Industry + Employment
Seminar file

12 December 1984

MR TURNBULL

In this quarter's economic bulletin from the University of Liverpool, Paul Ashton has set out an interesting proposition for dealing with long-term unemployment.

He points out that over the last 2 years the increase in tax thresholds has little more than offset the changes in Housing Benefit: although it is now marginally more worthwhile to work than it was 2 years ago, it is still much less worthwhile than it was in 1978 and 1979. Replacement rates (the usual measure of whether it is worth working or not) were 9 percentage points higher in 1983 than in 1978 and 1979 for families at average earnings levels with dependent children. Ashton reckons that an unemployed man with a wife and 2 children would find himself no better off taking a job at £6,650 per annum; and with 4 children, he would be worse off on a salary of £8,000.

He goes on to point out that in a recent PSI report it is revealed that the long-term unemployed are not making much effort to look for a job. In the 15 month period to September 1981, one quarter of the long-term unemployed surveyed had not made a single job application; and less than half of them had made more than 5. Less than 30 per cent of those surveyed had obtained a single job interview in the period.

Whilst some of the long-term unemployed are in areas where there is little prospect of an interview or a vacancy, these figures do reveal what common sense tells you is true: that the longer you are unemployed, the more hopeless the situation becomes, and the less equipped you are to do something about it.

Ashton concludes that we need an enlarged and modified Community Programme, so that every long-term unemployed person could be provided with a CP place. He thinks there is no need to offer anything above benefit: the cost would therefore be kept to £750 per place to cover administration, work expenses, materials and equipment. He believes this could be self-financing, as he thinks that the private sector would then start generating new low-wage jobs equivalent to benefit levels, which would reduce the unemployment costs as people came off benefit.

There are two things in his scheme which we have not recommended. The first is an element of compulsion, as he thinks the long-term unemployed should have to take a CP place. The second is his bullishness concerning the likely growth of private sector jobs at low pay rates to take up the slack. However, the attached article is both illuminating and interesting, and encourages us further in pursuing the benefit/Community Programme approach to making the labour market work better.

JOHN REDWOOD

Chapter 4

Replacement Ratios and Unemployment Decisions

by Paul Ashton

Since our last look at replacement ratios in December 1983, the 7% increase in tax thresholds above the inflation rate effectively reduced the proportion of work income received when unemployed. Working in the opposite direction, however, the April changes in the Housing Benefit (HB) 'tapers' (see Quarterly Economic Bulletin, March 1984) slightly increased replacement ratios for recipients of this benefit with earnings above the needs allowances, **and** added 7 percentage points to their marginal rates of tax.

New benefit rates

Last month the new social security rates came into effect. Supplementary benefits to the unemployed were increased in line with the RPI (less housing) at 4.7%. For those in work the HB needs allowances for adults were increased by 4.8%, and for child dependents by 8%. Set against this is the second instalment of the increase in the tapers – an additional 3 percentage points on marginal tax rates for those affected, making a total increase of 10 points since our last review. This represents a significant disincentive to earn more by working overtime, or by seeking promotion or further training.

Other changes in benefit include a 5.4% increase in child benefit to £6.85, and similar increases in Family Income Supplement for lower-paid families. The rules have been changed for payment of the latter benefit, however, and only new claimants received the increase in November. Other claimants must wait until the expiration of their existing awards which run for 12 months.

The net effect of the tax and benefit changes since December last varies from household to household and at different income levels, but given the rise in earnings over the year most replacement ratios would have fallen slightly.

Replacement rates

This small improvement in replacement ratios follows a slight improvement last year. But replacement ratios are still well above those of 1978 and 1979. On the DHSS's reckoning of work income relative to unemployment benefits (which like that of the IFS ignores work expenses and passported benefits), replacement rates in 1983 were around 9 percentage points higher than in 1978 and 1979 for families with dependent children at average earnings levels.

Our tables show how acute the problem of the unemployment trap still is: an unemployed man with a wife and two children, for example, would find himself no better off taking a job at £6,650 p.a. With four children, an unemployed man taking a job with a salary of £8,000 p.a. would find himself worse off by over £1 a week. Families with older dependent children or with higher housing costs will need to earn even more to exceed their unemployment income.

Beveridge and the long-term unemployed

Given the examples quoted above and those in the following tables, and given that we now have 1.25 million long-term unemployed, we should recall Beveridge's caution that:

> The danger of providing benefits, which are both adequate in amount and indefinite in duration, is that men, as creatures who adapt themselves to circumstances, may settle down to them.
>
> Beveridge Report, para. 130.

Evidence of the declining interest of the long-term unemployed in seeking work is given in a recent PSI report commissioned by the Department of Employment, **Long-Term Unemployment and Labour Markets,** (PSI, 1983). The report shows, for example, that in a 15-month period to September 1981, a quarter of the long-term unemployed surveyed admitted to not having made a single job application and that less than half had made more than five. Not surprisingly therefore, less than 30% of those surveyed had obtained a job interview in that period. The longer the period of unemployment, the less likely was an unemployed person to have attended an interview.

Whatever the precise reasons for this low level of job search, whether it is related to the level of benefits to the unemployed, or to the psychological effects of prolonged unemployment, or whatever, there seems little hope of remotivating the long-term unemployed as things stand. The situation is likely to deteriorate over time – indeed the PSI report noted that 41% of job-seeking males had reduced the time spent seeking work over the 15-month period.

Some drastic action is called for therefore if the long-term unemployed are not to lose interest altogether in joining or rejoining the workforce. There already exists a scheme to help those who have not worked for a year or more: the Community Programme (CP). This scheme offers twelve months work in the local neighbourhood on projects of use to the community but which would not normally be undertaken on a commercial basis. The rates of pay offered are the local hourly rate for the job for the number of hours worked. However, the scheme is voluntary, often only part time, and for some unemployed would entail taking a drop in income from their present level of benefit. There are currently over 25,000 unfilled vacancies, to which 20,000 more are shortly to be added.

An enlarged and modified Community Programme

What is proposed is that a (full-time) Community Programme place be offered directly to each of the long-term unemployed with a penalty imposed if the offer is refused. This penalty would extend to complete withdrawal of benefit after a certain number of offers are turned down. Such a drastic measure, it is maintained, is in the individual's own interest. Beveridge himself advocated that:

> Men and women who have been unemployed for a certain period should be required as a condition of continued benefit to attend a work or training centre, such attendance being designed both as a means of preventing habituation to idleness and as a means of improving capacity for earning. (para. 131)

He added too that, "conditions imposed on benefit must be enforced where necessary by suitable penalties" (ibid.).

The predictable outcry from the Opposition and from pressure groups should not deter the government, and certainly not this government, from imposing the kind of conditions Beveridge saw as necessary and in the long-term interest of the long-term unemployed. ıt.

Since there are currently too few places to ensure an offer is made to all the long-term unemployed, it is proposed that (a) the number of CP places be substantially increased, and (b) a gradualist approach be adopted, applying the measures in the first instance to those unemployed the longest (say over three years), gradually reducing the qualifying period to one year as more places come on stream. However, it would not in practice be necessary to provide **every** long-term unemployed person with a CP place, nor need it cost very much to effectively end long-term unemployment.

Benefit-wages

It is proposed that entrants to the scheme be paid the same in net earnings (plus an allowance for work expenses) as they currently receive in benefits: no financial incentive is needed. What long-term unemployed people need most is the dignity of work and the feeling of self-respect that employment engenders.

The cost of each place on the scheme, then, is limited to administration costs, work expenses, and any materials and equipment used - approximately £750 p.a. per place. The number of places required will be substantially less than the number of registered long-term unemployed. This is because (i) a (small) proportion of the unemployed have adequate undisclosed incomes presently being supplemented by social security benefits: they will turn down the offer of community work, and (ii) more importantly, new jobs offering (low) wages which, when supplemented with means-tested in-work benefits will provide an income equal to or a little above the benefit-wage levels, will emerge offering alternative work for the unemployed who prefer to work in the private sector in 'real' jobs offering more interesting and varied work.

Each person taking one of those new, low-wage jobs in the private sector will provide a net saving in benefits which will finance 2-3 jobs in the CP scheme. For example, an unemployed man with two children taking a job at £60 p.w. will receive £2.40 more than his benefit-wage (more if his work expenses are lower than £8.50) once FIS and HB are received. The net cost to the state of supplementing his wages will be £53.32 (including child benefit) against £101.40 (plus an amount for work expenses) payable as a benefit-wage - a saving of at least £47 p.w. or £2,440 p.a., enough to pay for over 3 CP work places. So, if enough low-paid jobs are created as a result of imposing conditions on the provision of benefits, **the total cost of effectively eliminating long-term unemployment could be nil.** For if the average benefit saving to the state is £2,000 p.a. per newly-created low-wage job, then the creation of 340,000 jobs would wholly finance enough CP jobs to provide all the remaining long-term unemployed with a community job. And even if only 250,000 new jobs were created (surely a conservative figure?) the net cost of providing the other million unemployed with a job on the CP scheme would be only £250 million. If it went the other way, with say 500,000 new jobs created, the exchequer would have a net surplus of £440 million! Either way though the unemployment figures would tumble by 1.25 million.

Guide to mnemonics of table:

NI	National Insurance	NET	net income + benefits	HEATING	heating allowance for under 5s
PASSP	passport benefits (FSM + FMN + FDOP)	RENT RB	rent rebate	SB	supplementary benefit
CB	child benefit	RATE RB	rate rebate	CH/ALL	SB child allowance (age related)
WEX	work expenses	MRT	marginal rate of tax (%)	FSM	free school meals
FIS	family income supplement	W RATES	water rates	FMV	free milk and vitamins (infants)
		R/R	replacement ratio	FDOP	free dental, optical + prescriptions

SINGLE PERSON: RENT OF £12.50 RATES OF £4.00

EMPLOYED		UNEMPLOYED	
50.00	GROSS	28.05	SB
3.43	TAX	0.00	CH ALL
4.50	NI	12.50	RENT
0.00	CB	4.00	RATES
0.00	FIS	0.00	HEATING
10.53	RENT REBATE	0.00	FSM
3.37	RATE REBATE	0.00	FMV
0.00	PASSPORT	1.50	W RATES
8.50	W EX	1.60	FDOP
47.47	NET	47.65	TOTAL

REPLACEMENT RATIO = 1

GROSS	TAX	NI	CB	FIS	RENT RB	RATE RB	PASSP	WEX	NET	MRT	R/R
50.00	3.43	4.50	0.00	0.00	10.53	3.37	0.00	8.50	47.47	%	1.00
60.00	6.43	5.40	0.00	0.00	8.03	2.57	0.00	8.50	50.27	72.00	.95
70.00	9.43	6.30	0.00	0.00	5.21	1.69	0.00	8.50	52.67	76.00	.90
80.00	12.43	7.20	0.00	0.00	2.31	.79	0.00	8.50	54.97	77.00	.87
90.00	15.43	8.10	0.00	0.00	0.00	0.00	0.00	8.50	57.97	70.00	.82
100.00	18.43	9.00	0.00	0.00	0.00	0.00	0.00	8.50	64.07	39.00	.74
110.00	21.43	9.90	0.00	0.00	0.00	0.00	0.00	8.50	70.17	39.00	.68
120.00	24.43	10.80	0.00	0.00	0.00	0.00	0.00	8.50	76.27	39.00	.62
130.00	27.43	11.70	0.00	0.00	0.00	0.00	0.00	8.50	82.37	39.00	.58
140.00	30.43	12.60	0.00	0.00	0.00	0.00	0.00	8.50	88.47	39.00	.54
150.00	33.43	13.50	0.00	0.00	0.00	0.00	0.00	8.50	94.57	39.00	.50
160.00	36.43	14.40	0.00	0.00	0.00	0.00	0.00	8.50	100.67	39.00	.47
170.00	39.43	15.30	0.00	0.00	0.00	0.00	0.00	8.50	106.77	39.00	.45
180.00	42.43	16.20	0.00	0.00	0.00	0.00	0.00	8.50	112.87	39.00	.42
190.00	45.43	17.10	0.00	0.00	0.00	0.00	0.00	8.50	118.97	39.00	.40
200.00	48.43	18.00	0.00	0.00	0.00	0.00	0.00	8.50	125.07	39.00	.38

COUPLE WITH NO CHILDREN: RENT OF £13.50 RATES OF £4.50)

EMPLOYED		UNEMPLOYED	
50.00	GROSS	45.55	SB
0.00	TAX	0.00	CH ALL
4.50	NI	13.50	RENT
0.00	CB	4.50	RATES
0.00	FIS	0.00	HEATING
13.50	RENT REBATE	0.00	FSM
4.50	RATE REBATE	0.00	FMV
0.00	PASSPORT	1.50	W RATES
8.50	W EX	3.20	FDOP
55.00	NET	68.25	TOTAL

REPLACEMENT RATIO = 1.24

GROSS	TAX	NI	CB	FIS	RENT RB	RATE RB	PASSP	WEX	NET	MRT	R/R
50.00	0.00	4.50	0.00	0.00	13.50	4.50	0.00	8.50	55.00	%	1.24
60.00	0.00	5.40	0.00	0.00	13.50	4.50	0.00	8.50	64.10	9.00	1.06
70.00	2.80	6.30	0.00	0.00	11.48	3.78	0.00	8.50	67.66	64.40	1.01
80.00	5.80	7.20	0.00	0.00	8.98	2.98	0.00	8.50	70.46	72.00	.97
90.00	8.80	8.10	0.00	0.00	6.22	2.12	0.00	8.50	72.94	75.20	.94
100.00	11.80	9.00	0.00	0.00	3.32	1.22	0.00	8.50	75.24	77.00	.91
110.00	14.80	9.90	0.00	0.00	0.00	0.00	0.00	8.50	76.80	84.40	.89
120.00	17.80	10.80	0.00	0.00	0.00	0.00	0.00	8.50	82.90	39.00	.82
130.00	20.80	11.70	0.00	0.00	0.00	0.00	0.00	8.50	89.00	39.00	.77
140.00	23.80	12.60	0.00	0.00	0.00	0.00	0.00	8.50	95.10	39.00	.72
150.00	26.80	13.50	0.00	0.00	0.00	0.00	0.00	8.50	101.20	39.00	.67
160.00	29.80	14.40	0.00	0.00	0.00	0.00	0.00	8.50	107.30	39.00	.64
170.00	32.80	15.30	0.00	0.00	0.00	0.00	0.00	8.50	113.40	39.00	.60
180.00	35.80	16.20	0.00	0.00	0.00	0.00	0.00	8.50	119.50	39.00	.57
190.00	38.80	17.10	0.00	0.00	0.00	0.00	0.00	8.50	125.60	39.00	.54
200.00	41.80	18.00	0.00	0.00	0.00	0.00	0.00	8.50	131.70	39.00	.52

COUPLE WITH 1 CHILD (1 UNDER 5): RENT OF £14.50 RATES OF £5.00

EMPLOYED		UNEMPLOYED	
50.00	GROSS	45.55	SB
0.00	TAX	9.60	CH ALL
4.50	NI	14.50	RENT
6.85	CB	5.00	RATES
20.00	FIS	2.10	HEATING
13.58	RENT REBATE	0.00	FSM
4.56	RATE REBATE	1.60	FMV
4.80	PASSPORT	1.50	W RATES
8.50	W EX	3.20	FDOP
86.79	NET	83.05	TOTAL

REPLACEMENT RATIO = .96

GROSS	TAX	NI	CB	FIS	RENT RB	RATE RB	PASSP	WEX	NET	MRT	R/R
50.00	0.00	4.50	6.85	20.00	13.58	4.56	4.80	8.50	86.79	%	.96
60.00	0.00	5.40	6.85	15.00	12.33	4.16	4.80	8.50	89.24	75.50	.93
70.00	2.80	6.30	6.85	10.00	11.08	3.76	4.80	8.50	88.89	103.50	.93
80.00	5.80	7.20	6.85	5.00	9.83	3.36	4.80	8.50	88.34	105.50	.94
90.00	8.80	8.10	6.85	0.00	8.56	2.96	0.00	8.50	82.97	153.70	1.00
100.00	11.80	9.00	6.85	0.00	5.66	2.06	0.00	8.50	85.27	77.00	.97
110.00	14.80	9.90	6.85	0.00	2.76	1.16	0.00	8.50	87.57	77.00	.95
120.00	17.80	10.80	6.85	0.00	0.00	0.00	0.00	8.50	89.75	78.20	.93
130.00	20.80	11.70	6.85	0.00	0.00	0.00	0.00	8.50	95.85	39.00	.87
140.00	23.80	12.60	6.85	0.00	0.00	0.00	0.00	8.50	101.95	39.00	.81
150.00	26.80	13.50	6.85	0.00	0.00	0.00	0.00	8.50	108.05	39.00	.77
160.00	29.80	14.40	6.85	0.00	0.00	0.00	0.00	8.50	114.15	39.00	.73
170.00	32.80	15.30	6.85	0.00	0.00	0.00	0.00	8.50	120.25	39.00	.69
180.00	35.80	16.20	6.85	0.00	0.00	0.00	0.00	8.50	126.35	39.00	.66
190.00	38.80	17.10	6.85	0.00	0.00	0.00	0.00	8.50	132.45	39.00	.63
200.00	41.80	18.00	6.85	0.00	0.00	0.00	0.00	8.50	138.55	39.00	.60

COUPLE WITH 2 CHILDREN (1 UNDER 5, 1 11-15): RENT OF £15.50 RATES OF £5.50

EMPLOYED		UNEMPLOYED	
50.00	GROSS	45.55	SB
0.00	TAX	23.95	CH ALL
4.50	NI	15.50	RENT
13.70	CB	5.50	RATES
25.00	FIS	2.10	HEATING
14.43	RENT REBATE	2.50	FSM
4.94	RATE REBATE	1.60	FMV
7.30	PASSPORT	1.50	W RATES
8.50	W EX	3.20	FDOP
102.37	NET	101.40	TOTAL

REPLACEMENT RATIO = .99

GROSS	TAX	NI	CB	FIS	RENT RB	RATE RB	PASSP	WEX	NET	MRT	R/R
50.00	0.00	4.50	13.70	25.00	14.43	4.94	7.30	8.50	102.37	%	.99
60.00	0.00	5.40	13.70	20.00	13.18	4.54	7.30	8.50	104.82	75.50	.97
70.00	2.80	6.30	13.70	15.00	11.93	4.14	7.30	8.50	104.47	103.50	.97
80.00	5.80	7.20	13.70	10.00	10.68	3.74	7.30	8.50	103.92	105.50	.98
90.00	8.80	8.10	13.70	5.00	9.43	3.34	7.30	8.50	103.37	105.50	.98
100.00	11.80	9.00	13.70	0.00	8.00	2.90	0.00	8.50	95.30	180.70	1.06
110.00	14.80	9.90	13.70	0.00	5.10	2.00	0.00	8.50	97.60	77.00	1.04
120.00	17.80	10.80	13.70	0.00	2.20	1.10	0.00	8.50	99.90	77.00	1.02
130.00	20.80	11.70	13.70	0.00	0.00	0.00	0.00	8.50	102.70	72.00	.99
140.00	23.80	12.60	13.70	0.00	0.00	0.00	0.00	8.50	108.80	39.00	.93
150.00	26.80	13.50	13.70	0.00	0.00	0.00	0.00	8.50	114.90	39.00	.88
160.00	29.80	14.40	13.70	0.00	0.00	0.00	0.00	8.50	121.00	39.00	.84
170.00	32.80	15.30	13.70	0.00	0.00	0.00	0.00	8.50	127.10	39.00	.80
180.00	35.80	16.20	13.70	0.00	0.00	0.00	0.00	8.50	133.20	39.00	.76
190.00	38.80	17.10	13.70	0.00	0.00	0.00	0.00	8.50	139.30	39.00	.73
200.00	41.80	18.00	13.70	0.00	0.00	0.00	0.00	8.50	145.40	39.00	.70

COUPLE WITH 3 CHILDREN (1 UNDER 5, 1 5-10, 1 11-15): RENT OF £16.00 RATES OF £6.00

EMPLOYED		UNEMPLOYED	
50.00	GROSS	45.55	SB
0.00	TAX	33.55	CH ALL
4.50	NI	16.00	RENT
20.55	CB	6.00	RATES
27.00	FIS	2.10	HEATING
15.73	RENT REBATE	5.00	FSM
5.56	RATE REBATE	1.60	FMV
9.80	PASSPORT	1.50	W RATES
8.50	W EX	3.20	FDOP
115.64	NET	114.50	TOTAL

REPLACEMENT RATIO = .99

GROSS	TAX	NI	CB	FIS	RENT RB	RATE RB	PASSP	WEX	NET	MRT	R/R
50.00	0.00	4.50	20.55	27.00	15.73	5.56	9.80	8.50	115.64	%	.99
60.00	0.00	5.40	20.55	25.00	13.73	4.92	9.80	8.50	120.10	55.40	.95
70.00	2.80	6.30	20.55	20.00	12.48	4.52	9.80	8.50	119.75	103.50	.96
80.00	5.80	7.20	20.55	15.00	11.23	4.12	9.80	8.50	119.20	105.50	.96
90.00	8.80	8.10	20.55	10.00	9.98	3.72	9.80	8.50	118.65	105.50	.97
100.00	11.80	9.00	20.55	5.00	8.59	3.29	9.80	8.50	117.93	107.20	.97
110.00	14.80	9.90	20.55	0.00	7.14	2.84	0.00	8.50	107.33	206.00	1.07
120.00	17.80	10.80	20.55	0.00	4.24	1.94	0.00	8.50	109.63	77.00	1.04
130.00	20.80	11.70	20.55	0.00	1.34	1.04	0.00	8.50	111.93	77.00	1.02
140.00	23.80	12.60	20.55	0.00	0.00	0.00	0.00	8.50	115.65	62.80	.99
150.00	26.80	13.50	20.55	0.00	0.00	0.00	0.00	8.50	121.75	39.00	.94
160.00	29.80	14.40	20.55	0.00	0.00	0.00	0.00	8.50	127.85	39.00	.90
170.00	32.80	15.30	20.55	0.00	0.00	0.00	0.00	8.50	133.95	39.00	.85
180.00	35.80	16.20	20.55	0.00	0.00	0.00	0.00	8.50	140.05	39.00	.82
190.00	38.80	17.10	20.55	0.00	0.00	0.00	0.00	8.50	146.15	39.00	.78
200.00	41.80	18.00	20.55	0.00	0.00	0.00	0.00	8.50	152.25	39.00	.75

Chapter 1

Twilight of the Union Bosses
by Patrick Minford

The prospects for the British economy are dependent on the outcome of the miners' strike. The hope must now be that many miners will accept economic logic and go back to work, and that there will be no concessions on the principle that uneconomic pits must be closed as soon as possible within an orderly programme of transition; those miners who remain on strike, perhaps for much of next year, will then de facto be closing down the pits at which they work, so accelerating the closure programme and causing themselves greater transitional hardship than necessary.

Summary of Forecast

	1984	1985	1986	1987	1988	1989
GDP Growth[1]	2.4	3.5	3.4	2.8	4.2	3.5
Inflation[2]	4.5	3.1	2.2	2.1	1.3	1.2
Unemployment (millions)[3]	3.1	3.1	3.0	2.8	2.6	2.2
Exchange Rate[4] (1975–100)	77.6	77.4	77.7	78.7	79.0	79.0
Treasury Bill Rate	9.7	7.9	7.1	6.6	6.4	5.2
5 Year Interest Rate	11.0	8.2	7.1	6.1	5.0	3.8
Current Balance (£ billions)	–0.4	0.5	3.3	5.0	4.5	4.3

1 Expenditure Estimate at Factor Cost
2 Consumer Price Index
3 U.K. wholly unemployed excluding school leavers (new basis)
4 Sterling effective exchange rate, Bank of England index

If this happens, other unions will take note of the new environment. The effects of that will be dramatic. So far miners have continued largely to act as if they had **not** experienced a sharp decline in membership (by more than 5% of the labour force in four years) and as if there had **not** been three Acts passed radically cutting back their immunities from the ordinary processes of the civil law. But with the defeat of the miners, they would no longer be able to ignore these realities, or hope that they could be reversed by 'direct action' of the NUM type. Realism will finally prevail. We should then see union wage agreements truly designed to ensure job security instead of job-destroying real wage increases; such agreements will also be in line with what union members appear (naturally enough) to be demanding, if opinion polls and rank and file attitudes to recent strikes in the docks and at Austin Rover are a guide.

Much is therefore at stake. The government must win this strike and be seen very clearly to win, however long it takes. It is encouraging that in recent weeks evidence of a firmer attitude has emerged, including on the use of the law; notably, nationalised Austin Rover management has, with effect, used the 1984 law in its own strike while the National Coal Board has at last firmly withdrawn from damaging negotiations which merely amounted to a string of its own concessions.

One issue raised by allies of the National Union of Mineworkers that has confused many well-meaning people is that of the 'social costs and benefits' of pit closure. It has been argued that, because pit closure causes unemployment, the social gains of pit closure are less than the commercially calculated gains (by the amount of additional unemployment benefits and lost taxes). This argument is absolutely fallacious. It does not allow for the effect on jobs of spending in better ways (for example, raising tax thresholds) the revenue now used in supporting uneconomic pits; when this is allowed for, jobs are **created** (net), not lost. The reason is that, if the money is spent on high cost pits, very little **supply** (of economic output) per pound spent emerges (in fact in the long term it is negative) whereas, if it is channelled into tax cuts, more people are drawn into work across the whole of efficient industry with a correspondingly large rise in supply per pound spent. The arithmetic of such calculations is discussed in the section on 'job-creation' below.[1] The implication is that the commercial calculations on pits **understate** the social gains; this will need to be taken into account by any outside body that is called in to review pits in line with the Coal Board's agreement with NACODS, the pit deputies' union.

Of course, there are noneconomic social considerations, such as the problems of small mining communities. This has always been recognised and is the reason for the generous redundancy and job transfer terms being offered to miners. Even so, some communities will be reduced, or broken up; however, to hold up the nation's economic progress in the name of preserving particular small communities **for their own sake** (when jobs are available to those who will move) is unlikely to command much support nationally. History is full of examples of communities that had to move with the times, not least mining communities.

The Chancellor's Autumn Statement:

The absence of any Cabinet strategy for reducing public expenditure has been again highlighted in the autumn breast-beating by spending ministers 'defending their corner'; even Ian Gow, previously a main protagonist of spending discipline, has succumbed – no doubt under calculating pressure from his officials – to the seasonal idiocy, apparently by threatening to resign over housing cuts in his ministry. Yet here if anywhere it should be obvious that there is no sense in pumping in public money, when council houses are being privatised (at a loss) as fast as they are built. The plea that public spending on construction is good for employment is false, as explained in the next section; it is based on old Keynesian thinking which this Cabinet at least is supposed to have seen through.

This Cabinet should be able to agree on privatisation as a principle to be applied as widely as possible within the public sector.[2] Around that principle a programme for systematic reduction of public expenditure over a first five-year period could probably be agreed. This would be easily explainable to the people and would give a secure basis for sustained tax cuts; at present no one can have any confidence that the programme of tax cuts will not need to be

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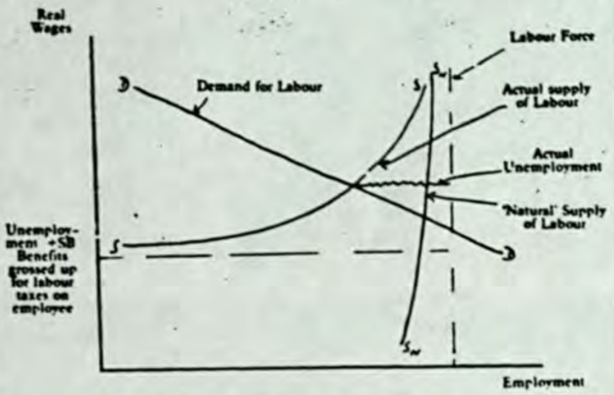
[1] And also at greater length in 'The Costs and Benefits of Coal Pit Closures' by Patrick Minford and Peter Kung, Public Service Review, November 1984.

[2] For more details of the possibilities, please consult my article, 'State Expenditure: A Study in Waste', Economic Affairs, Special Supplement, Vol. 4, No. 3, April–June 1984.

Basic Framework for Analysing UK 'Supply-side' and Unemployment – Illustrated Graphically.



1. Explanation of Diagram

The diagram shows the UK Labour Market, with the price of labour (real wages) on the vertical axis and the quantity of labour on the horizontal one; it is of course a standard 'supply and demand' diagram. Employment is determined at the point where supply equals demand; unemployment is the difference between this and the total 'labour force' (shown as the dashed line on the right).

The Demand for Labour is shown as increasing as real wages fall; this comes about via two mechanisms (1) substitution of labour for capital (within alternative efficient production techniques) (2) expansion of British exports or import-substitutes because of falling British costs in competitive world markets (this rise in exports or fall in imports allows **domestic** demand to rise also within the constraint on the balance of payments on current account).

The Supply of Labour is divided into two parts: the 'neutral' supply ($S_N S_N$) which would occur if there was no benefit system and the actual supply (SS, the relevant one) which is bent back towards the left by the unemployment and other benefits available when out of work. As average wages fall, so more and more people find themselves receiving net wages close to benefit levels; the result is that the wage they demand has a 'floor' under it (they will not reduce their wage demands, as job opportunities contract, but will rather stay on the dole than take the lower-paid jobs): Wages cannot obviously fall below benefits grossed up for income tax, the horizontal dashed line.

For a more detailed but non-technical explanation, see Patrick Minford, David Davies, Michael Peel and Alison Sprague, Unemployment – Cause and Cure (Martin Robertson, 1983) or – more briefly – A. P. L. Minford, 'Trade Unions Destroy a Million Jobs', Journal of Economic Affairs, Vol. 2, January 1981.

2. Some Other Points to Note

1. Demand for Labour relationship **cannot be shifted** (except temporarily) by fiscal and monetary policy; it is drawn up assuming there is current account balance.
2. Demand for Labour **is** increased (shifted to right) by higher productivity per man and by lower labour taxes (N.I. contributions, e.g.) paid by firm.
3. Supply of Labour is increased by lower income taxes (including N.I. contributions) or lower benefits for unemployed (curve shifts to right) and decreased by higher union mark-up (curve shifts to left).
4. Some key responses (estimated from UK data since 1964): long-run elasticity of demand for labour to unit labour costs (i.e. percent rise in employment for 1% fall in labour costs) – 1; long-run elasticity of wages demanded by workers to benefits grossed up for income tax – 0.5; long-run elasticity of wage demands to higher union penetration of workforce – 1.

Compare now spending money on tax cuts, the Chancellor's stated priority. A number of such tax cuts are shown in Table 1. We assume that the tax cuts have no effect on labour-intensiveness because they will be spent in much the same way as the 'neutral' taxes that finance them. But they have an effect on incentives to supply and demand labour. – See Box for a guide to the mechanism involved. Rises in tax thresholds make it worthwhile for unemployed people to take lower-paid jobs than before; this is an improvement of the 'unemployment trap', and a rise in labour supply at given wages. Cuts in firms' National Insurance contributions lower labour costs and so cause an increase in labour demand at given wages. The result in either case is a rise in the **supply** of output the economy is capable of producing and the number of jobs it is capable of sustaining; the implication is that demand can rise to this level without causing problems and jobs at this level of demand are 'real' (i.e. sustainable) jobs.

It can be seen that rises in tax thresholds dramatically dominate all other measures in the Table except National Insurance Contributions by employers which are a close second. It follows of course that money diverted from public expenditures at the top of the Table to tax cuts at the bottom will create jobs; for example closing high cost pits and cutting tax thresholds will create 7.7 thousand jobs (per £100 million diverted) in the medium term and 15 thousand in the long term.

The PSBR target and demand:

The calculations in Table 1 are based on the **supply** effects of these expenditures – i.e. the medium to long term effects on jobs. But it may be asked what about the short-run demand effects?

'Real jobs' are jobs which last and are not merely the product of a temporary boost in demand. Therefore this question reveals a search for temporary palliatives rather than enduring solutions to unemployment.

As for such palliatives, however, the Liverpool Group can find no evidence that directing demand to say construction from tax cuts stimulates aggregate demand; any analysis to that effect that we know of is based on old-fashioned Keynesian 'multipliers', which are quite discredited. When all factors (interest rates, exchange rates, labour intensity, import content, etc) are allowed for, there is no obvious effect either way that we can find.

It seems therefore most sensible to decide on the composition of 'job-creation' expenditures on the basis solely of their effect on real sustainable jobs as in the last section.

If demand is an issue it should relate to the PSBR target itself. Indeed that is usually implicitly what is intended by proponents of infra-structure spending; they wish it to be financed by a higher PSBR and it is from the financing that they adduce additional demand.

This is old ground we are now covering. The main problem with using the PSBR to stimulate demand (via a 'temporary' boost to borrowing) is that of credibility. The object of the MTFS was to persuade people that the government would stick to its counter-inflation strategy over the foreseeable future that it is in power, in spite of all the pressures in a Parliamentary democracy to exceed

Table 2: A feasible PSBR and tax cuts profile assuming government expenditure is constant in real terms.
(£ billion, cash figures)

A. Treasury Arithmetic*	1985/6	1986/7	1987/8	1988/9	1990/91
Money supply target (mid point of range, M0)	6	5	4	3	1
Approximate implied inflation	3½	2½	1½	—	1
(Treasury assumption)	(4½)	(3½)	(3)	(3)	(2½)
Public expenditure programmes	132	136½	141½	146	150
(of which asset sales)	(2½)	(2)	(2)	(2)	(—)
Other adjustments	22	22½	22	22	22
(of which debt interest)	(16½)	(16)	(16)	(16)	(16)
Revenue at constant tax rates	148½	157½	165½	173	182
MTFS PSBR (% of GDP)	7(2)	7(2)	7(1¾)	7(1¾)	2(½)
Implied MTFS tax cuts (cumulative)	1½	5½	9	12	12
Public expenditure programmes excluding asset sales (at constant 1985/6 prices)	134 (134)	138½ (134)	143½ (134)	148 (134)	150 (132)

B. Adjustments to this if Liverpool Forecast substituted for Treasury's (+ indicates Liverpool estimate is higher than Treasury's) – same PSBR as in A.

	1985/6	1986/7	1987/8	1988/9	1990/91 Long Run
Debt Interest	—	-½	-½	-1	-3½
Tax cuts	—	—	—	—	+1½
Public expenditure programmes excluding asset sales (at constant 1985/6 prices)	134	134	134	134	134

C. Bringing tax cuts forward via borrowing more in early years (effects as compared to B).

	1985/6	1986/7	1987/8	1988/9	1990/91
Debt interest	—	+0.1	+0.1	+0.2	+0.2
PSBR	8	8	8	4	2
Tax cuts (cumulative)	2½	6½	10½	13	13½

* The figures in this part are based on the 1984 Budget Statement, crudely adjusted for 1986/7 onwards on the basis of the Treasury's Autumn 1984 Statement (from which the 1985/6 figures are taken).

\+ Effect of Liverpool Inflation forecast assumed to be neutral on PSBR (i.e. revenue and expenditure effects cancelling).

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expenditure are in other
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very much smaller, amounting
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effects of social capital formation via the demand for intermediate inputs from other industries. Given the methodology used to obtain these results detailed comparisons between the main programme areas should be made with care. The estimates do however suggest that social

TABLE 11.8 : Alternative policies: impacts on employment, inflation and the balance of payments

Differences from a base run	Year 1	4	6
Employment generated (000s) per £1bn PSBR			
Reduction in standard rate of tax	166	203	199(b)
Reduction in national insurance contributions(a)	65	120	132
Increase in public current expenditure	185	90	72
Marginal employment subsidy	144	103	81
Effect on prices (%) per £1bn PSBR			
Reduction in standard rate of tax	-1.9	-3.4	-5.3
Reduction in national insurance contributions(a)	-2.4	-3.4	-4.6
Increase in public current expenditure	0.7	1.0	1.1
Marginal employment subsidy	-3.2	-1.1	-1.1
Effect on the balance of payments as % of GDP per £bn PSBR			
Reduction in standard rate of tax	-0.5	0.1	0.2
Reduction in national insurance contributions(a)	-0.1	0.1	0.2
Increase in public current expenditure	-0.2	-0.1	-0.1
Marginal employment subsidy	-0.3	-	-

SOURCE: Simulation results as described in Whitley and Wilson (1983).

(a) Equivalent to an average employment subsidy.

(b) This corrects a typographical error in Whitley and Wilson (1983), Table 4.

capital formation involving the building of dwellings results in many more jobs per million pounds than in the other categories. The immediate demand for dwellings impinges almost entirely on the construction industry which has a low propensity to import and a relatively low level of average productivity. In addition, construction of dwellings is particularly labour intensive work. In contrast, social capital formation in Education generates the five year contract signed in 1982 is technically in its second year.

There is even a strong suggestion that the Department of Trade and Industry, still deeply concerned at the possible damage the niggles over the contract is doing to other would-be British contracts with India, suggested this autumn that rival GEC should help out with specialist knowledge. NEI denies gression on Rihand, it is on the mend."

He also claims that the time penalty risks or fines for lateness on the contract are not as big as some people imagine, and that the shipping, transportation and erection costs of the plant — in hostile terrain — are reimbursable by NEI . . . saving it from too mortal a savaging.

Maggie Brown

Tax cuts 'the way to create more jobs'

THE Government is right to believe that tax cuts would be a more efficient way of stimulating the economy and creating jobs than the same money spent instead on more public spending, according to an independent study of the Treasury's spending plans published today.

In marked contrast to most other analyses, two researchers at Warwick University's Institute for Employment Research find that an extra £1 billion of public borrowing would create 203,000 jobs after four years through income tax cuts, but only 90,000 if funnelled through increased public spending.

The same money spent on cutting National Insurance or paying subsidies for extra jobs creates respectively 120,000 and 103,000 jobs.

Other articles in Public Expenditure Policy 1984-5, edited by Paul Cockle, argue that education will be hardest hit by planned cuts with real spending per pupil falling, and that a crunch on defence spending could sweep away a major defence role such as the Trident deterrent.

Local authority spending is likely to come under firmer control than in past years not because of rate-capping but because of the more draconian system of grant clawback if councils overspend, LSC lecturer, Richard Jackman says.

The Warwick employment researchers challenge another conventional wisdom with calculations showing that the extra jobs created for £1m of public spending are greater in areas of current spending, especially health and education, than in investment in "social capital formation," including fashionable infrastructure.

The Government gets most jobs per public spending pound in education, with 97 jobs created for every extra million pounds, whereas the most jobs intensive capital programme — housing — shows an increase of only 64 jobs. Each million on defence creates only 22 jobs.

They warn, though, that their conclusion on the greater job-creating impact of tax cuts depends on the assumption that tax cuts would reduce the extent to which workers push up wages in pursuing a target for real take-home pay. This is one of several competing theories in this controversial area of economics and implies that tax cuts cause lower wage demands, lower inflation, more consumption and greater international competitiveness.

A separate article shows that the government's scope for tax cuts until 1986-7, though less than officially assumed, is relatively secure at between £4 and £5½ billion regardless of several different scenarios including a wage revolt in the public sector, an American slump and a "revitalised Britain." This, though, assumes that a revolt against the long depression of public sector wages relative to private ones would be offset by cuts in spending programmes.

Public Expenditure Policy 1984-5, edited by Paul Cockle, MacMillan, £8.95.

Christopher Huhne