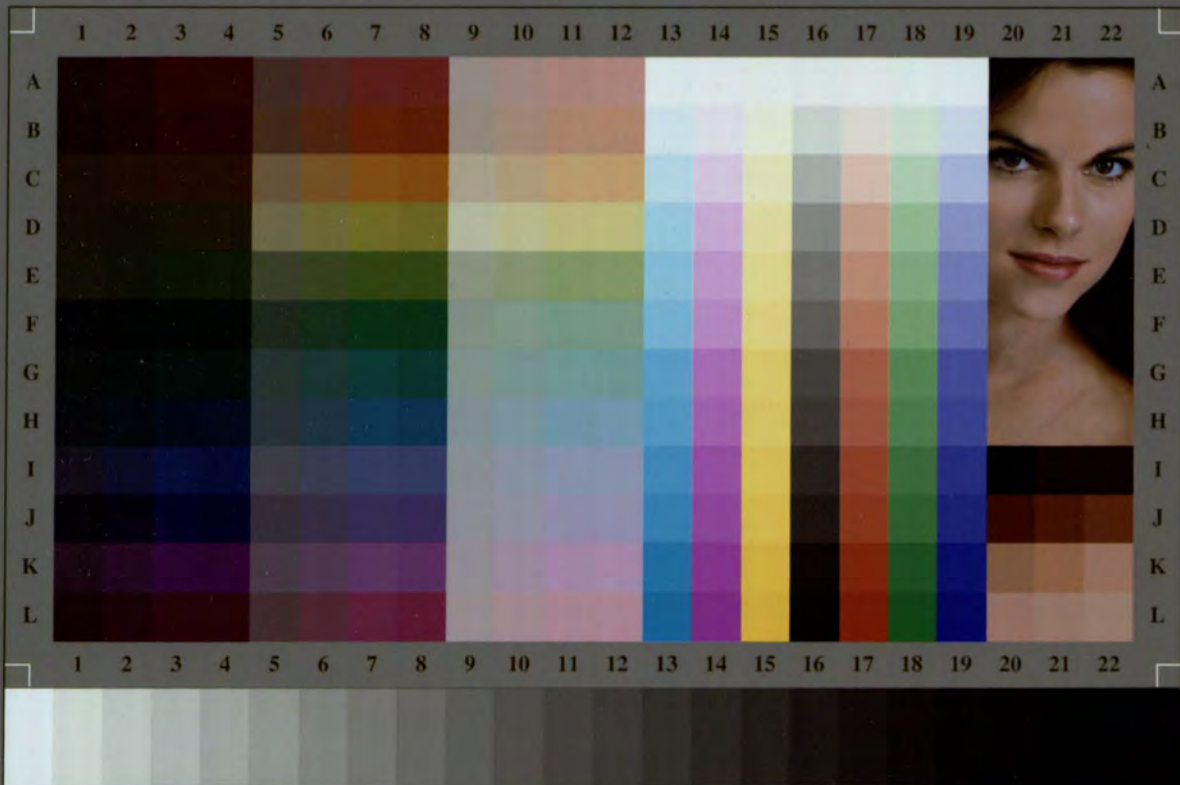


PART 2 ends:-

AT to HMT+ Meeting Record 29.5.84 .

PART 3. begins:-

SS/DES to CH/Exch 5-6.84 .



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