Manpower

CONFIDENTIAL

6 November 1981

MR HOSKYNS

cc Mr Wolfson
Mr Walters
Mr Vereker
Mr Scholar

REDUCING UNEMPLOYMENT

1. You probably saw the attached article in today's Economist containing seven suggestions for measures to reduce unemployment. Here they are with a very brief note on my understanding of the current position:

(1) Abolish Wage Councils. PM gave Norman Tebbit a remit to look again at this on 22 September and bring it back to E. He appeared unenthusiastic about abolition then, and does not plan to bring it to E before December. We could try to accelerate the process - after all, all the arguments have been rehearsed several times at E(EA) and E over the last year or more.

(2) Raise EP exemptions from firms under 20 to under 50. The 1980 changes were not exactly exemptions - merely extended qualifying periods. Mr Prior convinced MISC 14 in July that all that was needed in this field was better publicity for the changes already made. However, the Chancellor has since raised it again. He did not press the case for complete exemptions - which would create two classes of employee. Nor did he suggest raising the threshold to firms employing under 50. But he did raise the idea that redundancy payments for employees of small firms (under 20) should comprise only the Government contribution (see (5) below). Alan Walters has floated exemptions, and I intend to write again to the Treasury about this, so that the issue is raised at the MISC 14 discussion on 27 November.

(3) Phase out rent controls. H Committee considered some very limited steps in this direction earlier this year. I believe the Prime Minister was among those who felt no further action should be taken in this field during the lifetime of this Parliament - on political grounds. The Chancellor, Sir Keith and Mr Heseltine succeeded in putting it to Cabinet on 30July, but the decision went against any action in this Parliament ("purist nonsense"). I doubt if we can reopen it. You will need to consider how such a sensitive issue can be handled in Manifesto and pre-Election commitment terms.

(4) Optional early retirement for the long-term unemployed. This would reclassify a large group from "unemployed" to "retired". It would mean they received higher benefits. Norman Tebbit did not put this forward among his special employment measures. When the July package was constructed, I think the Prime Minister felt that the extension of the Job Release Scheme was as far as we should go on early retirement. It's cosmetics, but we could reconsider whether it's politically advantageous.

(5) All redundancy payments for under 23 year olds to be borne by Government. Unlike the Treasury proposal discussed at (2) above, this would increase Government spending, but maintain workers' redundancy rights. It might be argued that it would make companies more likely to sack young people than others, because it costs them less to do so. We could write to the Treasury to get their reactions.

(6) Cut NIS. There has been correspondence on this. The Chancellor has made it clear that he can only judge this in the light of the rest of the Budget. He will almost certainly make no move before the Budget, but has acted to keep his options open for an announcement then which would take effect in mid-summer.

(7) Tapering tax rates at the bottom of the income tax range. This is very expensive. People start paying tax at such a low level at present that it could be better to spend any available money (and there isn't any) on raising the threshold rather than tapering. I have always been sceptical about the incentive impact of a rate as low as 30%, but Alan may have views on whether this is worth drawing to the Chancellor's attention.

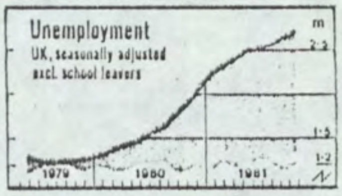
2. I believe the Prime Minister does not read the Economist. Do you think we should draw this article to her attention? Whether we do or not, do you think we should take action to hasten any of the suggestions it contains?

AD.

ANDREW DUGUID

ECONOMIST
7 NOVEMBER 1981

Seven winter suggestions



Measures that the Thatcher government could sensibly introduce, in order to bring unemployment down

Headlines screaming "three million unemployed" will greet the halfway stage of Mrs Thatcher's government later this month. There is worse to come. The London Business School, fount of moderate monetarism, thinks that adult unemployment will go on rising in Britain for the next nine months or so, and then only start inching down. It thinks the misery index—inflation plus unemployment rates—could be 22% at the next general election in 1984. It was 15% when Mrs Thatcher rode purposefully into Downing Street in 1979.

Today, a shade less purposeful, a lot more defiant, she is right to say that Heath-style reflation would boost the misery index by adding much more to inflation than would come off unemployment. She is wrong to think that the government can do nothing to shorten the dole queue.

Three things to abolish

Three bits of legislation need scrapping or amending in the search for jobs. First to go should be the 34 wages councils, which set minimum wages and conditions for 2.3m British workers. They are a hangover from the 1920s, when officialdom needed to act as referee between unscrupulous employers and sweated workers. Today officialdom has better, less paternalistic ways of intervening, like health and safety laws. Wages councils hit the newly vulnerable members of society: those who are not worth employing at the prescribed minimum wage, often because they lack experience.

This vicious circle—no experience, no job, but no job, no experience—is drawn more tightly around today's school leavers than anybody else. The way out is via lower wages. Trade unionists argue that cheaper school leavers will simply displace older workers, producing no net gain in jobs. There are now piles of recent academic research to show that they are wrong. One of the most careful studies, from the National Bureau of Economic Research in America, concludes "that a subminimum wage for youths would have increased their employment with at most a small loss of jobs among adults". And a subminimum wage at 16 is a small price to pay for the experience that could earn you average wages at 26, especially if the alternative is 10 years of drifting between dole queues and half-jobs.

The second piece of job-destroying legislation is the Employment Protection Act, the last Labour government's danegeld for wage restraint that the unions never delivered. Among other things, it means that redundancies in Britain are now expensive, time-consuming and full of litigious potential. Nice, if you are already employed. Nasty if you are not, because employers think many times before taking on new staff.

The Thatcher government has already exempted firms with fewer than 20 employees from the act. It should now raise that limit to 50. Firms with fewer than 50 workers have created almost all the net new jobs in industrial economies over the past 15 years.

The third legislative broom is needed in housing. Mrs Thatcher's government has made it easier for people to get somewhere to live if they have to move for their jobs. Rules about security-of-tenure for short lets have been relaxed. Most councils now operate a scheme that gives priority to newcomers taking up a job who have given up houses elsewhere. The government should now go further and phase out the rent controls that for 65 years have discouraged landlords and squeezed the most flexible way for people to find a roof.

Like redundancy protection and minimum wages, rent controls are loudly defended by their beneficiaries. Their victims, often only dimly aware of why they cannot get a job or a house, are not rampant abolitionists. The government would therefore run a political risk in thus legislating people back into jobs—especially as these three ideas would, at most, cross 200,000 off the unemployment register in the next few years. Small beer, when the official total of 2.7m adults itself excludes those who have simply dropped out of the hunt. The changes that seem advisable in the budget would be more popular.

Four changes for the budget

Try these four ideas, in order of probable cheapness.

(1) Allow the long-term unemployed to take early retirement—say, men at 60, women at 55. This would cut the jobless total by perhaps 100,000 and its benefits would be more than cosmetic. Those who chose to retire would be eligible for various pensioners' perks (eg, cheaper rail travel); they would not be barred from taking a job should any come up; and their pensions would be higher than their existing unemployment pay. Cost: about £60m a year.

(2) Whenever a company recruits someone under 23, shift the liability for redundancy pay from firms to the government for a period of three years or so. This would remove one biggish reason why companies are reluctant to take on young workers. Cost: guessing, £70m a year.

(3) Cut the employers' national insurance surcharge, which now stands at 3½% (and harvests almost £4 billion a year for the treasury). This week Sir Geoffrey Howe was lukewarm about cutting it. In 1978, however, he correctly described the surcharge as "a tax on jobs, a tax on profits and a tax on investment". Reducing the surcharge would be the quickest way to cut industry's costs and improve its ability to employ more people. Cost: roughly £1 billion for every percentage point cut.

(4) Taper the tax rates at the bottom of the income tax range. British workers start paying tax at a marginal rate of 30%; in Japan the lowest rate is 10%, in America 14%, in Holland 17%. That 30% is an uncomfortable jolt for anyone. For many low-paid people in Britain, it turns a job into a financial sacrifice, because they simultaneously lose various benefits. In theory, tax rates could be rejigged without any loss of revenue; in practical terms that would be difficult to achieve, so the tax-cutting should be done in steps. Cost: allow a maximum of £1 billion a year.

All of these seven steps would reduce unemployment very directly. None would operate by creating lame-duck jobs. Four of the measures would put government borrowing up, but four would bring industry's costs down. None of the measures needs to conflict with the path forward that Mrs Thatcher has chosen—to boost productivity and hence ensure more competitive and durable jobs than would have existed if the hand-to-mouth policies of the past 30 years had been continued. That path was never going to be smooth or short. Without deliberate job-creating policies, however, it will start to look suicidal.