Econ Budget Pt 9

FROM: R I G Allen
DATE: 3 February 1983

For Information:

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Mr Burns
Mr Cassell
Mr Kemp
Mr Gleed
Miss Deyes
Mr Ridley
Mr Harris
Mr Hall
Mrs Lomax

No 10
PS/S/S
Employment

CHANCELLOR

TUC ECONOMIC REVIEW 1983

As proposed in my minute of yesterday, I attach some notes on the TUC's Economic Review published at 12.15 pm today.

2. The material is as follows:

A. A note by Miss Deyes on the relationship between the Review, and in particular its Budget proposals, and earlier Reviews; the measures are a fairly familiar mixture. The note also summarises the relationship between the Review and recent TUC/Labour Party Liaison Committee and Labour Party plans.

B. A note by Mr Gleed of MP1 assessing the TUC's programme for the Budget.

C. Some defensive Q/As on the main points of the TUC programme - more public sector investment; more expenditure on training, etc; planning agreements; the NEA; use of Treasury model, and so on - and other aspects of the Review particularly critical of Government policies and achievements - unemployment, productivity, and so on.

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R I G ALLEN
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Extract from the TUC Economic Rview 1983 , summarising proposals

THE TUC ALTERNATIVE

The TUC recovery package is divided into two parts: *Action Now* is a one-year action plan that could be started now. The *Five Year Expansion Plan* is the follow up — a wide ranging strategy designed to promote jobs, growth, democracy and more equality in Britain.

ACTION NOW

£10 billion Budget package

Reconstruction of Britain programme: housing/education/hospitals/energy/roads/cities/water and sewers/telecommunications	£3,200 million
Manpower, Education, Training measures	£1,800 million
Aid to Regions	£850 million
Local Authorities inner city aid	£250 million
State Pensions increase	£700 million
Social Benefits increase	£750 million
NHS extra spending	£175 million
Cut in VAT from 15 to 12.5 per cent	£2,300 million

Devaluation of £

Selective import controls

motors/machine tools/textiles/tyres/furniture

FIVE YEAR EXPANSION PLAN

Economic

- Development of *Action Now* strategy geared to 4 per cent annual growth rate.
- 10 per cent cut in working time over five years.
- £30 billion Reconstruction of Britain (public investment) programme.
- selective import controls.
- expansion of manpower/education/training programmes.

Democratic Planning

- annual tripartite National Economic Assessment of how economic resources/priorities are shared out.
- new Department of Economic and Industrial Planning.
- new National Planning Council to provide links between Government, employers and unions.
- Agreed Development Plans: Government/company/union planning agreements on jobs, investment, products, etc.
- new information, consultation and representation rights for unions at work.
- new National Investment Bank channelling public wealth into British Industry.
- Regional Development Planning Authorities to give new planning framework a regional/local dimension.

RESULTS

The TUC has tested the effect of this Budget package on the economic model used by the Treasury. After one year these are some of the results over and above the effect of current policies:

unemployment	down 574,000
national output	up 3.3 per cent
prices	up 0.9 per cent
living standards	up 3.2 per cent

RESULTS

The points above are the broad guiding principles of an expansion plan — the TUC is not laying down a minutely detailed blueprint. A programme based on these principles will:

- lay the basis for a successful, growing economy;
- get unemployment below 1 million after five years;
- create a new democratic way of planning how our industries and economy develop – instead of abandoning them to 'market forces';
- radically improve income and job opportunities for women; and
- tackle income inequalities and low pay.

4-17a

TUC ECONOMIC REVIEW 1982 AND ITS PREDECESSORS

1. TUC Economic Review 1983 covers recommendations for the next Budget, providing £10 billion expansion in 1983-84 compared with £8.3 bn in 1982-83 - described as similar 'in proportionate terms' to last year's 'because the amount of spare capacity in the economy is the same' (para 4.8 of the Review). (Recommendation for 1981-82 in Economic Review 1981 was £6¾ billion.) See para 4 below for Budget breakdown.

2. Budget recommendations are once again seen as part of 5 year programme for recovery - the same perspective as in 1982 and in 1981. This 5 year programme (chapter 5 of the Review), involves, as in 1982 and 1981, system of 'democratic planning'; a National Economic Assessment; active manpower, education and training policies; expansive public spending programmes; lower interest rates and competitive exchange rate (but see para 6 below for reaction to recent fall in sterling); and 'managed trade' to prevent effects of import surge to meet increased domestic demand.

3. Also present in the 1983 Economic Review, as in 1981 but not 1982, is reference to the international dimension - particularly policies to help developing countries to expand (chapter 8).

4. Budget Breakdown (para 4.10)

Spending Measures	1981 £	1982 £	1983 £
1. Public sector construction	400m	2,100m	3,200m
2. plus nationalised industries (EFLs)	600m	200m	
3. aid to industry/ industrial strategy	250m	600m	-
4. regional policies	-	-	850m
5. sems or training	710m	1,700m	1,800m
6. improved State pensions	750m	750m (to yield 'real terms' improvement)	700m
7. other State benefits (inc CB)	400m	700m (to yield 'real terms' improvement)	750m
8. NHS	300m	60m	175m

9. educational services	1,150m	included in 5 above	included in 5 above
10. other local govt services	160m	225m	250m
<u>Revenue measures</u>			
Income tax allowances to be raised in line with inflation	(amount not specified in text)	assumed	assumed
Reverse employees' NIC increase 1981-82	(amount not specified in text)		
Reduce NIS by ½%	540m	-	-
Reduce VAT to 12½%	-	2000m	2,300m
Total Budget package (gross)	6.2 bn	8.3 bn	10 bn
Change in PSBR	unspecified increase	less by £28 mn.	extra £6.4bn

5. Within the Budget package the 1983 Review sticks to the 1982 formula in calling for a cut in VAT (the 1981 Review proposed cutting NIS but the 1982 Review preferred VAT for the more immediate impact on demand and the direct effect on price inflation; the 1983 Review adds scepticism (para 4.19) about employers using NIS cuts to help employment). As compared with 1982 the 1983 spending allocates relatively much more to investment than to current spending (pensions and benefits combined attracting no more additional money than last year). Spending on industry is not isolated in the 1983 breakdown but in 1982 it included some regional assistance: this is now shown as a separate item and includes an employment subsidy (para 4.12) whereas the 1982 Review noted work was being done on what regional incentives were needed.

6. The fall in sterling since the 1982 Review has elicited a shift from the 1981 and 1982 recommendations for depreciation of the £. The 1982 Review called for an 'orderly' and 'limited' depreciation of the £ to 'more realistic levels' and recommended reduction of high UK interest rates as a useful method; thereafter increased efforts should be made at international level to achieve orderly trading in foreign exchange; jettisoning of the monetary targets would free the Government to do more to 'regulate the exchange markets'. The 1983 Review advoccates (para 4.6) 'a reimposition of exchange controls' - not specified in the 1982 Review but commended in 1981 - and 'an exchange rate which is maintained at a lower level from its overvaluation in 1982'. What this level should be is not stated and the Review specifically recognises 'that the system of floating exchange rates makes it difficult for any Government to pursue an exchange rate in isolation'. 'Nevertheless', it says, 'the active use of interest rate policy, intervention by the Bank of England and the use of exchange controls could give the Government some influence.'

7. Relationship with Labour Party proposals

Pr[illegible]sals for reflation within a framework of national and company-level planning and accompanied by a 'National Economic Assessment ' were brought together as far back as July 1981 in a TUC -Labour Party Liaison Committee document ('Economic Issues facing the next Labour Government '). That also envisaged exchange controls and 'planned trade' .

They were elaborated in a further Liaison Committee document which was adopted at the Trades Union Congress and Labour Party Conference last autumn ('Economic Planning and Industrial Democracy '). The same idas reappeared in 'Labour's Programme 1982 ' - the manifesto-in-embryo issued in June 1982.

A five year programme for public sector investment to cost £24 billion was put forward by the TUC in 'Reconstruction of Britain' in August 1981. The 1983 Review upvalues this to £29.5 billion ,with £ 3.2 billion in year 1 rising to £ 9 billion of extra public sector investment in year 5.

The £ 10 billion Economic Review Budget package for 1983-84 compared with Mr Shore's estimated direct costs of £8-9 billion in each of the next five years recommended in the 'Shore Programme' put out last November ('Programme for Recovery '). That involved progressive reduction of VAT (2 per centage points in year 1 and year 2), abolition of NIS (not in theTUC 1983-84 Budget), and total extra public spending rising from £ 5 billion in year 1 to £18 billion in year 5, split equally between capital and current.

The 1983 Economic Review package envisages a PSBR of 4.7 per cent in 1983-84; Mr Shore's package(illustrative simulation) involved a PSBR of around 3-4 pe cent of GDP in each of the five years.

290/216

FROM: MR GLEED
DATE: 3 FEBRUARY 1983

~~MR ALLEN~~ - 9/2nd

cc: Mr Burns
Mr Cassell
Mr Kemp
Mrs Lomax
Mr Mortimer
Mr Hartley

TUC ECONOMIC REVIEW 1983

You asked for a fairly quick assessment of the TUC's programme for the Budget.

2. As is clear from the Review, the fundamental approach of the TUC differs considerably from that of the Government. Their aim is not the control of public expenditure in order to provide room for a combination of lower budget deficits, lower interest rates and tax cuts, but instead a major expansion of the public sector to provide jobs - both direct, in central and local government and on special employment measures, and also indirectly, via higher public investment and as big expansion of public sector orders.

3. As we have emphasised before, particularly in the NEDC paper, the Treasury Model is not well equipped to handle major changes in strategy of this kind, because the behaviour of financial markets, wage bargainers and economic agents in general depends on how they expect governments to react to inflationary pressures. If people believe that the Government will be unwilling or unable to resist inflationary pressures, they are likely to push that much harder on the door. Part of the deceleration in inflation over the past few years, eg. the squeeze on profit margins, has been due to the Government's perceived strategy on inflation. A different stance on this would affect inflationary expectations adversely.

4. This qualification needs to be borne in mind when assessing what effect the TUC's results would show on the Treasury model. Assuming <u>no</u> major change in behaviour or inflationary expectations, and no increase in interest rates, the results the TUC obtain do not seem unreasonable. They differ from the NEDC results - which showed a fairly rapid crowding out of higher public sector investment - mainly because the TUC assume that interest rates would not have to rise, and that the higher public sector borrowing involved would be accommodated by faster monetary growth. (On a package of this size £M3 growth might be 4-5% higher in 1983-84 than otherwise). However, a major deterioration in inflationary expectations - which the results make no allowance for - would increase the inflationary costs. It might also prove difficult to avoid raising nominal interest rates if inflation were 3% or more higher than otherwise, and this would tend to reduce the output and unemployment effect on years 3 and 4.

5. The results also show only the first stage of the TUC's programme, and, even on the TUC's estimates, would only

<u>TUC's estimates of effect of their proposals</u>	Change to <u>level</u> of GDP (%)	Change to <u>growth</u> of GDP (% points)
Year 1	3.3	3.3
Year 2	4.3	1.0
Year 3	4.7	0.4
Year 4	4.2	-0.5

provide a boost to the growth in GDP for the first two years. So, as the document indicates elsewhere, further reflationary measures could be expected to meet their 4% p.a. growth targets (eg. the full Reconstruction of Britain public investment package would cost £29.5 bn over 5 years, or £6 bn a year - twice the amount allocated to public investment in the budget proposals for 1983). This again would worsen the inflationary prospects - although the boost to output would be larger in later years.

6. Similar remarks apply to the other main plank of the TUC's programme - selective and temporary import controls. While these would - if effective - give a further boost to output and employment, they would also exacerbate inflationary pressures - both directly, since imported goods prices subject to quotas would tend to go up - and indirectly by protecting domestic producers and their employees from international competition.

7. Despite these remarks, the TUC's <u>presentation</u> of their results has improved compared to last year, which may show some pay-off to the labours involved in the NEDC paper and the Model Manual:

(i) The results are shown for four years instead of just year 1, and they emphasise that results for the first two years are more reliable than those for years 3 and 4.

(ii) They emphasise the difference between assuming an accommodating and a non-accommodating monetary policy, and the role of judgement in producing the results.

(iii) They acknowledge - and attempt to meet - some of the criticisms of their approach - effects of higher borrowing on the PSBR and money supply, and hence on inflation.

8. There are obviously points of detail and of their analysis which we would dispute, in particular:

(i) Some of the jobs estimates on the manpower and training strategy are probably optimistic.

(ii) The retention of exchange controls is not, as we seem to repeat continually, compatible with a belief that the Government should have done something to keep the £ more sensibly valued.

Richard Gleed

R GLEED
MP1

TUC Budget representations

1. Does Chancellor agree with the representations?

Will study and fully consider TUC's views. All representations play a useful part in putting together a Budget, and views of national organisations like the TUC are particularly important. Share concern of TUC over level of unemployment and desire to see improvement in economic performance. Does not guarantee we agree over the means to those ends.

2. Will Chancellor be seeing TUC to discuss their Budget recommendation?

Have not up to present (close on 3 February) had a request from them for a meeting.

3. Size of TUC proposals

TUC proposes £10 billion gross package, involving additional PSBR cost, on their estimates, of £6½ billion. These are very large sums. Would not want to jeopardise gains made by our prudent fiscal policies.

4. But TUC programme run through Treasury computer produces output and employment growth with only modest rise in inflation - What's wrong with that?

Testing packages on the Treasury model does not mean results definitive. Projections are never more plausible than assumptions fed in. Model cannot accurately assess effect of major changes in policy, predict confidence effects, or foresee success - or failure - of a National Economic Assessment.

5. Participative planning

Best way to prosperity is to allow market forces to operate and not to inhibit decision-making with controls and centralised directions. Government policy to promote employee commitment is through wider share ownership and profit-making.

6. National Economic Assessment

Wage restraint is of critical importance. But TUC reiterate reliance on a vague NEA without clarifying how it would work or could be made to stick. Past experience of incomes policies and social contracts does not inspire confidence.

7. A National Investment Bank

Problem of funding not one of a lack of sufficient funds but lack of profitable investment opportunities. Steps were taken to meet the financing gaps identified by the Wilson Committee (eg setting up Loan Guarantee Scheme, lauch of zero coupon bonds). It is central plank of Government policy to increase the profitability of investment.

8. Increase public sector investment

/TUC's plans for 1983-84 first instalment of £20 billion over five years programme./

Immediate problem not to make more funds available but to get local authorities and nationalised industries to spend the capital provision open to them. Capital expenditure in 1983-84 now planned (1983 PEWP) to be some 12 per cent higher than estimated outturn for 1982-83. (PM wrote to LAs and NIs in November explaining Government's concern at extent of underspending, and changes are being made in the capital allocation procedures for local authorities to combat underspending in future.)

9. Increase housing programme?

/Major part of proposed public sector investment 1983-84 is £1.4billion for home building and renovation./
No case for such an addition: it will add to public spending, pressure on interest rates and inflation.

Local authorities have not spent as much as they could in 1982-83. But we have made provision for significant growth in 1983-84: gross housing capital investment can increase by 12% and local authority spending by 20%.

The private sector is the key to recovery in house building and it is doing well: new starts in 1982 were up by 20% over 1981. The Government is concentrating on repair and improvement: higher rates of improvement grants are available; and we have allowed local authorities to spend without limit on improvement grants in both 1982-83 and 1983-84.

10. Regional Development?

[TUC propose £850 million in 1983-84 including employment premium.]

Regional economic policy instruments have been under review by officials of Departments concerned. Minister now considering their report. No decisions yet taken.

11. True Scale of Unemployment

[TUC add 3.3 million unemployed (old series) 0.6 million unregistered unemployed, 0.4 million on special measures to give job shortage of 4.3 million.]

Specious to include those on special measures who are not unemployed. Unregistered unemployed can only be estimated; different definitions and methods will yield different results. Claimant figures are best indications of trend.

12. 'Cost' of unemployment

[Effect of measures on PSBR would be mitigated by savings on benefits to tax revenue from employment growth and spending from lower unemployment.]

Effects of changes in unemployment on public finances will vary widely according to underlying circumstances - eg world trade changes, UK competitiveness, level of UK earnings etc. Not therefore sensible to talk about cost of unemployment. Payments of UB and SB to registered unemployed currently expected to total about £5 billion in 1982-83. Comparable figures for total of taxes and NIC not collected cannot be given. No basis exists for estimating what the level of earnings and tax receipts would be if all the unemployed were working.

13. <u>Shorter work-time?</u>

If reductions in working time are to reduce unemployment there must also be a corresponding reduction in incomes. If weekly pay remains constant while hours are reduced, unit labour costs are forced up, competitiveness worsens and output and employment suffer.

14. <u>Training and employment measures</u>

Government planning to spend £1½ billion in cash in 1982-83 and £2 billion in 1983-84 on special employment and training measures. This shows their concern to alleviate the impact of unemployment on the most vulnerable.

15. <u>Wage cuts not route to increasing employment?</u>

[Economic Review paras 3.1-6 ~~3 January 6~~]

On the contrary. More modest wage increases - not necessarily wage cuts - along with improved productivity provide only route to lasting improvements in competitiveness and to recapture of lost markets

16. <u>'Productivity miracle' illusory?</u>

[Economic Review paragraph 3.9]

Certainly not right to call it a 'miracle' but performance impressive, well in excess of what could have been expected at this point in the economic cycle. Output per head in manufacturing is 13 per cent higher than at the end of 1980.

17. <u>Selective Import Controls would assist economic reconstruction?</u>

[The TUC is calling for import controls on sectors and products which will play a key role in economic reconstruction or which will be subject to serious problems of adjustment to new market conditions.]

No. The UK Government is looking for an expansion of world trade, not a contraction. Protectionism only reduces competition, which raises prices and limits the choice to the consumer.

18. But wouldn't import controls help to reduce unemployment?

No. Protectionist measures only lead to retaliation by other countries. The UK economy is particularly vulnerable to this. One third of our output is exported. We cannot afford to have other countries putting up barrier against our goods and services.

19. Doesn't the growth in imports show that there is a one-way traffic in trade?

On the contrary, although imports have risen in recent years, so have exports. Non-oil exports held up in 1982 despite falling world trade. In December the monthly value of UK exports topped £5 billion for the first time. As a result the current account is performing very well - about £4½ billion in surplus for 1982.

20. Is the UK alone in trying to keep markets open?

No, we could not act as the sole defenders of an open trading system. Instead we are working with our partners in the EC and GATT. Together we can respond in a co-ordinated way to unfair competition.

21. So what can be done to safeguard British producers against the dumping of subsidised imports?

The UK has the right to take selective action where British producers are subject to unfair competition. Under international agreements the EC and GATT can counter by imposing specific duties with the aim of getting the countries responsible to abandon such practices.