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Press Office Copies to PS

SCS Sheenagh Wallace

AT

FROM: M T FOLGER
DATE: 14 December 1984

CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Byatt
Mr Monck
Mr Battishill
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr G White
Mr McDonald
Mr Stredder
Mr M Williams
Mr Vernon
Mr Cropper
Mr Lord
CA/01

Note
I briefed Press Office to say that the import figures in para 7 were not part of a sophisticated argument comparing differing policy options but a quick way of illustrating point that investment was not necessarily lower in imports than tax cuts. This is particularly so for industrial plant and machinery.

AT
17/12

PUBLIC SECTOR INVESTMENT: COST PER JOB, IMPORT CONTENT

This note seeks your approval for the briefing line to be taken on these issues in the light of remarks by the Prime Minister on 13 December.

Cost per job

2. At OA col 1202 the Prime Minister said inter alia "the cost per job through increasing infrastructure can vary from £35,000 to £55,000." (Full Hansard entract attached at A.)

3. No figures have been given recently for the "cost per job" of such spending. It is possible that the Prime Minister may have been misremembering figures from the "Monck Report" (submitted under Mr Monck's 3 August minute to you). Table 2 of that report (copy attached at B) gave (classified) figures for the first year PSBR costs per job of central government investment as £35 to 45 thousand (and £25 to 35 thousand for local authority investment). £35 to 55 thousand is thus distinctly at the top end of the range.

4. I have agreed with Mr Monck, MP and EI divisions a form of words for use should the Prime Minister or others need to refer to this point again. It is designed to stress the relativity with SEMs, whilst at the same time clawing the cost per job figures back into the right ballpark, yet without contradicting what was said yesterday. The proposed wording is:

"Government investment not cost-effective way to create jobs

[PM OA col 1202 13 December 1984]

Spending on government investment schemes would be a very expensive way to create jobs. Typically the cost per job might be more than ten times that of specially-targetted employment and training measures. [IF PRESSED: For public investment schemes, the cost to the PSBR might be between £25,000 and £35,000 in the first year, and could range even higher, for each person taken off the unemployment register.]"

5. If you are content with this line then it would be helpful if your office could inform No.10 accordingly on Monday morning. The words can then be taken into briefing for Questions next week.

Import content of different types of expenditure

6. You may have noticed that the Prime Minister is reported to have given figures for this at the 1922 Committee on the evening of 13 December (see FT story attached at C).

7. She was drawing on figures, provided at No.10's request by MP, as follows:

average import content, per cent

consumers' expenditure	21
construction	14
GDFCF(domestic capital formation)	30

The Prime Minister's use of these figures may have served to redress the balance of argument about the choice between public investment and income tax cuts.

8. Nevertheless we have advised No.10 for the time being that, although the figures have now leaked onto the record from a supposedly private Party meeting, they should not be put into general circulation in standard briefing material. This is because:

(a) the figures are average propensities (although reported as marginal by the FT). The marginal propenities suggested by the Treasury Model might be roughly double these average estimates.

(b) in that Mr Hattersley and others are not pressing for extra spending on "average GDFCF", but for "infrastructure" and "housing" spending, then the relevant propensity could plausibly be argued to be more like 14 per cent than 30. On that basis, and on Mr Hattersley's view of the world, it would be preferable to consumption with its average propensity of 21 per cent. So the average relativities are not very helpful to the government's case.

9. No.10 are aware of these problems and your office will confirm our interim advice to them on Monday unless you would like us to take a different line.

MTF

M T FOLGER

A

OA col 1202 14 December 1984

Mr. Hattersley: It should be obvious even to the Prime Minister that money invested directly in the United Kingdom is more likely to create jobs than money devoted to increasing consumption, which, by its nature, is likely to result in higher imports and to create jobs abroad. On the Labour side of the House and, I believe, widely throughout the country, it is understood that the right hon. Lady's obsession with a cut in direct taxes is matched and mirrored by the increased indirect taxation that has more than compensated for the reduction in that particular over the past five years.

Most important of all, as the Prime Minister has chosen the high unemployment option, are we to be relieved from now on of the lowered voice and the bogus compassion? The truth is that the Prime Minister and the Government choose high unemployment. That is the message that should be given to the country.

The Prime Minister: The right hon. Gentleman is not correct. Increasing infrastructure is not a cost-effective way in which to increase the number of jobs. The cost per job through increasing infrastructure can vary from £35,000 to £55,000. It is an expensive method, which tends to lead to a lot of hire of plant but not much hire of men. Reduction of tax can lead to extra jobs, as it leads to extra demand. The right hon. Gentleman's thesis that investment always leads to purchases from home sources while reduction of tax leads to purchases abroad is not correct. In an age of specialisation much of the investment in equipment and machinery goes abroad.

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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)	15-20	10-15
Local Authority investment	25-35	15-25
Central Government investment	35-45	20-30

** 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.

FT 14 December 1984

Attempt to ease pension fears

BY PETER RIDDELL, POLITICAL EDITOR

ANY ACTION in the Budget to tax lump pension payments will not be retrospective and no-one will gain from retiring before Budget day rather than after, Mr Nigel Lawson, the Chancellor told MPs yesterday.

His remarks in Commons Treasury Questions were intended to end the wave of threatened, and actual, early retirements, particularly among police officers and others in the public and private sector, who fear the possible introduction of such a tax.

Senior Tory MPs, the pensions industry, and yesterday, the Confederation of British Industry, have pressed Mr Lawson for an early statement to end the uncertainty. But his Commons comments offered only partial re-assurance.

He refused, in accordance with normal practice, to confirm or deny speculation about his Budget plans but said he was "concerned at reports that some people may be contemplating premature retirement on the basis of rumours on the tax treatment of pension lump sums.

"I can assure the House that there is no reason for anyone to retire early on account of such rumours. This Government would not propose, and the House would not accept, retrospective legislation of that kind."

He made plain that his remarks were intended solely to deal with fears leading to such premature retirement.

The implication is that if such a tax were imposed—which is far from certain—amounts which have accrued to finance a lump sum payment before Budget Day would not be affected. Any changes would affect only the part of a person's career after then.

Mr Lawson refused, however, to be drawn on questions about whether any changes would apply to people who became members of pension schemes before Budget Day. Similarly, he sidestepped questions about whether contributions to occupational pension schemes might be taxed.

As a result, some Tory MPs afterwards felt his answers did not go far enough. Dr Oonagh McDonald, one of Labour's Treasury team, said Mr Lawson's remarks would only create more uncertainty among employees and employers by failing to say whether a tax might be imposed on contributions to pension schemes and/or on their investment incomes.

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Scope for tax cuts

He would then be able to moderate the effect on special interest groups by using the £13½bn scope for tax cuts which the Treasury plans to deliver in the four years between 1985-86 and 1988-89.

Significantly, Mr Lawson told the Treasury and Civil Service Committee recently that he is still looking towards a four-year tax-cutting programme of this size.

Ministers have made it clear that the main tax-cutting emphasis next year will be on raising income tax thresholds and allowances. The aim is to improve incentives for all workers and to reduce the number of people in the tax net.

An increase in thresholds would also be intended to improve incentives for the unemployed to take lower-paid jobs.

A cut in national insurance contributions next year seems unlikely, in spite of the fact that it could ease unemployment by directly reducing the cost of labour. Company liquidity is greatly improved this year and the Confederation of British Industry has not been pressing strongly for a cut in employers' contributions.

Replying to recent backbench calls for additional public capital investment, Mrs Thatcher last night gave Treasury figures showing that 21 per cent of additional consumer spending went on imports but that the proportion of extra capital investment spent on purchases overseas was 30 per cent.

Mrs Thatcher used statistics to argue that the Government's 18-month record after the last election was much better than at the same stage of the last parliament.

She said that the most important thing on people's minds was unemployment, but that if the Government had "cut and run" to a spending philosophy it would never have won the last election.