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USOECN ALSO FOR EMBASSY

E.O.12356: DECL: OADR
TAGS: ECON, PGOV, ELAB, KPRP, UK
SUBJECT: LABOURNOMICS: THE ISSUES

REF: LONDON 7913

1. C - ENTIRE TEXT.
2. SUMMARY. THE LABOR PARTY'S ECONOMIC PROGRAM HAS TWO BASIC PILLARS:

- REJUVENATING THE INDUSTRIAL SECTOR, AND
- REDUCING THE UNEMPLOYMENT ROLLS BY ONE MILLION PEOPLE WITHIN THE FIRST TWO YEARS OF OFFICE.

IN ORDER TO ACCOMPLISH THESE GOALS, THE PARTY SAYS IT WOULD:

- INCREASE GOVERNMENT SPENDING, PARTICULARLY THROUGH

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- . LOCAL GOVERNMENT;
- IMPLEMENT A GREATLY ENHANCED JOBS TRAINING SCHEME;
- ESTABLISH AN ELABORATE SYSTEM OF TRIPARTITE PLANNING;

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- RESORT TO SOME STILL VAGUELY DEFINED PROTECTIONIST
POLICIES; AND
- PUT IN PLACE A NUMBER OF PROGRAMS IN THE
INDUSTRIAL SECTOR AIMED AT ENHANCING INVESTMENT
AND STIMULATING THE HIGH TECH SIDE OF
MANUFACTURING.

(THIS IS THE SECOND PART OF THE TWO-PART LABOURNOMICS
SERIES BEGAN WITH REFTTEL.) END SUMMARY.

3. IN "LABOURNOMICS THE SETTING" (REFTTEL), WE
DISCUSSED THE LABOR PARTY'S ECONOMIC PROGRAM IN TERMS OF
ITS PHILOSOPHY, AIMS, AND SETTING. FOLLOWING IS A
DISCUSSION OF THE KEY ELEMENTS OF THE PROGRAM, AS THE
LABOR PARTY DOCUMENTS OUTLINE IT.

I. KINNOCK'S "NEW INDUSTRIAL STRENGTH FOR BRITAIN"

A. WHY MANUFACTURING?

RESURRECTING BRITISH MANUFACTURING IS THE CORE OF
THE LABOR PARTY'S ECONOMIC PROGRAM. LABOR NOW VIEWS
MANUFACTURING AS A SOURCE OF "WEALTH" AS WELL AS
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"JOBS." IT REJECTS THE VIEW THAT BRITAIN CAN LIVE BY
SERVICES ALONE, POINTING TO THE SHARP DETERIORATION OF
BRITAIN'S MERCHANDISE TRADE BALANCE DURING THE PAST FEW
YEARS. LABOR NOTES THAT SERVICES MAKE UP ONLY 23
PERCENT OF EXPORT EARNINGS AND MANUFACTURES, 51
PERCENT. IT DOES NOT BELIEVE GROWTH IN SERVICES EXPORTS
CAN MATCH THE RAPID RATE OF DECLINE IN MANUFACTURING
TRADE. TO BE COMPETITIVE, BRITAIN WILL NEED A STRONG
INDUSTRIAL SECTOR, IT REASONS.

B. THE INDUSTRIAL ENVIRONMENT

ALTHOUGH IT WOULD BE TOO MUCH TO THINK THAT A LABOR
PARTY COULD COMPLETELY RESIST ITS DIRIGISTIC TENDENCY
TOWARD ECONOMIC INTERVENTION, LABOR'S PROGRAM
CONSCIENTIOUSLY FOCUSSES ON IMPROVING THE INDUSTRIAL
ENVIRONMENT. FOR EXAMPLE, IF ELECTED LABOR SAYS IT WOULD:

- GIVE COMPANIES A BREAK ON SOCIAL INSURANCE

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CONTRIBUTIONS TO BRING DOWN WAGE COSTS AND ENCOURAGE NEW
HIRINGS.

-- PROVIDE TAX INCENTIVES TO ENCOURAGE INVESTMENT IN
NEW PLANT, PARTICULARLY IN HIGHER TECH TYPES OF
INDUSTRIES.

-- CREATE TAX DISINCENTIVES FOR HOLDING FUNDS ABROAD.
THE OBJECTIVE IS TO STIMULATE A REPATRIATION OF CAPITAL,
THUS AVOIDING THE NEED FOR EXCHANGE RATE CONTROLS SHOULD
THE CURRENT ACCOUNT FALL INTO DIFFICULTY AS A RESULT OF
THE PROGRAM'S REFLATION.

-- INITIATE A TRIPARTITE VOLUNTARY PLANNING PROCESS
WITH AN EYE TOWARD ESTABLISHING ACCEPTABLE PRIORITIES

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AMONG ALL ACTORS (ESPECIALLY THE UNIONS) AND CONTAINING
INFLATION. A LABOR GOVERNMENT WOULD COMMENCE BY CALLING

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A NATIONAL ECONOMIC SUMMIT OF GOVERNMENT, INDUSTRY, FINANCE, AND TRADE UNIONS TO STUDY THOROUGHLY ECONOMIC OPTIONS. A NATIONAL ECONOMIC ASSESSMENT FORUM WOULD BE ESTABLISHED TO DETERMINE ECONOMIC PRIORITIES IN VIEW OF CONSTRAINTS FACING THE ECONOMY AND TO ACHIEVE GENERAL AGREEMENT ON POLICIES TO BE FOLLOWED.

-- ESTABLISH A BRITISH INVESTMENT BANK (BIB) TO INCREASE THE AVAILABILITY OF LONG-TERM CAPITAL FOR INDUSTRY. THE BIB WOULD BE ADMINISTERED BY THE DEPARTMENT OF TRADE AND INDUSTRY AND WOULD MAKE CREDIT AVAILABLE FOR INDUSTRY, SOMETIMES AT LOW INTEREST RATES.
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-- SIGNIFICANTLY EXPAND PUBLICLY AND PRIVATELY FINANCED TRAINING AND EDUCATION SCHEMES.

-- ENHANCE THE DEPARTMENT OF TRADE AND INDUSTRY'S ROLE, ESPECIALLY TO PROVIDE MORE EXPORT PROMOTION SERVICES.

-- INCREASE GOVERNMENT FUNDING OF BASIC RESEARCH. LABOR WOULD ALSO INCREASE SPENDING ON UNIVERSITY RESEARCH AND THE UK'S SCIENCE AND RESEARCH COUNCILS. IT ALSO SAYS IT WILL PLACE THE EMPHASIS ON PRIVATE SECTOR/UNIVERSITY RESEARCH PROJECTS.

-- INCREASE GOVERNMENT SPENDING ON INFRASTRUCTURE IMPROVEMENTS. LABOR PLANS TO SPEND INCREASED SUMS ON MODERNIZATION AND MAINTENANCE OF ROADS AND RAILWAY SYSTEMS, RENEWAL OF DRAINAGE AND SEWAGES SYSTEMS, URBAN RENEWAL, HOUSING, AND SCHOOLS.

-- SUSTAIN A GRADUALLY EXPANSIONARY DEMAND POLICY TO FACILITATE INDUSTRIAL PLANNING. AS LABOR PUTS IT: "THE OVERALL BALANCE OF MONETARY AND FISCAL POLICY WILL BE GEARED TOWARDS A STEADY AND CONTROLLED EXPANSION OF DEMAND -- AN EXPANSION WHICH FITS THE NEEDS OF DOMESTIC INDUSTRIAL EXPANSION."

II. TWO YEARS TO DECREASE UNEMPLOYMENT BY 1 MILLION

A. WHERE DO THE JOBS COME FROM?

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CUTTING THE UNEMPLOYED LIST BY A MILLION PEOPLE WITHIN TWO YEARS OF ASSUMING OFFICE IS THE SECOND PILLAR OF LABOR'S ECONOMIC PROGRAM. IT WILL NEED TO CREATE MORE THAN A MILLION JOBS TO DO THAT. THE PARTY EXPECTS SUPPLY-SIDE MEASURES TO GENERATE 250,000 OF THESE JOBS IN THE PRIVATE SECTOR. INFRASTRUCTURE INVESTMENT, IMPLEMENTED MAINLY AT THE LOCAL GOVERNMENT LEVEL, WOULD CREATE ANOTHER 250,000. TRAINING SCHEMES WOULD TAKE 360,000, PRIMARILY YOUNGER WORKERS, OFF UNEMPLOYMENT ROLES. AND FINALLY, INCREASED GOVERNMENT SPENDING ON SOCIAL SERVICES -- EDUCATION, HEALTH, ETC. -- WOULD PROVIDE 300,000 JOBS. GRAND TOTAL, ACCORDING THE LABOR'S ESTIMATES: 1,160,000 JOBS.

THIS IS NOT AN UNREALISTIC GOAL, SINCE THE BULK OF THE JOBS WILL COME IN THE PUBLIC SECTOR. THE SDP/LIBERAL ALLIANCE HAS MADE A SIMILAR PROMISE (ALLOWING ITSELF THREE YEARS INSTEAD OF TWO). LABOR SUPPORTERS THINK IT IS A CONSERVATIVE (WITH A SMALL "C") APPROACH. THE PARTY CASTS IT AS A SHOT IN THE ARM, A PROGRAM WHICH WILL NOT NEED TO BE REPEATED ONCE ITS INDUSTRIAL PROGRAM BEGINS BEARING FRUIT.

C. WHERE DO FISCAL AND MONETARY POLICY FIT IN?

IN ITS POLICY DOCUMENTS, LABOR ESSENTIALLY IGNORES FISCAL AND MONETARY POLICY. INSTEAD, IT DISCUSSES THEM ONLY AS SUPPORTIVE MECHANISMS. LABOR SAYS PUBLIC SPENDING WILL BE INCREASED TO RENEW INFRASTRUCTURE, IMPROVE THE QUALITY OF SOCIAL SERVICES, OR SUPPORT R AND D AND BASIC RESEARCH. ON THE MONETARY SIDE, IT WOULD EASE CONDITIONS TO BRING DOWN INTEREST RATES. INTEREST RATES WOULD BE KEPT RELATIVELY LOW IN ORDER TO FACILITATE GREATER INVESTMENT. OVERALL GOVERNMENT DEMAND, THE PARTY ADDS, WOULD BE GRADUALLY EXPANDING IN ORDER TO SUPPORT INDUSTRY. TAXES WOULD BE RAISED ON THE

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TOP FIVE PERCENT OF THE POPULATION TO PAY FOR GREATER SPENDING ON SOCIAL SERVICES. MONETARY AND FISCAL POLICY WOULD BE "BASED ON THE NEED TO MAINTAIN A STABLE AND COMPETITIVE EXCHANGE RATE." ETC. OBVIOUSLY, ALL THIS TRANSLATES, EVEN BY LABOR'S OWN CALCULATIONS, INTO A LARGER BUDGET DEFICIT.

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III. A RETURN TO PROTECTIONISM?

A. TRADE ACCOUNT AND CURRENT ACCOUNT PROBLEMS

PRIVATELY, PARTY ECONOMISTS RECOGNIZE THAT THE PROGRAM POTENTIALLY HAS SOME HOLES. "THE CURRENT ACCOUNT IS OUR BIGGEST CONSTRAINT," KINNOCK'S ECONOMIC ADVISER TOLD US. PUTTING A MILLION WORKERS BACK TO WORK IS BOUND TO BE EXPENSIVE, AND THE PROBLEM IS HOW TO KEEP EXPANDING DOMESTIC DEMAND FROM SUCKING IN IMPORTS, GENERATING JOBS IN GERMANY AND JAPAN INSTEAD OF GLASGOW AND MANCHESTER. THE PARTY HAS PUBLICLY COMMITTED ITSELF NOT TO RESORT TO EXCHANGE CONTROLS. INSTEAD, THE PROGRAM CALLS FOR A CAPITAL REPATRIATION SCHEME THAT

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WOULD REQUIRE BRITISH INVESTORS TO KEEP A GIVEN

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PERCENTAGE OF THEIR ASSETS IN THE UK IN ORDER TO ENJOY TAX PRIVILEGES. HOLDING COMPANIES, LARGE MULTINATIONALS, AND PENSION FUNDS WOULD BE PARTICULARLY AFFECTED.

OBSERVERS IN THE CITY ADMIT TO US THAT THE SCHEME WOULD PROBABLY HAVE THE DESIRED EFFECT OF BRINGING BACK CAPITAL. YET THEY NOTE THAT TO THE EXTENT IT SUCCEEDS, IT COULD PUSH UP STERLING, THUS WORSENING THE CURRENT ACCOUNT AND HURTING THE VERY INDUSTRY LABOR WANTS TO HELP. LABOR HOPES, OF COURSE, THAT THE UPWARD PRESSURE ON STERLING WOULD COMPENSATE FOR DOWNWARD PRESSURES COMING FROM THE TRADE ACCOUNT DEFICIT (AND POSSIBLY CITY JITTERS) FORESEEN FOR THE INITIAL PHASES OF LABOR'S PROGRAM. IT ALL GETS VERY "IF'Y," AND IT IS HARD TO SAY HOW STERLING WOULD FINALLY COME OUT. IT IS POSSIBLE THAT THE ONLY THING REPATRIATION MIGHT ACCOMPLISH WOULD BE A DISTORTION OF CAPITAL FLOWS BETWEEN THE UK AND THE REST OF THE WORLD.

THERE IS ALSO BRITAIN'S VERSION OF THE OLD "INFANT INDUSTRY" PROBLEM, I.E. HOW WOULD THE UK'S BEATEN DOWN BUT REJUVENATING (AS PER THE PROGRAM) HOPEFULLY SUNRISE INDUSTRY MANUFACTURERS EVER COMPETE IN TODAY'S WORLD WITH JAPAN AND THE NIC'S, OR EVEN GERMANY AND FRANCE AT HOME OR ABROAD? LABOR RECOGNIZES THAT IN THE LONG RUN COMPANIES WILL HAVE TO BE COMPETITIVE TO STOP AN INVASION OF IMPORTS. BUT IN THE SHORT RUN, IT SAYS, THEY WILL NEED PROTECTION.

B. LABOR'S PROTECTIONIST DILEMMA

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SINCE THE LABOR PARTY CLAIMS IT WILL HONOR BRITAIN'S MULTILATERAL COMMITMENTS TO THE GATT AND THE TREATY OF ROMÉ, THIS OBVIOUSLY CREATES A DILEMMA -- WHICH THE PARTY RECOGNIZES. IF BRITISH INDUSTRY NEEDS PROTECTION, PARTICULARLY FROM SOME OF THE UK'S CLOSEST TRADING PARTNERS, THE LEEWAY FOR UNILATERAL PROTECTIONISM IS NONETHELESS LIMITED. AND MULTILATERAL MEASURES WOULD REQUIRE THE COOPERATION OF COMPETITORS. THE PARTY SAYS IT WANTS AS MUCH FREEDOM AS POSSIBLE TO IMPLEMENT ITS ECONOMIC POLICIES -- IT OPPOSES BRITISH MEMBERSHIP IN THE EMS (AT LEAST UNDER THE CURRENT ARRANGEMENT) AND THE EC'S INTERNAL MARKET INITIATIVE, FOR EXAMPLE -- BUT IT NEEDS INTERNATIONAL COOPERATION FOR ACHIEVING ITS POLICY GOALS.

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HERE PARTY IDEOLOGUES RUN SHORT ON IDEAS, ESPECIALLY GOOD ONES. THEY TALK OF USING GOVERNMENT PROCUREMENT FOR SECURING PROTECTION FOR BRITISH PRODUCERS. AND THEY PROMISE TO BRIDLE MULTINATIONALS OPERATING IN BRITAIN, WHICH, THEY SAY, ARE TOO OFTEN SOURCING IN SUCH A WAY AS TO ENCOURAGE IMPORT PENETRATION. LABOR SAYS IT WILL ENFORCE SOME FORM OF PERFORMANCE REQUIREMENTS (OUR WORD NOT THEIRS) ON MULTINATIONALS' TRADE PATTERNS IN ORDER TO FORCE A CONTINUAL IMPROVEMENT IN MULTINATIONAL COMPANIES' TRADE BALANCES. ASIDE FROM WHATEVER OBJECTIONS WE WOULD RAISE TO SUCH A POLICY, IT WOULD BE ANATHEMA TO BRITAIN'S EC PARTNERS. IT IS HARD TO SEE HOW THE UK WOULD SELL THAT IN THE EC CONTEXT, EVEN THOUGH THE QUESTION OF MNC ACTIVITIES IS ALWAYS A POPULAR ONE.

C. CHANGING THE INTERNATIONAL TRADING SYSTEM

KINNOCK HAS ALSO SUGGESTED REVAMPING THE INTERNATIONAL TRADING SYSTEM TO ALLOW COUNTRIES, WHICH REACH A DEFINED MAXIMUM LEVEL OF TRADE DEFICIT,
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PROTECTION TO CORRECT THE TRADE IMBALANCE. TO PREVENT THE TRADE DEFICIT FROM RISING FURTHER, THE DEFICIT COUNTRY WOULD BE ALLOWED TO USE ANY MEANS WHICH DID NOT DISCRIMINATE BETWEEN COUNTRIES OR INDUSTRIES. KINNOCK'S

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EXAMPLES OF SUCH MEANS: UNIFORM TARIFFS, AUCTIONED
QUOTAS OF FOREIGN EXCHANGE, DUAL EXCHANGE RATES, OR
SIMPLY DEVALUATION.

COMMENT

4. WHILE WE DISCUSSED THE MORE GENERAL CRITIQUE OF
LABOR'S PROGRAM IN REFTTEL, PERHAPS THE THING WHICH JUMPS
OUT AT US FIRST OF ALL IS ITS PROTECTIONIST TENDENCIES.
EVEN PARTY ECONOMISTS ADMIT THAT THE PROGRAM IS
VULNERABLE ON TRADE, THE CURRENT ACCOUNT, AND
INFLATION. AND THESE COULD LEAD BRITAIN DOWN A
PROTECTIONIST ROAD. THE POTENTIAL FOR ADVERSELY
AFFECTING US-UK TRADE RELATIONS IS OBVIOUS. BRITAIN,
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NONETHELESS, REMAINS TIED TO THE EC AND GATT, AND SINCE
LABOR IS COMMITTED TO BOTH, IT WOULD BE DIFFICULT FOR
ANY UK GOVERNMENT TO GET VERY FAR OFF THE RESERVATION.
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