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Policy Unit

PRIME MINISTER

## A STRATEGY FOR JOBS

We must first reaffirm the basic principles as Arthur Cockfield (paper 15) and Cecil Parkinson (paper 18, Sections I-II) have done.

You could open the discussion by stating as the overriding priority: Public Expenditure must be reduced. That is the only way to reduce public borrowing and hence to reduce interest rates and taxation, and hence to stimulate growth and revive employment. No ingenious novelties can evade this basic truth. Any proposal involving fresh government money must therefore be a shift in and not a net addition to public expenditure.

Our strategy for jobs may also include better training, more encouragement for new products and new firms, removals of barriers to employment and increased mobility of labour.

But none of these assets will generate the net overall improvement in employment we are seeking, unless the burden of the state is reduced. If a cautionary tale is needed, those who still believe that more borrowing is the right route to fuller employment should take note of the Netherlands: public borrowing up from four and three-quarter percent of GDP in 1979, to eight and a half per cent in 1982 - but unemployment up to seventeen and a half per cent today.

The prime challenges are accordingly:

1. To reduce subsidies to uneconomic activities in the public sector (paper 2, paragraph 4). Coal, steel, shipbuilding, rail and other transport are now costing £3.7 billion a year. We ought to nominate a target of at least halving that figure over a 3 year period, ie £1,800 million by 1986.

2. To reduce the growth in defence costs. We shall not be able to carry out a pledge to renew the three per cent real growth target. Better to say so honestly now and plan on that assumption than erect unrealistic plans which we shall have to rat on in the late 1980s - with the usual hurried and ill-conceived cuts.

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3. To control public spending on health and social security. In a modern industrial society, these are both natural growth areas, (Cockfield paper 15, paragraphs 7 and 8). That growth cannot be effectively restrained over a long period. The only way is to widen the scope for private provision. Two nettles must be grasped: the state earnings-related pension, and tax relief for personal health insurance.

4. Tackling the national costs of agricultural subsidy as well as the CAP costs. This would involve taking clear long-term decisions about the size and shape of the farming industry we want, instead of drifting along with the NFU-driven assumption that "more is better".

In addition, there are other important areas where we ought now to be looking for savings and better use of public money - regional aid and special employment measures.

We recommend that the Chequers meeting should endorse explicitly the Government's renewed commitment to the reduction of public expenditure. Otherwise, there is a danger that the Government will be perceived to be setting off on a "new" tack and so weakening in its pre-Election resolve.

We must first stress continuity and the renewed vigour of our onslaught on public expenditure and the size of the state sector.

1. INDUSTRIAL POLICY

(a) What taxation changes are needed to stimulate enterprise throughout the economy?

The abolition of NIS (£900 million in a full year) remains a strong candidate to remove the bias in the system against hiring people and in favour of installing machines. There is new pressure for this to be counterbalanced by a cut in capital allowances. We boast of the "most generous system in the world", but investment in Britain continues to lag. (Would we do even worse without capital allowances?) Some argue that ultimate profitability (and hence the rate of Corporation Tax) is a more important factor in investment decision. A phased reduction in both the scope and rate of capital allowance should be considered.

It is too early to judge the success of the Business Expansion Scheme. But we do urge a halt to the proliferation of schemes to help small business. It is more important to make sure that the ones we already have are easy to understand and gain access to.

There is a lot to be said for improving share option relief. But in general, surely we sould aim simply to reduce tax rates wherever possible, and not narrow the tax base or add further complicated reliefs. As Arthur Cockfield says, it's the sheer burden which weighs us down, not so much the system - although there is plenty to criticise.

(b) What can the Government do to assist the improvement of industrial performance, including better exploitation of new technology?

As Cecil says (paper 19) we must not discriminate against services which are more likely to create new jobs. But we must not ignore the fact that many manufacturing businesses remain highly labour-intensive - engineering, software. Equally, in our enthusiasm for small firms, we must not overlook the potential for extra jobs in successful large firms. In other words, we want to remove the biasses and distortions in the system, not introduce new ones. Above all, we want to reduce Government intervention, not introduce new and inevitably increasingly expensive forms of Government intervention.

Cecil suggests a whole string of new or widened fields for DTI activity: demerger/buyouts, marketing support, innovation, R&D, "catalytic action" in new industries like Cable. This is all highly dubious. How disastrous Government catalysis was in promoting mergers in 1960 and 1976. Are we any more likely to be right with demergers? The same goes for much of Peter Walker's paper. We are already spending very large sums of public money on "support for innovation", yet basic civil industrial research is declining alarmingly while we continue to overspend on defence research (paper 19, paragraphs 39-42).

We should not increase DTI expenditure on "helping" industry. The discipline of a phased reduction in the departmental budget will put pressure on the DTI to spend its money more wisely. And we must shift expenditure from military to civilian research. Again, the simplest answer is to reduce the MOD's research expenditure, and a parallel reduction in the defence effort of private enterprise will follow as they realise there is going to be less money in the pot for defence.

(c) Can the resources currently devoted to regional policy be better deployed?

Yes. Spend less and spend it on job-related projects. We should adopt the Lawson/CPRS target of a net reduction of £200 million plus. The only way to reduce deadweight is to phase out automatic grants entirely and shift further towards selective aid with a cost-per-job limit. This will rule out more Sullom Voe-type projects and shift the emphasis towards small business and services - without prejudicing our potential £300 million from the European Regional Development Fund.

The main point is not to redraw the map of assisted areas yet again, but to make it clear that REP is sociopolitical, not economic. It will also be more popular if we make it explicit that it is a jobs programme.

The Urban Programme, which is scarcely mentioned, is now almost as costly as REP. It must be more tightly scrutinised with the same cost-per-job limit.

(d) What new policies, in addition to any general tax changes, are needed to encourage small firms and the self-employed?

There is no shortage of schemes. The main point is to make them work and to overcome the scruples of the Revenue, as David Young has argued.

(e) How can we further reduce the legislative and administrative burdens - including the planning constraints - imposed by the planning system on industry?

The uproar caused by Patrick Jenkin's "Green Belt" circular shows the need for careful presentation and forethought, especially in dealing with our own supporters.

We need to show in advance that the land on which we propose to allow development really is derelict. We must also tackle the shibboleth of "prime agricultural land" by careful de-zoning. This will not be a quick or simple process. We might start with a two-pronged attack by:

i. asking all counties to increase their targets for the amount of land available for housing; but

ii. also asking all boroughs and public authorities to speed up the selling off of urban land for housing and the provision of access, drainage etc where necessary.

Only by doing both at the same time can we hope to satisfy the builders who say that the inner cities alone cannot meet the demand for building land of the right quality, and the environmental lobby which believes that no acre of countryside should be built on until the last urban site has been developed.

2. THE LABOUR MARKET

(a) What changes should be made in trade union law and otherwise to reduce trade union power to obstruct changes, reduce labour mobility, and generally damage employment prospects?

Norman Tebbit's paper 9 gives an admirable summary of the state of play, and review of the options for further action. We continue to support the idea of a White Paper on Employment. His paragraph 17 summarises the other fields of action in which the power of trade unions to damage employment prospects may be reduced.

As always, we must continue to make it clear that the 1983/84 Act will not be a final resting-place, but merely one further stage on our progress towards restoring a fair balance between unions and employers in the interests of employment and prosperity for all who work in industry.

(b) What changes are needed to reduce barriers to employment arising from barriers to employment protection legislation, minimum wage legislation, Wages Councils, etc?

Again, Norman's proposals seem admirable. In particular, there is no point in fiddling with Wages Councils before we can denounce the ILO Convention in 1985/86. Abolishing the Agricultural Wages Councils may be more trouble than it is worth, but excluding young people from their scope.

We endorse the Tebbit judgments on how far guarantee and redundancy payments and unfair dismissal provisions should be altered.

(c) <u>What scope is there for schemes designed to bring wages to market-clearing levels, eg by (i) capping unemployment benefit; or (ii) extending the Young Workers' Scheme to cover adults</u>?

We doubt whether the political costs of capping unemployment benefit for family men would be outweighed by the benefit, in terms of jobs. Unemployment has been rising fast in many of those countries which do cap unemployment benefit. Survey evidence generally supports the conclusion that the workshy are mostly young people, particularly those living at home, and these would not be affected by capping. The cap would mostly catch parents with two or more children who were genuinely seeking work.

None of these objections applies to reducing (or not indexing) unemployment benefit for young people living at home. This would be much less politically controversial and much more likely to increase the take-up of low-paid jobs.

The MSC does not see much evidence of low-paid jobs remaining unfilled, but that may be because many employers have given up advertising such vacancies on the grounds that they are unlikely to attract satisfactory recruits. We do not support extending the YWS to adults. It would only add considerably to public expenditure, and the amount of deadweight might be worse than it already is for young workers.

(d) <u>Should we take further measures specifically to encourage youth employment</u>?

We share Nigel's objections to the Cockfield "Passport for a Job". It would further narrow the tax base. Deadweight and displacement would be considerable. There are similar objections to the Cockfield "Help for those starting up in Self-Employment". The Enterprise Allowance seems a better bet.

(e) Should the Government seek changes in pensions schemes, for example wider pension portability, to encourage greater labour mobility?

Revaluation of preserved rights would be the only real answer. It would be enormously costly to employers who are already finding difficulty in meeting their pensions commitments. With the cost of employing people already so high, we cannot recommend adding to the burden for the sake of an uncertain gain in labour mobility.

POPs - individual, portable, money-purchase schemes - are highly desirable. We wholeheartedly recommend that the option of a 226 scheme should be available to all employees, as Nigel Vinson has suggested. It may well be that only a minority of people take this riskier route in preference to the safety of a final-salary guarantee. But they ought to have the chance.

Better still, they ought also to have the right to invest in a variety of types of schemes, including those which involve high-risk investment. So long as the state flat-rate scheme continues, why should a 45-year-old employee not be allowed to risk his preserved pension rights on buying a fish-and-ship shop? The existing structure of tax reliefs is a major factor in making Britain a low-risk, high-pension society.

(f) What further changes in housing policy are needed to improve labour mobility?

Extending assured tenancies to newly improved and converted dwellings in the private sector would be a worthwhile step towards general decontrol.

In the council house sector, the mobility measures we have already taken may well need extending, as suggested.

For owner-occupied dwellings, the principal need is to encourage new building. The volume builders believe that the supply of land is the principal barrier. This is the only way of reducing house prices without adding to the huge variety of government subsidies already available.

Similarly, if we are to reduce the costs of moving house, breaking the solicitors' monopoly of conveyancing would cost the Government nothing; whereas a reduction in stamp duty, however desirable, is extremely costly and involves huge deadweight.

3. <u>HOW CAN WE FURTHER OPEN UP THE PUBLIC SECTOR TO MARKET FORCES</u>?

The Manifesto programme of privatisation is a heavy one. It cannot be left to the haggling process of E(DL) and L Committees. We must have a timetable, as suggested by Nigel Lawson and David Young. It should be drawn up by a small group of Ministers under your chairmanship. Its task will be much easier if:

i. We use to the maximum the powers under <u>existing</u> legislation to sell off parts of nationalised industries. In some cases, virtually the entire activities of the business can be disposed of in this way.

ii. We are not mesmerised by the idea of making the business profitable before selling it. After all, we believe that private owners will know how to make it profitable quicker than Government ever could. In particular, we should not pump in subsidy - eg to the industry's redundancy or pension funds - in order to achieve a sell-off price that looks good in the House of Commons.

iii. When dealing with a natural monopoly, we break it up into regions before selling.

iv. When dealing with an unnatural monopoly (created by Act of Parliament) we remove all legislative barriers to competition.

4. <u>EDUCATION AND TRAINING</u>

<u>How can the efforts of schools, higher education, the MSC and industry be better deployed to give workers and managers the skills and enterprising approach they require</u>?

The "economic facts of life" suggested by Keith is obviously intended as only one part of learning about the real world at school. It has unfortunately achieved a somewhat isolated prominence in public discussion. I think we ought to bring together - eg in a White Paper - all the elements in our programme for equipping children at school with some of the skills needed for dealing with adult life.

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CONCLUSIONS AND FOLLOW-UP

We tentatively suggest that you might seek to extract some of the following conclusions from the meeting:

A. Reaffirmation that the overriding means to prosperity and fuller employment must be to reduce public expenditure and the burden of the public sector.

B. Agreement to pursue a programme to halve the total of subsidies to uneconomic public sector industries by 1986.

C. Agreement to reduce the bias in the tax system against employment of labour. The abolition of NIS as soon as possible.

D. Agreement to reduce regional subsidies by £200 million and to make REP explicitly a job subsidy with a cost-per-job limit available equally to manufacturing and service industries. Agreement to reduce capital allowances to make room for the abolition of NIS and reductions in Corporation Tax.

Agreement to reduce the DTI's assistance to industry, except in the case of purer research in new technologies.

E. Agreement to pursue a programme to make more land available for housing, in urban areas and in areas of high demand.

F. Agreement to continue the Government's programme of trade union reform as outlined by the Employment Secretary.

G. Agreement to remove the barriers to employment as suggested by the Employment Secretary.

H. Agreement not to cap unemployment benefits, but to investigate the possibility of a lower rate of benefit for young people living at home.

I. Lord Cockfield's "Passport for a Job" and Self-Employment Scheme not to be pursued. The Young Workers' Scheme not to be extended to adults. But provided results are favourable, the Enterprise Allowance to be extended.

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J. The Government to permit employees to contract out of company pension schemes into a variety of personal, portable savings schemes. No revaluation of preserved rights for early leavers, on grounds of cost to employers.

K. Agreement to extend assured tenancies to newly-built accommodation to rent. Agreement to investigate all ways of lowering the cost of moving house, including the solicitors' monopoly of conveyancing in the light of the Benson Report.

L. Agreement to set up a privatisation timetable group, chaired by the Prime Minister. The group also to accelerate disposals under existing legislation, including disposals of activities which have not yet achieved profitability.

M. Agreement to publish a White Paper on "Schools and Skills".

I have not suggested conclusions on Health or the State Earnings-Related Pension, as these might be dealt with at the forthcoming seminar.

Nor have I suggested conclusions on Defence or Agriculture, but I do not think they can be omitted, in view of the huge share of public research and development money they enjoy.

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