MASTER

National Economic Development Council

1

NEDC(84) 4th Meeting

MINUTES of a Meeting at the NATIONAL ECONOMIC DEVELOPMENT OFFICE
Millbank Tower, Millbank, London SW1, on Wednesday, 4 April 1984

PRESENT:

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
(in the Chair)

Sir Donald Barron	Sir Terence Beckett CBE
Mr J S Cassels CB	Sir Campbell Fraser
Sir George Jefferson CBE	The Rt Hon Sir Keith Joseph Bt, MP Secretary of State for Education and Science
The Rt Hon Tom King MP Secretary of State for Employment	Dr J S McFarlane
Sir Walter Marshall CBE FRS	Mr J J R Pope
The Rt Hon Norman Tebbit MP Secretary of State for Trade and Industry	Mrs R E Waterhouse CBE

The following were also present:

The Rt Hon Alick Buchanan-Smith MP, Minister of State for Energy

The Hon William Waldegrave MP, Parliamentary Under Secretary of State for Employment

Mr N J Atkinson Manpower Services Commission	Mr U J Baker Department of Trade and Industry
Mr J Ball Department of Employment	Mrs P Birdseye Confederation of British Industry
Sir Terence Burns HM Treasury	Mr J Caines Department of Trade and Industry

Miss R Crockett
Confederation of British Industry

Mr L Dicks-Mireaux
Bank of England

Mr C J Farrow
Bank of England

Mr M T Folger
HM Treasury

Mr M A Hall
HM Treasury

Mr J R S Homan
National Economic Development Office

Mrs Z Hornstein
Department of Employment

Mr B S Kalen
HM Treasury

Mr A Kilpatrick
National Economic Development Office
(for item 2)

Mr P Landymore
National Economic Development Office
(for item 2)

Mr C Leach
National Economic Development Office

Dr M A Loudon
Nationalised Industries' Chairmen's Group

Mr K McDowell
Confederation of British Industry

Mr P McGregor
National Economic Development Office

Mr N J Monck
HM Treasury

Dr D Morris
National Economic Development Office

Miss M O'Mara
HM Treasury

Mr E Pash
Department of Energy

Mr T Rickett
National Economic Development Office

Mr S Ryder-Smith
National Economic Development Office
(for item 3)

Mr T Sparrow
National Economic Development Office

Mr I Urquhart
Department of the Environment

Mr A Whiting
Department of Trade and Industry

Secretariat:

Mr P V Dixon

Mr D A Truman

1. INTRODUCTION

The CHANCELLOR OF THE EXCHEQUER said that apologies for absence had been received from the Secretary of State for the Environment, who would be represented by the Parliamentary Under Secretary of State for the Environment; the Secretary of State for Energy would be represented by the Minister of State for Energy. Apologies had also been received from the Governor of the Bank of England, from Dr Main and from Mr Young.

2. ECONOMIC STRATEGY AND THE 1984 BUDGET

The CHANCELLOR OF THE EXCHEQUER made a slide presentation (full text circulated at the meeting and copies of slides to be made available). He said that inflation, after its sharp fall between 1980 and 1983, was expected to continue at a low level. Output, especially of oil and the service industries, had been increasing since mid-1981 and was forecast to rise by 3 per cent in 1984 and at a rate of 2½ per cent into 1985. As inflation and cost performance improved, there would be room for more output within a decelerating growth of nominal GDP. Although unemployment was still rising, there had been a heartening turnround in employment; the prospect could be improved by lower pay rises, as in competitor countries. The Medium Term Financial Strategy continued the downward path for both monetary growth and the PSBR; this was aimed at reducing inflation and interest rates. If public expenditure were held steady in real terms, as assumed in the Green Paper, both the PSBR and non-North Sea taxes should be able to be reduced as a proportion of GDP. The projections were consistent with the achievement of stable prices.

Turning to the Budget itself, the CHANCELLOR picked out four changes as improving the business environment: abolition of the National Insurance Surcharge (NIS); the reforms in Corporation Tax (CT); the arrangements for share options to reward enterprise; the measures to assist company finance, such as the reduction in Stamp Duty on equities and exemption of corporate bonds from Capital Gains Tax. Concentrating on the CT package, he said that the old system was inconsistent in its treatment of different assets, of debt as compared to equity, and of capital as compared with labour; as a result, investment in the UK was of low quality and profitability by comparison with that in other countries. The reforms would improve the profitability after tax of projects with a high pre-tax rate of return and, taken together with the abolition of NIS, the bias against jobs would be reduced. The treatment of investment by the tax system would remain comparable with that overseas, while the taxation of profits would be less; this should leave room for higher current expenditure on innovation.

SIR CAMPBELL FRASER welcomed this placing of the Budget in a longer context, the emphasis on competitiveness and the need for profits. He was grateful for the abolition of NIS; but it was necessary to ensure that wage settlements, public and private, were decently restrained; he was concerned that the projections might not be achieved if current trends continued.

The PSBR was lower than that advocated by the CBI, but higher growth would give room for manoeuvre. He welcomed the change in CT, though he hoped the period over which the allowances were to be phased out might be reconsidered. Bringing forward payments of VAT on imports would help some firms and make things more difficult for others; he wondered if an exception could be made for raw materials. The CBI were working on a strategy for the improvement of competitiveness and profitability over the medium term - this would involve the tax system and public expenditure; more would have to be spent on the infrastructure.

MR POPE favoured the changes in CT. He accepted also the changes in the Business Expansion Scheme; too much had been siphoned off into agriculture, which was not what was intended; there remained mechanical difficulties which could be eased by permitting investment through Small Firms Investment Companies and which he wished to discuss with the Secretary of State for Trade and Industry.

SIR GEORGE JEFFERSON thought that the combined effect of the CT changes would be adverse in the short term and might put pressure on prices; apart from that, he welcomed the Budget.

DR McFARLANE suggested a longer bridge between the old and the new systems for CT and a straight line basis, rather than declining balance, for the new allowances. Unless inflation came down to 2½ per cent or less, the loss of stock relief and of the allowances would outweigh the benefit of the lower rate of tax. One should be aware of the effects of the changes on important industries with low rates of return.

SIR TERENCE BECKETT commented that unit labour costs were a better indicator than wage costs. This was where things were going wrong, and he had written to the chief executives of companies about it. Regarding the aim of keeping public expenditure constant, he thought that it would be wise to carry out a sensitivity analysis on the implications of some of the aims not being achieved and what would have to be done to safeguard the overall position; this would be useful in public debate. If the aims were achieved, and growth took place, Government should consider using the extra room for measures to reform personal tax to provide more incentives as well as to relieve the poverty trap. More needed to be spent on infrastructure, particularly to link British industry with its European markets. The CBI had in mind the need for further study of possible future shifts from direct to indirect taxation.

SIR DONALD BARRON welcomed the general thrust of the Budget; it was right to discard the assumption that capital expenditure was all that was needed; but it had yet to be proved that the changes would be enough to stimulate adequate marketing, research and product development. A particular worry for the banks was whether the investment stimulated by the prospect of the allowances disappearing would coincide with a period when the tax changes reduced the resources available to companies.

MRS WATERHOUSE welcomed the changes in Stamp Duty and the Investment Income Surcharge, but would have preferred the removal of the "composite rate" arrangements from the building societies rather than their extension to the banks - non-tax-payers subsidised tax-payers as a result. She had some concern about the effect of the change in VAT on contruction work already in the pipeline; and about the effect of the abolition of life assurance relief.

The DIRECTOR GENERAL said that it was gratifying that the proposal of the Knitting EDC relating to VAT on imports had been accepted and concurred with the CBI that the treatment of raw materials might be studied further. He was also glad that proposals from several EDCs for grants to help particular types of investment had been reflected in the announcement by the Secretary of State for Trade and Industry during the Budget debate. He supported the change in the balance of the tax system, which would put current expenditure on innovation on a level with capital investment; but how it would work in practice would need to be watched. He raised a question about the possibility of any dent in unemployment, and especially long-term unemployment, given the prospective increase of over 450,000 in the labour force between 1984 and 1989 and productivity probably not growing significantly less than the 2¼ per cent assumed for the growth in the economy. The Green Paper was more interesting than the Press had implied; it was reassuring that oil and gas would still be contributing £5½ billion in tax in 1993-94; but the projections implied that the trade surplus in oil would disappear about the end of the present decade. The Green Paper rightly drew attention to the "poverty trap" and "unemployment trap"; if downward flexibility in wages were seen as a means of reducing unemployment, this might make the unemployment trap worse; larger Child Benefits financed out of the married man's tax allowance, as suggested by the Financial Times, might be a way out. On public expenditure, there remained the question of principle as to how to deal with services for which one would expect there to be growing demand if they happened to be those (such as health) for which the public sector was responsible; a greater degree of private financing was referred to as a possibility in the Green Paper and this should be considered for infrastructure also.

The SECRETARY OF STATE FOR TRADE AND INDUSTRY said it was a radical and reforming Budget which had been successful because the Chancellor had been forthcoming in consultation with his colleagues and had thus been able to deal in advance with problems which would otherwise have occurred.

The MINISTER OF STATE FOR ENERGY said that for the second year running the Budget had been an encouraging one for the offshore oil industry and more might be done in future to stimulate incremental production; there was a need to ensure that our supplying industries responded to the opportunities.

The SECRETARY OF STATE FOR EDUCATION expressed interest in whether, on the basis of other countries' experience, it was possible to construct a relationship between low unit labour costs and more jobs. SIR DONALD BARRON mentioned the influence of volume on labour costs. SIR TERENCE BECKETT said that one needed to look especially at three components: pay settlements, earnings and productivity; taking all factors into account, our competitiveness had worsened by 6 per cent in the last year by comparison with the rest of OECD; only half of the earnings "drift" represented overtime, the remainder being bonuses, upgrading and incremental systems which were a product of past incomes policies.

SIR WALTER MARSHALL welcomed the change of emphasis relating to investment. All a Government could do was to set the climate and it had now done so in two important ways. The main reason why companies had not given attention to innovation in the past was because they had been absorbed in industrial relations problems, but that element in the climate had been changed drastically during the Government's previous term. The other preoccupation at board level was how to minimise taxation, but the effect of this Budget was to turn the attention of management to its real business. Beside these two simple points, the detail was unimportant.

The CHANCELLOR OF THE EXCHEQUER, responding to the discussion, said that the projection of public expenditure in real terms in the Green Paper was ambitious but realistic. The possibility of higher productivity growth than he had assumed need not be bad news for unemployment if it meant that output also was higher. He agreed that the CBI had been right to point to the damage done by previous incomes policies. It was difficult to isolate any single factor as influencing employment but the difference between the United States and the UK as regards the pattern of earnings and job creation, discussed in his paper on "jobs" for the Council meeting in December, pointed a clear moral which the complications did not vitiate. The possibility of exempting imports of raw materials from the earlier payment of VAT had been studied and was illegal under Community law. On infrastructure there would doubtless be further discussions, but about £5 billion of current expenditure was going on repairs and maintenance which might be more cost-effective than new construction. The length of time over which the CT allowances were phased out was a matter of judgement; if it were longer, it would take longer also to get the rate down to 35 per cent. Although the changes were neutral in overall effect during the change-over period as a whole, they were favourable to industry in the longer run, since the allowances affected timing whereas the reduction in the rate (and also the abolition of NIS) had continuing effects. He agreed with Sir Terence Beckett that one should not at this stage pre-judge the pattern of future tax reduction; an assumption had been used in the Green Paper only for illustration. In response to a suggestion from SIR CAMPBELL FRASER that the presence of the TUC would have introduced more balance if less unanimity into the discussion, the CHANCELLOR agreed that the Council regretted their absence, although it had not prevented a worthwhile discussion.

The COUNCIL:

(i) Took note of NEDC(84)28, covering the Financial Statement and Budget Report 1984-85 ("Red Book"); and the Green Paper (CMND 9189) on Public Expenditure and Taxation into the 1990s;

(ii) requested that copies of the slides shown should be circulated.

3. THE UK LABOUR MARKET

THE SECRETARY OF STATE FOR EMPLOYMENT, introducing NEDC(84)29, noted that the labour force had grown by over 1 million in each of the last two decades and that the same was to be expected in the eighties. The increase in the female activity rates might be a factor in the growth of jobs, many of which were part-time, without apparent effect on unemployment. Hours worked during a lifetime had declined and the proportion of employment in smaller firms was increasing although this trend might not be significant. He hoped this background paper would be useful in the context of the jobs exercise.

SIR TERENCE BECKETT expressed concern about the widespread assumption that the working week would be reduced, particularly when the assumption did not involve a corresponding reduction in pay. We should not think of a general trend but of the emergence of kaleidoscopic changes in patterns of work. SIR WALTER MARSHALL asked for clarification whether the paper referred to reduction in the number of hours actually worked or in the nominal working week; pressure for a shorter week reflected wishes to reclassify work as overtime. The SECRETARY OF STATE FOR EMPLOYMENT said that the paper referred to hours worked in a lifetime.

The PARLIAMENTARY UNDER SECRETARY OF STATE FOR THE ENVIRONMENT said that the overall figure for service employment included that for local authorities; if employment there were to decline it should not affect views about the prospects for employment elsewhere in the services sector.

MR POPE thought that the comments on the size of employing firms would benefit from further research, particularly since the Director General's paper (NEDC(84)27) showed large reductions in employment in some of the biggest industries. He hoped to bring a paper to the Council about the role of small firms in employment, but they were not the only source of jobs; was the increasing proportion of employment in small firms reflecting the demise of large ones or was it new growth?

MRS WATERHOUSE noted that the rise in female activity had flattened out possibly because females gave up more readily in a period of recession, the "discouraged worker effect". But women might not wish to go back to their traditional caring role; she believed that the Beveridge concept of men as the breadwinners had changed and we now had a structure which involved two people in work. SIR DONALD BARRON suggested, instead, that there was research evidence that relatively small payments might persuade many women to stay at home. The SECRETARY OF STATE FOR EMPLOYMENT said that in Europe measures were needed to tackle female unemployment, which was a less serious problem in the United Kingdom. The SECRETARY OF STATE FOR TRADE AND INDUSTRY thought that, in the United Kingdom, the wages of industrial workers were too low, because of abysmal productivity, to provide a decent standard of living and women worked to raise family incomes to an acceptable level. SIR TERENCE BECKETT thought that women provided a more tractable labour force and were therefore in demand by employers.

The DIRECTOR GENERAL said that the increasing proportion of part-time jobs for women in the services sector was not a substitute for full-time jobs. American experience suggested that a high proportion of extra jobs in the service sector would be in public services, education and health. In the UK, service sector jobs tended to be concentrated in the South-east where unemployment was already lower than elsewhere. Warwick University believed that we would need 82,000 more engineers and scientists by the end of the decade and even more technicians, while semi-skilled and unskilled jobs would decline by nearly a million. The need for education and training continued to increase. In the United States, Germany and Japan, unemployment among 16 and 17 year olds was less common than in Britain because such people were in full-time education or training. Despite 290,000 young people in the YTS, there were still 200,000 unemployed 16 and 17 year olds; it would be better if they were taken out of the regular work force to acquire skills and competence for the future. We should not be complacent about overtime, which had remained at about 8½ hours per week for each operative working overtime in manufacturing, and was equivalent in the case of all men manual workers to about half a million full-time jobs; often this was inflexible and a source of inefficiency; other countries managed with much less.

The CHANCELLOR OF THE EXCHEQUER commented that these last remarks reinforced Sir Terence Beckett's point that cuts in working hours should not be allowed to increase costs. There had been a useful discussion.

The COUNCIL:

(iii) noted NEDC(84)29.

4. REVIEW OF THE SECTOR ASSESSMENTS

The DIRECTOR GENERAL said that NEDC(84)27 rounded off the 1982 exercise in which the sector committees assessed the prospects for their industries to the end of the decade. Most of the reports had been published and accepted as authoritative. They had given impetus to the work of the EDCs and the Council might wish to pass on to them its appreciation. The paper analysed the competitive performance of 30 of the EDC sectors together with some others. The charts, indicating change, not the absolute position of sectors, showed how these had fared in home markets and in international trade over the period 1975 to 1981/2. They revealed declining competitiveness, reflected also in the move of the balance of trade in manufactures into deficit in 1983. Some industries with advanced technological content had done well but others, including electronic consumer goods and information technology, were among the weakest sectors; although the UK electronics industry was expanding by around 6 per cent a year in real terms, this was only half the world-wide rate. More work needed to be done to follow up the assessments before there was thought of repeating the exercise.

The SECRETARY OF STATE FOR TRADE AND INDUSTRY agreed that the Office was to be congratulated on bringing to conclusion a difficult piece of work which was helpful in structuring the work programme of EDCs and in examining some common problems. The emphasis on improving efficiency and technological change was reflected in his aims for his own Department. There was an interesting list of initiatives to which might be added quality and design. He noted the wide range of success, with some companies in poor sectors doing well while there were laggards in good sectors; the aim should be to raise the general level to that of the best. The momentum needed to be maintained and the discussion taken to the company and plant level; some of the work was also relevant to the Council's exercise on jobs. It might be possible to repeat the exercise in due course, but it would not be a good use of resources to do so in the near future.

SIR TERENCE BECKETT expressed concern about the picture shown by the charts. Most of the EDCs covered older industries and their findings might be unrepresentative of Great Britain as a whole. The high-volume, low-cost industries had performed badly; one had to think of the implications of their decline - high quality boutiques could not substitute for them. Perhaps it was that the British were not adept at large-scale activities. The Budget and changes in regional policy might make the climate more difficult for capital-intensive industry. In response to a question from the Chancellor, he suggested that the paper might be confined to internal use.

In further discussion, other points about the charts included the following:

(a) Firms and industries which continued to lose market share would eventually become endangered even if they managed to to be profitable in the interim.

(b) The lower right hand quadrant, which showed industries subject to increasing international specialisation, was not necessarily an indicator of danger.

(c) The great increase in oil, both as an import substitute and as an export, even though some of the counterpart was to be seen in the capital account, made it inevitable that other industries would perform relatively poorly for a time.

(d) Declines in export market shares simply meant that the UK economy was growing less quickly than world trade, which had been the case for a long time.

(e) Since the period covered was 1975-82, the lessons to be drawn were not necessarily current ones.

MRS WATERHOUSE referred to the work of the Distributive Trades EDC and the tendency, mentioned in the paper, for the margins of suppliers to be squeezed by the actions of distributors; this was the opposite of what was apparently intended and should be further examined.

The CHANCELLOR OF THE EXCHEQUER, summing up, said that the paper and discussion were a useful conclusion to the exercise on Sector Assessments. The EDCs had done good work, which still needed to be followed up before a further exercise was initiated. Publication of the paper should be considered when it had been revised in the light of points made in the discussion. It should be brought back to the Council, though it might not be necessary to discuss it again.

The COUNCIL:

(iv) Took note of the summing up by the Chancellor of the Exchequer;

(v) invited the Director General to revise NEDC(84)27 in the light of the discussion and re-submit it to the Council.

5. RELEASE OF DOCUMENTS

It was agreed that NEDC(84)29 could be released.

6. CORRIGENDUM

Minutes of MARCH Meeting: page 1, item 2, paragraph 1, line 11. This should read : ".......from about 10,000 to between 14,000 and 16,000......"

National Economic Development Office
Millbank Tower
Millbank
London SW1P 4QX

10 April 1984