

## PRS unemployment report: summary

- Origins:
- ① Oil price: lack of demand
  - ② Supply-side deflationist (with low percentages of unused capacity)  
'supply shocks' due to a. increased competition from newly-developing countries  
b. plant obsolescence through oil price increase
  - ③ Reluctance of unions to accept that smaller real wage increases were attainable ~~reinforced by~~ because of:
    - a. lower productivity increases
    - b. higher public expenditure (social wage)
    - c. rise in real oil prices & decline in terms of trade

reinforced by deeply ingrained aspirations & expectations including wide use of indexation.

Wages in UK because

- a. Strong union pressure over wages
- b. More monopolies
- c. Long-termist shielding employees from market pressures
- d. Employment protection legislation
- e. Notions of 'fairness' over wages
- f. Wage boards
- g. Benefit levels

& above all industrial weakness reflected in low productivity growth, due not so much to low investment but low capital & labour productivity; inefficient innovation; collective bargaining & industrial relations; insufficient incentive to acquire skills. Fall in manufacturing output & employment unique.

Most recently worldwide cyclical factors

Outlook: Aim now should be 1-1/2 million (4 per cent) not 3% recommended by Beveridge or 400,000 (1/2 per cent of early 1960s)

Economy to start growing at 2-3 per cent but unemployment will not necessarily fall. Factors:

- a. Growth of working population 4% from 1981 to 1991 (large number of old to young taking)
- b. lower participation (favourable)
- c. Productivity trends. (but micro-technology likely to have slow effect)

1 m. workers have been unemployed for a year  
20% of under 25s are unemployed  
But only 20% of unemployed have family commitments

General approach to remedies

- a. Must be a lasting & real solution
- b. Will take a long time

Improve competitiveness, increase flexibility of product & labour markets  
increase profitability. particular adaptability to real wage falls.

Distinction between primary & secondary sector - primary large, well established employer; secondary smaller enterprise

Primary want strength, with paid staff; but needs internal flexibility (Japanese have bonus payments & no demarcation disputes)

Encourage secondary sector.

Get across message that employees rights hoped for previously not attainable now.

## Measures to improve general economic performance

### a. Education & Training

UK proportion of people continuing education beyond 18 v. low

Restrictive practices on apprenticeship system

- School leaver certificate
- Disseminate experience of YTS scheme
- educational maintenance allowances in high unemployment areas
- more education for unemployed through HEAs or adult education institutes

### b. Unions

Reduce power - secret balloting before strikes

don't allow unions to prevent non-union contract labor or extend collectively-negotiated wages or job security arrangements to secondary sector. involve employees more with futures of companies

### c. Labour mobility

- Stop local authorities from excluding non-residents
- More funds for housing associations to help mobile workers
- Outside London, remove Rent Act control from private letting
- Simplify & cheapen house purchase.

### d. Competition policy

- More rigorous anti mergers policy
- more de-merging
- tougher attitude to abuse of monopoly power
- more privatisation, decentralisation.

### e. Small firms

- concentrate enterprise zones in secondary sector
- develop pilot enterprise scheme
- extend public purchasing to secondary firms
- development help for small firms through local enterprise links

### f. Innovation

- Increased tax relief for R & D expenditure + initial profits
- More commercial awareness in Govt. R & D
- More help for 'demand-led' projects
- Review (scrap) British Technology Group's right of first refusal for product of public R & D
- Tighten patents
- Get UGC & NAB to identify & rectify skill shortages

## Efficient ways of generating more employment

### Tax & benefit system

- Abolish Wage Councils
- Get rid of minimum standard employment
- Reduce capital subsidies & labor conditions
- Discourage household services
- Take account of employment effects in public expenditure decisions

- Re-introduce wage slip
- Link benefits to lower of earnings or prices, or (better) earnings
- Require people on supp. ben. to accept any job which offers no less pay
- Raise tax savings more effectively than PIT, universal child benefit or raising tax floor.

### New patterns of working time

- Statutory limit on overtime
- Encourage part-time working.

## Other measures to cope with unemployment

- Give priority to labor intensive public expenditure, preferably through secondary private sector
- Expand JRS
- Concentrate on employing those

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CENTRAL POLICY REVIEW STAFF  
REPORT ON UNEMPLOYMENT  
SEPTEMBER 1982

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CPRS REPORT ON UNEMPLOYMENT

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CHAPTER 1: INTRODUCTION

1.1 The seeds of the present phenomenon of unemployment were sown in the prosperous years of the 1950s and 1960s. This post-war boom continued for an unprecedented time and led people to believe that economic growth would continue indefinitely as a normal feature of life and that living standards would always be rising. This came to be regarded not just as a hope, nor even a target to be worked for, but an entitlement. With this went the view that no-one should ever fall behind, let alone accept a lower living standard - any adjustments could always be made by creating more wealth. The expectation of ever rising living standards led to demands for higher wage increases which could not in time be matched in terms of higher real output and resulted in inflationary pressures that later proved difficult to control. At company level, it led to a fall in profitability and, at the national level, public expenditure rose as a proportion of GDP because of commitments entered into in the prosperous years.

1.2 These problems arose to some degree throughout much of the industrialised world. But in Britain they came on top of long standing weaknesses in industrial performance including the failure to invest in new products, skills and processes. And in Britain for various reasons we were slower and less successful in adjusting to the changed circumstances. The pervading attitudes and resistance to change were reinforced by the accommodating policies of Governments of which one example was the reluctance to adjust to the effects of the first oil price increases in 1973. Even when Governments preached austerity, they appeared to accept a duty to maintain the living standards of the working population. Small wonder that beliefs in the existence of a basic right to improved living standards remained unaltered.

1.3 The present Government came to power with a mandate to achieve the long delayed adjustments necessary to create a stable and growing economy. There have been two main thrusts of policy: to squeeze out inflation and to remove "supply side" deficiencies which constrain British businesses from producing efficiently and competitively. The timing of these policies coincided with a world recession which put extra strains of adjustment on the economy.

The sudden shift away from policies which accommodated inflation and inefficiency, together with other upward pressures on the exchange rate, caught both businesses and workpeople unprepared. Their belief in the policies' ability to cure inflation came too slowly. Hence the wage agreements reached proved far too high for businesses' capacity to pay. The net result of all this was a massive rise in unemployment.

1.4 The policies to squeeze out inflation have had considerable success and there are hopeful signs of some long term improvements in productivity and efficiency. But more needs to be done to improve the efficiency of response of the economy overall, notably by reducing the size of the public sector, lowering taxation and changing the tax structure, reducing rigidities throughout the economy and increasing competition in product markets in both public and private sectors.

1.5 Recovery in competitiveness is a prerequisite for success in tackling unemployment. Nevertheless the fact must be faced that economic growth achieved through competitiveness, brought about by productivity improvements and new technologies, cannot in itself guarantee full employment. The level and pattern of employment generated by such growth will be markedly different from that of the past. In a totally free labour market, adjustments would be made smoothly to bring the supply and demand for labour into line. But no labour market is totally free and Britain's is particularly rigid. As obstacles are removed so the situation over time should improve. But the rigidities are strong and the process of adjustment could be prolonged. Despite the safety net now offered by the social security system (one of the inevitable obstacles to a totally free labour market) unemployment is a serious problem for society and for the individuals affected. Many of the effects of the current unemployment have still to show through, for prolonged worklessness reduces people's long run capacity to make a productive contribution to society.

1.6 The primary need is to remove the many deficiencies in market mechanisms which prevent unmet wants in society from being translated into jobs for the unemployed. As a nation we are not prosperous enough to look to

the sharing of existing work as a cure-all solution; but we do need to remove the rigidity of thinking about jobs only in terms of the standard working week or career span. We could contemplate a prosperous society with much less work across the life cycle - most people work much less hard than their forebears did and our greater leisure is a bonus on top of higher material standards. But we could not accept a society in which people are unwillingly without paid work throughout their lives. Flexible patterns of working time would help translate the fruits of higher productivity into more leisure rather than into unemployment.

1.7 Given an expanding and competitive economy, and flexible adjustment of the labour market, there is no reason why full employment should not return. But the time span is uncomfortably long and it will be difficult to gain public acceptance for many of the steps along the path. Progress will be gradual. There are no easy answers. In the transitional period it will continue to be necessary to take measures to ease the pain of unemployment and reduce its cost to society whilst ensuring that the measures taken do not subvert the longer term reforms and indeed where possible support them. At the same time they need to be as cost effective as possible in reducing the adverse effects of unemployment. This will mean reducing its concentrated impact (notably on the long term unemployed, the young and the worst affected geographical areas). It also calls for increasing emphasis on ways of using the resources currently available to enable or induce people who are unemployed to use their time constructively.

1.8 This report cannot, and does not aim to, do equal justice to all these themes, but seeks rather to provide a basis of analysis - of causes, prospects, and possible courses of action - which will help the Government to formulate its future policies for employment. The report starts with a discussion of the causes of the increase in unemployment (Chapter 2) and its composition (Annex A). Prospects and consequences are considered in Chapter 3. Chapter 4 suggests an approach to the reform of the labour market (and product markets) which tries to combine the need for greater efficiency of supply side response (Chapter 5) with an increase in employment opportunities (Chapter 6). Possible changes in the tax and social security

systems to support these objectives are tackled in Chapter 7. The report then discusses the development of more flexible patterns of working time (Chapter 8). This is followed by a discussion in Chapter 9 of ways of coping in the shorter term with the impact of unemployment. The report concludes by presenting a range of measures for discussion. A continuing theme of the report is that many of the steps that can be taken to reform markets will have their major impact among the more flexible, smaller employers (which we call the secondary sector) rather than the large, well established employers (the primary sector) where changes will occur more slowly.

1.9 In preparing this report, the CPRS has received help from other government departments, notably the Treasury, Department of Employment, Department of Health and Social Security and also from a number of individuals.



## CHAPTER 2: ORIGINS OF UNEMPLOYMENT

**Unemployment Trends**

2.1 Rising unemployment in the United Kingdom is a long-standing feature of the economy. Unemployment rose even during the prosperous post-war years of the 1950s and 1960s, though the pace of increase worsened in the 1970s (figure 1). In 1955, nearly 240,000 people (excluding school leavers) were registered as unemployed; in 1973, over 600,000; in 1979, 1.3 mn. These figures are for years of peak activity in the business cycle and reveal a strongly rising trend in unemployment. Since 1979, unemployment has more than doubled, partly as a result of recession. In August 1982, nearly 3mn people (3.3mn including school leavers) were unemployed, 12½ per cent of all employees.

2.2 Unemployment in the OECD area as a whole also rose sharply from around 1973. In the European Community, the increase was from 3 per cent to over 9 per cent between 1973 and 1982. Of the major EC economies, West Germany had the lowest levels but just recently has suffered a faster-than-average rate of increase in unemployment (figure 2). The United Kingdom continued to experience rates of unemployment higher than in France and Germany after 1973, and, since 1979, its relative position has deteriorated sharply against all major economies. In the 1960s the United States and Canada had higher rates of unemployment than Europe but in the 1970s the pace of increase was less marked: unemployment in the United States, in particular, was only slightly higher in 1979 than in 1973. Japan experienced consistently low levels of unemployment: the rate rose from around 1¼ per cent in 1973 to 2½ per cent in June 1982.

2.3 Labour force growth increased in the OECD area as a whole between 1973 and 1979. Employment growth slackened a little, though less than would have been expected on the basis of past experience: the near halving of the OECD rate of output growth after 1973 was associated with a reduced growth of productivity. Across economies, there was no general relationship between rising unemployment and labour supply growth. A sharp increase in unemployment was recorded in France where there was no marked shift in the

FIGURE 1

Registered unemployment in United Kingdom, 1961-1981  
 Registered unemployed, excluding school-leavers

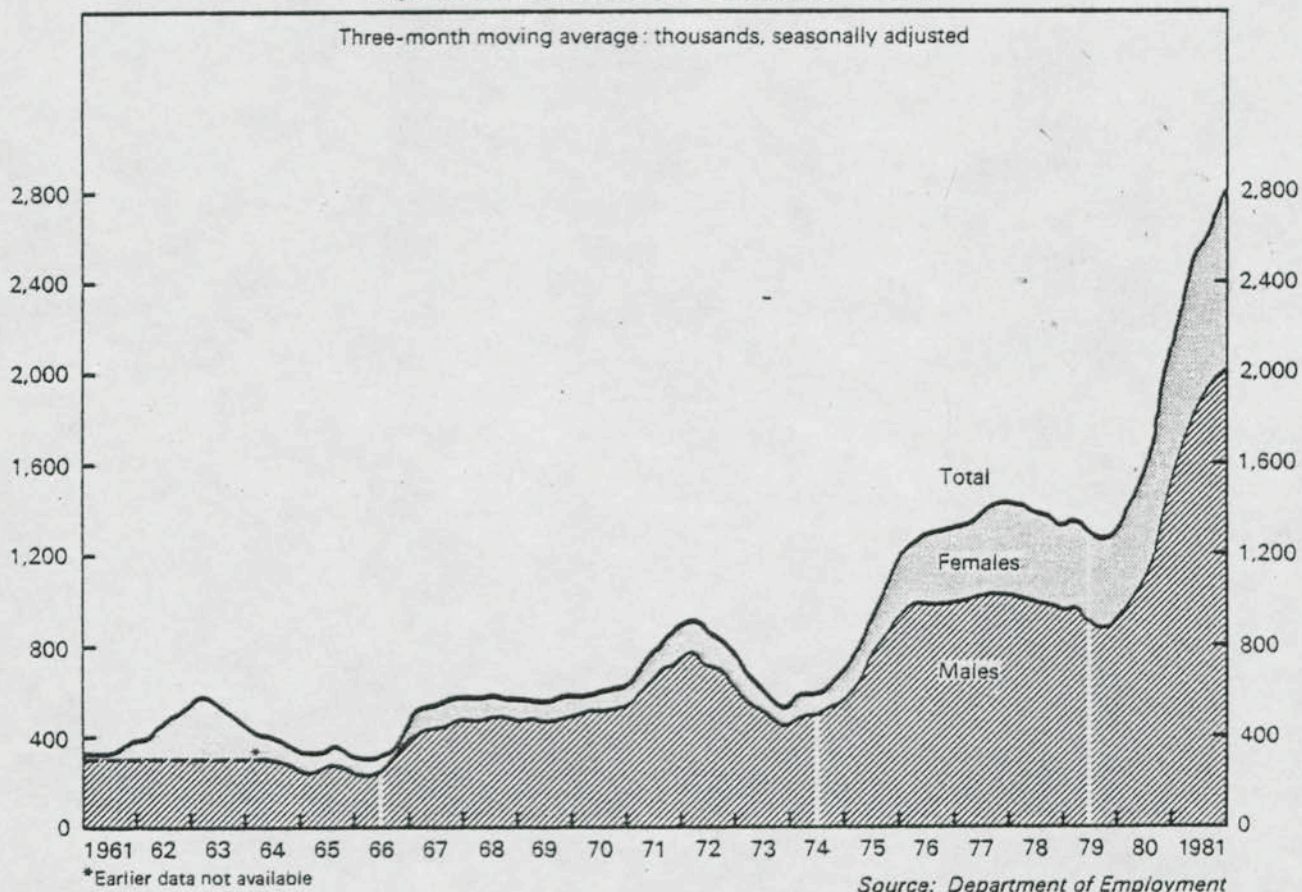
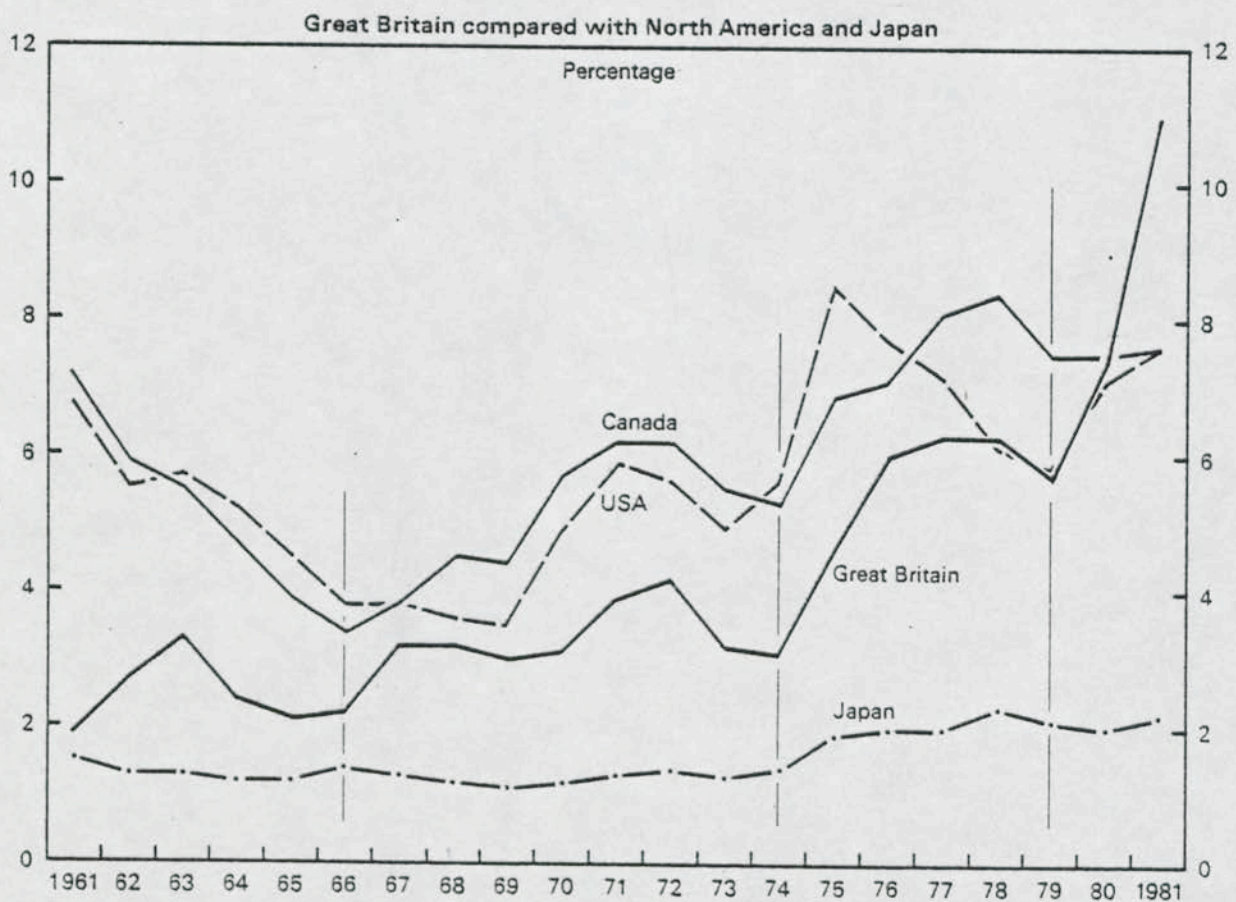
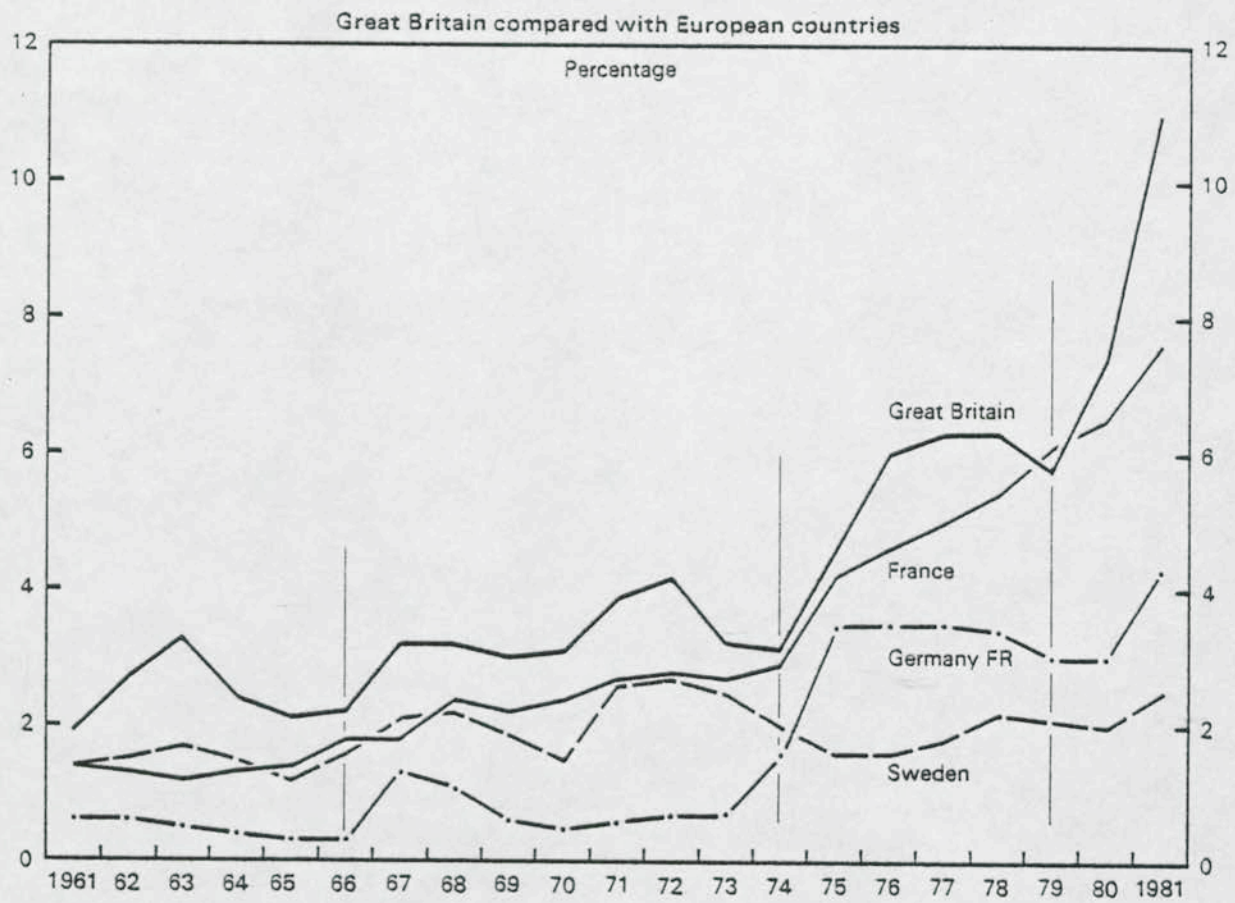


FIGURE 2

International trends in unemployment, 1961-1981  
 Unemployment rates adjusted to US concepts



Source: Bureau of Labor Statistics, US Department of Labor.

growth in the labour force after 1973; in Germany, the labour force fell as "guest-workers" were made redundant and returned home. The United States was notable for the strong growth in both its labour force and employment after 1973.

2.4 In the United Kingdom, between 1973 and 1979, the rise in unemployment was associated with a somewhat faster increase in the labour force (figure 3), reflecting the high but subsequently declining birth rates of the early 1960s. These led to an influx of young people in the mid 1970s. Moreover, there was a further rise in the participation rate of women in the labour force. Total employment remained flat between 1973 and 1979, though manufacturing employment continued to fall (figure 4).

2.5 Since 1979, OECD employment growth has fallen, particularly sharply in Europe, with the onset of recession. At the same time, the labour force has continued to grow in most economies. In the United Kingdom, however, both employment and the working population (ie the employed plus registered unemployed) fell after 1979, the latter by 600,000 between early 1979 and early 1982. As a result of recession, there was a sharp decline in the participation rate of men in the labour force (particularly for those in the 60-65 age group) and an end to the rise in female participation. Participation rates, which were relatively high in the United Kingdom, consequently fell back towards the levels experienced overseas. Had this not happened, the rise in unemployment here would have been even steeper.

#### **Unemployment in the Industrial World: Some Common Causes**

2.6 Immediately after the first oil price rise and the severe inflationary problems which followed, slower industrial world growth and poorer job prospects were due in part to a deficiency of demand. The build up of unspent OPEC oil revenues had a deflationary effect on the rest of the world. This effect came on top of a normal reversal of the previous boom conditions and attempts by governments to squeeze out inflation by fiscal and monetary

FIGURE 3  
 Employment, labour supply and unemployment, Great Britain, 1961-1981

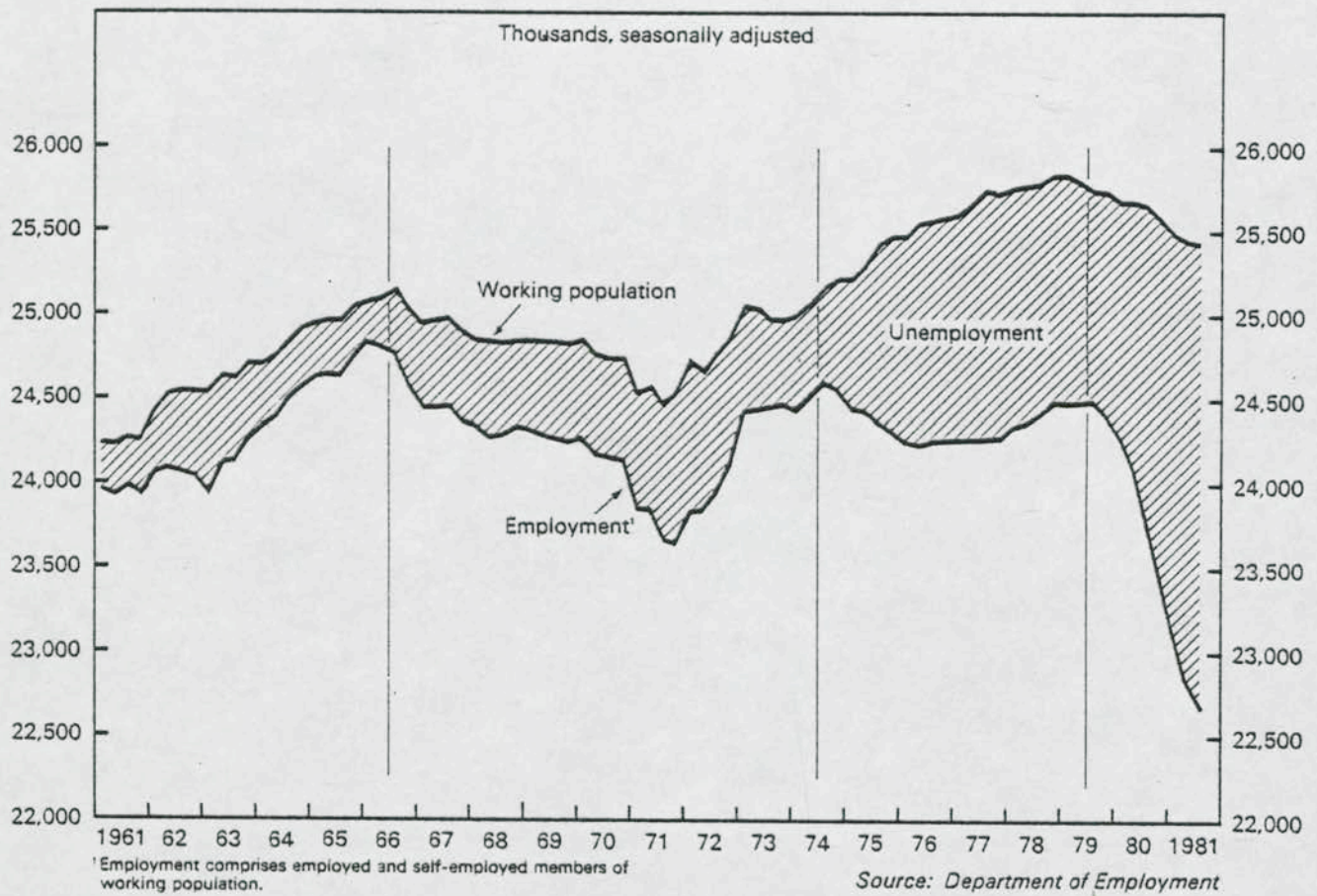
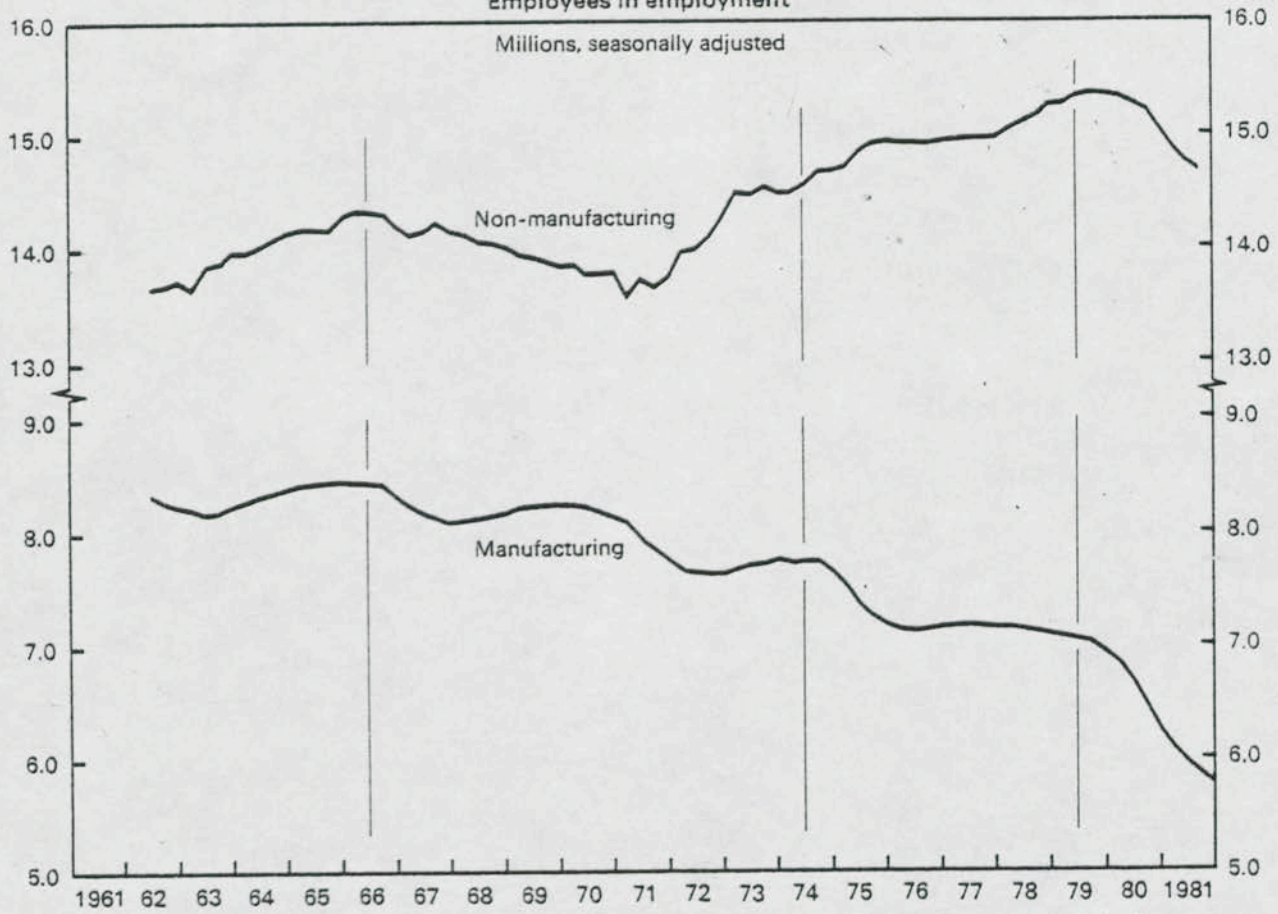


FIGURE 4  
 Manufacturing and non-manufacturing employment, Great Britain, 1961-1981  
 Employees in employment



Source: Department of Employment

policies. The United Kingdom response was slower with the result that the economy went into recession later and inflation was higher. The deflationary effects in individual countries were transmitted to others through reductions in imports and a general slackening of international trade.

2.7 The general expectation at the time was for a medium term recovery. OPEC would, after a while, spend more of its swollen revenues. Even if it did not, the revenues re-cycled in the world's capital markets would provide a source of cheap money which could sustain higher activity in the industrial world. The problem of squeezing out inflation would cause a temporary, if substantial, fall in real demand and output. But once inflation had been conquered, it would be possible for industrial world growth to return to previous levels.

2.8 It did not. Trend rates of growth were lower even in economies (like Japan and Germany) which succeeded in squeezing out inflation after 1973/74. In several economies, at different times, attempts at domestic reflation were prejudiced by a resurgence of inflationary pressures.

2.9 Furthermore, despite slower growth, the amount of spare productive capacity in several economies by the late 1970s was surprisingly small. In 1979, the level of utilisation of capacity in manufacturing in the United Kingdom and the proportion of firms facing skilled labour constraints were at about the average level recorded in the 1960s and early 1970s. Recent estimates by the OECD Secretariat also suggest that, like the United Kingdom, the United States, Germany and Japan (though not France or Canada) were getting back to levels of capacity utilization enjoyed in the early 1970s.

2.10 These observations imply that the slowdown and persistence of slower industrial world growth reflect growing supply-side deficiencies in industrial economies. In many cases, the main constraints on expansion and creation of new jobs appear to turn on a lack of suitable productive capacity which is profitable at prevailing levels of real wages and a fear that renewed growth would stimulate a resurgence of inflation.

2.11 The reasons for these developments are undoubtedly complex and not fully understood, but it is possible to identify some of the more obvious causes.

Supply Shocks

2.12 A variety of "supply shocks" in the 1970s rendered economically obsolete certain industrial plant and the jobs which went with it. Such obsolescence occurs quite naturally as a result of technical progress but, in the 1970s, the rate of obsolescence and thus scrapping of existing industrial capacity and jobs in the advanced economies probably accelerated on three counts -

a. There were increasingly strong pressures from newly industrialising countries as suppliers of competitive manufactured goods. The share of OECD imports of manufactured goods supplied by the NICs rose from 4½ per cent in 1970 to 8 per cent in 1977. The impact was concentrated in particular sectors: not only traditional ones like clothing but also newer activities like consumer electronics. The associated scrapping of plant and jobs (particularly unskilled jobs) probably added to unemployment, given the difficulties of re-allocating the labour thereby released to new product areas, often requiring higher skills.

b. The rise in the oil price, which quadrupled in 1973/74 and nearly trebled 5 years later, and the associated rise in real energy prices also rendered prematurely obsolete some proportion of existing industrial capacity and jobs. In some cases, plant which had been installed and operated profitably in an era of cheap energy was scrapped immediately; in other cases, the scrapping of energy-intensive capacity occurred more slowly as the investments concerned ceased to make any worthwhile contribution to overhead costs. These adjustment problems, which are continuing, are illustrated in the United Kingdom by the decline of the energy-intensive, basic industries like steel and chemicals.

c. Some of the investment in capital intensive processes which was stimulated by low or negative interest rates, later became unprofitable when real interest rates rose at the end of the decade.



Unrealistic Pay Demands

2.13 Some jobs and productive capacity were also lost in the 1970s as a result of an unwillingness of labour unions in a number of economies to accept a lower rate of advance of real wages, despite the reduced ability of economies to deliver such advances.

2.14 The attainable real growth in personal incomes, particularly of tax payers, declined after 1973 for a number of reasons -

a. A fall in productivity growth. This fall was partly induced by recession, but its origins also go back to the late 1960s. At that time, there were signs of weakening in the forces which had nurtured the historically unprecedented growth rates of the 1950s and 1960s. For example, there was an abatement to the prolonged post-war investment boom and reduced scope for productivity improvement by shifting labour off the land or, in Europe and Japan, by catching up with United States technology.

b. The continued rise in public expenditure. Long term commitments on public provision had been undertaken by Western governments in prosperous years when demands for better and more health care, education and support for the needy and disadvantaged seemed affordable as well as socially desirable. But when growth fell after 1973, the public expenditure share of GDP rose rapidly throughout the OECD area. By 1980, total outlays of governments represented nearly two-fifths of the GDP of OECD economies; this compares with a figure of a third in 1973. The rise in public spending created severe public finance problems and further increased the tax burden. Taxes in the OECD area rose from 32½ per cent of GDP in 1973 to 36½ per cent in 1980. Higher taxes probably reduced work incentives and, by frustrating the desire of workers for increasing personal living standards, reinforced the pressure for higher wages.

c. The rise in real oil prices. More goods in real terms had to be traded to pay for a given quantity of oil, leaving less for personal consumption. This "terms of trade" deterioration reduced OECD real income by about 2 per cent in both 1973 and 1979 though the United Kingdom was to some extent cushioned from this effect.

2.15 Generally, expectations for growth in real living standards did not attune quickly to what was feasible after 1973. The reasons include: the sheer complexity of modern industrial economies and the associated difficulties of understanding the economic implications of major changes; the belief that post-war growth rates would continue indefinitely and therefore that growth in the 1970s would return to previous levels; the unwillingness of leaders in political life and in industry to spell out the unpalatable message that real living standards had to adjust and grow more slowly; the (by then) established practice of effectively indexing pay to the rise in consumer prices in many economies; and deeply ingrained aspirations, befitting affluent societies, to own a home, at least one car, a TV and the latest luxury gadget. In short, aspirations for a fast rise in real incomes made possible by the growth in productivity in the 1950s and 1960s were generally extrapolated into a period when such aspirations were no longer realistic.

2.16 Our assessment is that unrealistic real income aspirations adversely affected capacity growth and jobs, if not immediately, then over a period of time. Experience differed between countries -

a. Pressure for higher real wages in excess of underlying productivity growth, or when oil prices had risen, in some cases succeeded but only at the expense of profits and jobs. A number of economies - notably, but not exclusively, in Europe - experienced sustained reductions in profit shares during the 1970s. A fall in actual and prospective profitability probably led, in turn, to accelerated scrapping of capacity and therefore jobs and a gradual substitution of machines for too expensive labour.

b. In addition, in some economies such as the United Kingdom, producers granted high nominal wage increases but attempted to pass them on in price increases in order to preserve profit margins. This

frustrated the desire for higher real wages. In principle, this process, repeated, would have led to hyperinflation. Government attempts to contain inflation, even at some stable level, led in the face of wage claims out of line with reality to an increase in spare capacity and labour market slack. In cases where pay aspirations adjusted very slowly, the end result may have been a scrapping of capital equipment and an atrophy of human skills.

#### Experience Across Economies

2.17 While the importance of these mechanisms remains a matter of debate, the flexibility or lack of it in the evolution of real wages helps to explain some of the differences between economies after 1973. The following examples illustrate this with particular reference to the different extent and pace of adjustment to the rise in oil prices:

a. The comparative buoyancy of employment in the United States may be partly ascribed to its real wage moderation in the face of the oil prices rises and a depreciating dollar, the latter partly reflecting reflationary policies. Real wages fell following both oil price rises and profit share in the United States remained reasonably stable. This moderation in real wages might be put down to union weakness and the rather low rate of unionization in the United States but also to its wage contract system which typically fixes cash wages 3 years in advance, (though increasingly these contracts include cost of living adjustment).

b. Despite its oil import dependence, the Japanese economy absorbed the second oil price rise comparatively smoothly because of moderation in nominal and real wage demands. This contrasts strongly with behaviour after the first oil price increase: GDP in Japan fell (by 1 per cent) in 1974 (following 9 per cent growth in 1972/73) and inflation rose to nearly 25 per cent. Nominal wages also rose very rapidly and although real wage growth began to moderate, there was nevertheless a severe squeeze on profits. Continued moderation in real wage growth thereafter and the more favourable adjustment to the second oil shock may be partly ascribed to monetary restraint but also to the underlying

flexibility of labour costs in Japan. This reflects the high degree of social consensus and commitment of workers to the long term viability of their companies, themselves subject to considerable competition, Japan's bonus payments system, and the extensive use of sub-contractors and small firms (which act as a buffer during economic downturns).

c. The absorption of the oil price increases by the German economy provides an example of more serious problems of real wage adjustment. After the first oil shock, there was a strong wage push in the face of a slowdown of economic activity. Unions - despite early warnings - appeared to disregard the fact that the rise in consumer prices resulting from the worsening of the terms of trade as oil prices rose represented a real income loss for which compensation could not be demanded from domestic firms without employment losses. Unlike in Japan, precisely the same kind of adjustment problem appears to have occurred in 1980. Professor Giersch (of the Kiel Institute), in particular, ascribes much of the heavy loss of jobs in Germany precisely to the pressure from unions for advances in real wages.

#### United Kingdom Experience

2.18 In the United Kingdom, there is evidence (notably in the very low rates of return on capital) of sluggish adjustment of aspirations. One estimate is that the effect of the fall in sustainable real income growth and the rise in the tax burden in the face of inflexible real wage aspirations increased permanently the unemployment rate consistent with merely stable inflation by 1½ percentage points in the mid 1970s. A number of factors (some of which apply with equal force in other economies) explain sluggish adjustment of pay aspirations in the United Kingdom despite heavy unemployment:

##### a. Unions

Unions have placed much more emphasis on improving wages than on maintaining or increasing the number of jobs, possibly as a result of the experience of full employment in the prosperous post war years and the commitment of governments at that time to manage demand in order to secure jobs. Old attitudes and objectives take time to change and

unions have found it easier to accept redundancies than to relax pressure for higher pay. Thus for most of the last ten years, for every stoppage caused by redundancy questions, there have been 20 stoppages over wages. Old attitudes and objectives have been reinforced by increased industrial muscle. The bargaining power of unions has been strengthened over the years by extensive legal immunities, by developments of modern technology which have increased the potential disruptive power of key groups of workers and by increases in membership. Union membership rose from 44 per cent of the labour force in 1960 to 55 per cent in 1979, one of the highest levels of union density by the standards of the major industrial economies. Some estimates suggest also that the "union mark-up" (ie the wage differential between union and non-union workers) rose significantly between 1968 and 1973 though it has since remained fairly constant.

b. Less Competitive Product Markets

Despite competition from imports, some product markets may have become less competitive as the result of the increased concentration of output in the hands of fewer large firms (discussed further in chapter 5). In addition, some industries, particularly in the public sector, are monopolies. The resistance of employers to pay claims may have weakened since they were able to pass on higher pay in the form of higher prices. This point is allied to a. in the sense that unions often have the greatest market power in companies/industries where competitive forces are weak.

c. Internal Labour Markets

In the United Kingdom, and in other major economies, a number of people have long term job security in the public sector and within large companies. These employers often have highly developed "internal labour markets" where most jobs are filled by the promotion or transfer of existing staff and not by new entrants. The purpose of these arrangements is to motivate and to encourage loyalty amongst experienced and well-trained employees. The extent of internal labour markets is reflected in the length of job tenure enjoyed by many in

employment. A recent estimate is that, in the mid-1970s, men in employment in the United Kingdom could expect to spend an average of 20 years (and women 12 years) with the same employer. At that time, the average length of job tenure in manufacturing appeared to be as high as in public administration. The effect of these developments is to shield substantial numbers of those in jobs from the direct influence of competitive forces in the labour market. Unless accompanied by specific agreements to promote pay flexibility (like profit sharing as in Japan), the growth of internal labour markets will therefore have reduced the responsiveness of wage increases to changes in economic conditions.

d. Employment Protection Legislation

In the United Kingdom and elsewhere, the general effect of the development of internal labour markets on wage responsiveness was reinforced by employment protection legislation.

e. Employers' Attitudes

There are strongly entrenched notions of "fairness" which make employers reluctant to push down the pay of employees and cut their living standards, and to pay below the local "going rate". Employers are also averse to sacking people in order to take on, at a lower wage, someone formerly unemployed and willing to work for lower pay. This partly explains the difficulty of the unemployed pricing themselves into jobs.

f. Wages Councils

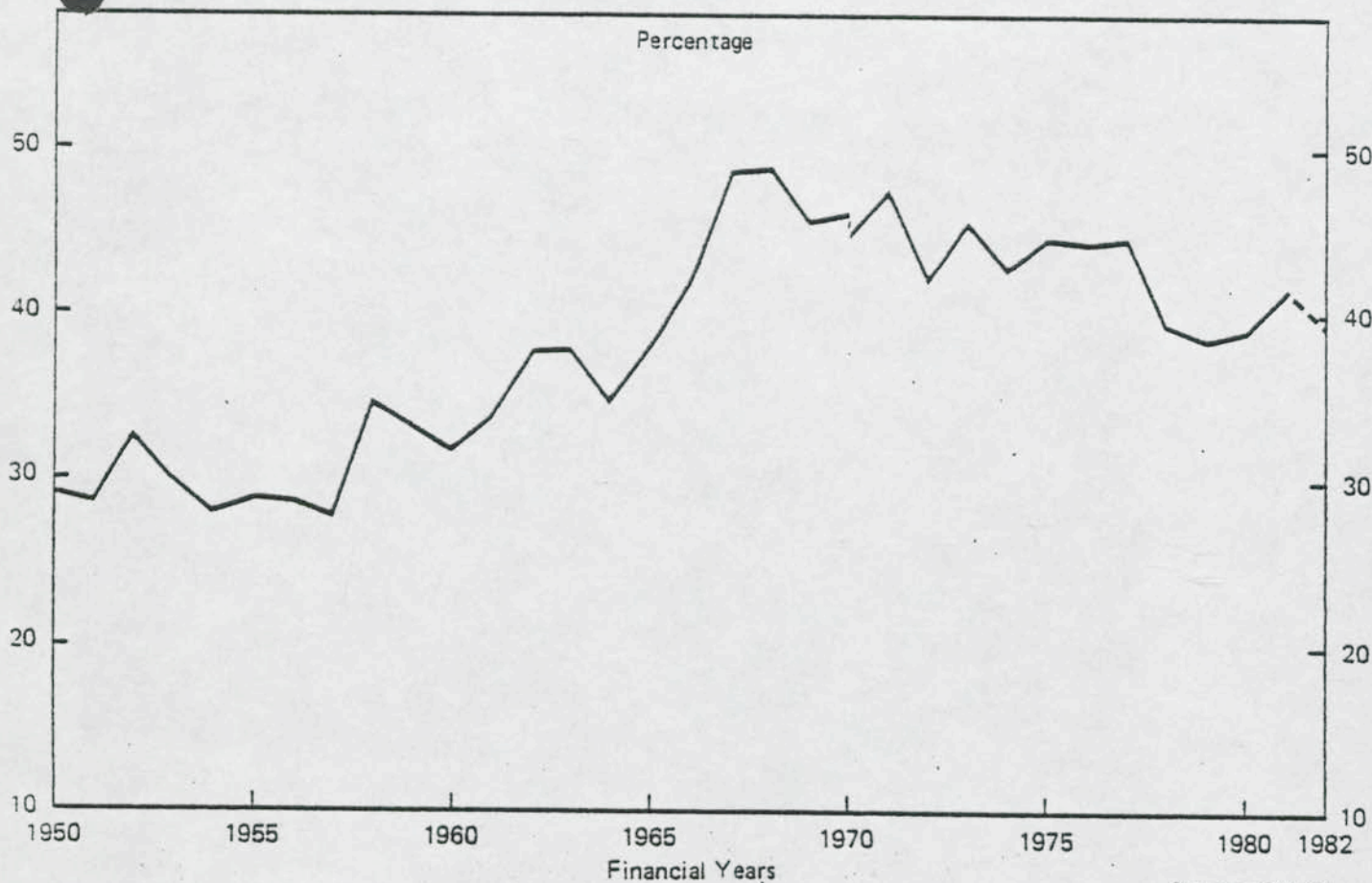
Wages councils may have made it difficult to adjust the wages of the lower-paid and largely unskilled workers.

g. Benefit levels

Figure 5 shows how social security benefits rose sharply in relation to earnings in previous employment in the late 1960s before falling gradually in the 1970s. The increase in benefit in the late 1960s probably caused people to take up existing vacancies more slowly, adding

FIGURE 5

Replacement rates for unemployed, Great Britain



Source: DHSS

Notes

1. The replacement rate is total benefit received out of work divided by total net earnings in work.
2. Total benefit paid is total expenditure on Unemployment Benefit, Supplementary Benefit and Child Benefit/family allowances for the unemployed divided by the average number of registered unemployed people. For 1982/83, the estimated increase in income tax revenues due to the taxation of Unemployment Benefit and Supplementary Benefit has been deducted from the PESC estimate of benefit expenditure.
3. Total net earnings is a weighted average of the estimated net earnings of the various age, sex and family groups represented on the unemployment register. Net earnings are gross earnings plus Child Benefit/family allowance (where appropriate) less income tax and employees' national insurance contributions. The earnings of the groups have been adjusted in the light of the findings of the 1978 DHSS Cohort Study on the actual earnings of men experiencing unemployment. To calculate net earnings, various simplifying assumptions were made but from 1970 onwards the tax calculations allow for change in the main family characteristics of the unemployed. This accounts for the small break in the replacement rate series in 1970.

to registered unemployment. For the period since 1979, while benefits have remained roughly stable relative to the earnings of all workers, they may have risen in relation to the wages at which the unemployed could expect to find work, particularly if the opportunities are mainly in the non-unionised sector. In this respect the current replacement rates illustrated may underestimate the disincentive to return to work. This is discussed in more detail in Annex B which points to the conclusion that a small minority of the register show little active interest in finding work and a rather larger number are selective about the kinds of work sought, but current social security benefit levels are not causing large numbers of the adult unemployed to choose to remain permanently out of work. A more powerful effect on employment may have come through the influence of benefits on the "wage floor". Although there is no strong evidence, employers may be reluctant to be seen to be paying less than the "family wage" (eg supplementary benefit level payable to a family man with two children). Hence benefit may hold up the going level of low pay. The effect on the total range of pay rates above the floor is not clear. Further analysis of the effect of benefits is being prepared by Professor Walters, in collaboration with Liverpool University, and is expected to become available during September.

#### **The United Kingdom's Industrial Weakness**

2.19 In the United Kingdom the problems just described come on top of domestic supply weaknesses and generally poor industrial performance. This combination of adverse factors created additional problems for jobs.

2.20 The most obvious symptom of industrial weakness in the United Kingdom is its low productivity growth, although labour productivity is only one aspect of industry's overall competitiveness. Productivity growth has been persistently worse in the United Kingdom than abroad, with the inevitable result that there has emerged an ever-widening gap in levels of productivity. The National Institute, for example, estimated that, even in 1955, manufacturing output per man-hour was higher (by a margin of 8-18 per cent) in some major European countries. By 1980, estimates on a similar basis put the level of productivity in the United Kingdom at less than half that in the United States, the Netherlands, Japan and Germany; little more than half that of France and Belgium; and around two-thirds of that of Italy.



2.21 The long-standing malaise in British industry is only partly explained by economic factors. Relative to the level of output, productive investment in the United Kingdom does not compare too unfavourably with abroad; studies have shown that capital productivity - the increment to output achieved from investment - is, like labour productivity, a major weakness. Misdirected R and D expenditure, over-diversified product ranges, high marginal tax rates, excessive capital subsidies and uncertainty created by stop-go macro-economic policies have all contributed something to the explanation, but not the whole story.

2.22 A pervasive factor, which has been identified by commentators for over a century, is the lack of adaptability of British industry; its unwillingness to innovate and inability to secure a good return when it does. This deficiency, together with the poor productivity of existing resources, has often been said to derive from management weakness - an "entrepreneurial failure". British managers have often been found to be less well educated or trained and lacking the animal spirits evident in their peers overseas. Part of the problem here may stem from institutional factors such as Britain's failure to develop a comprehensive technical education system.

2.23 Another pernicious influence has been the United Kingdom's system of collective bargaining and industrial relations. Labour militancy in the United Kingdom probably reflects not only union intransigence and greed but also the weakness of management in handling industrial relations and underlying class conflict. As a result, industrial performance and productivity have suffered. In a comprehensive study, Prais (of the National Institute) notes the greater frequency of short, small, "wildcat" strikes in Britain compared to abroad. Whilst harming the workers little in the short run, these are particularly disruptive to production. Moreover, the increased incidence of strikes with increasing sizes of plants is much more marked in Britain than in Germany or the United States. The result is a "comparative disadvantage for Britain in this respect in those industries in which production is required for technical reasons to be carried out on a very large scale". The highly decentralized, locally-based nature of collective bargaining, combined with the defensive strength of unions, inhibits long term planning and co-ordinated decision

making, encourages restrictive labour practices, delays the adoption of new techniques and militates against quick responses to changes in the organisation of work. This disadvantage, allied to the degree to which trade unionism has penetrated the workplace, appears to be particularly pronounced in the United Kingdom.

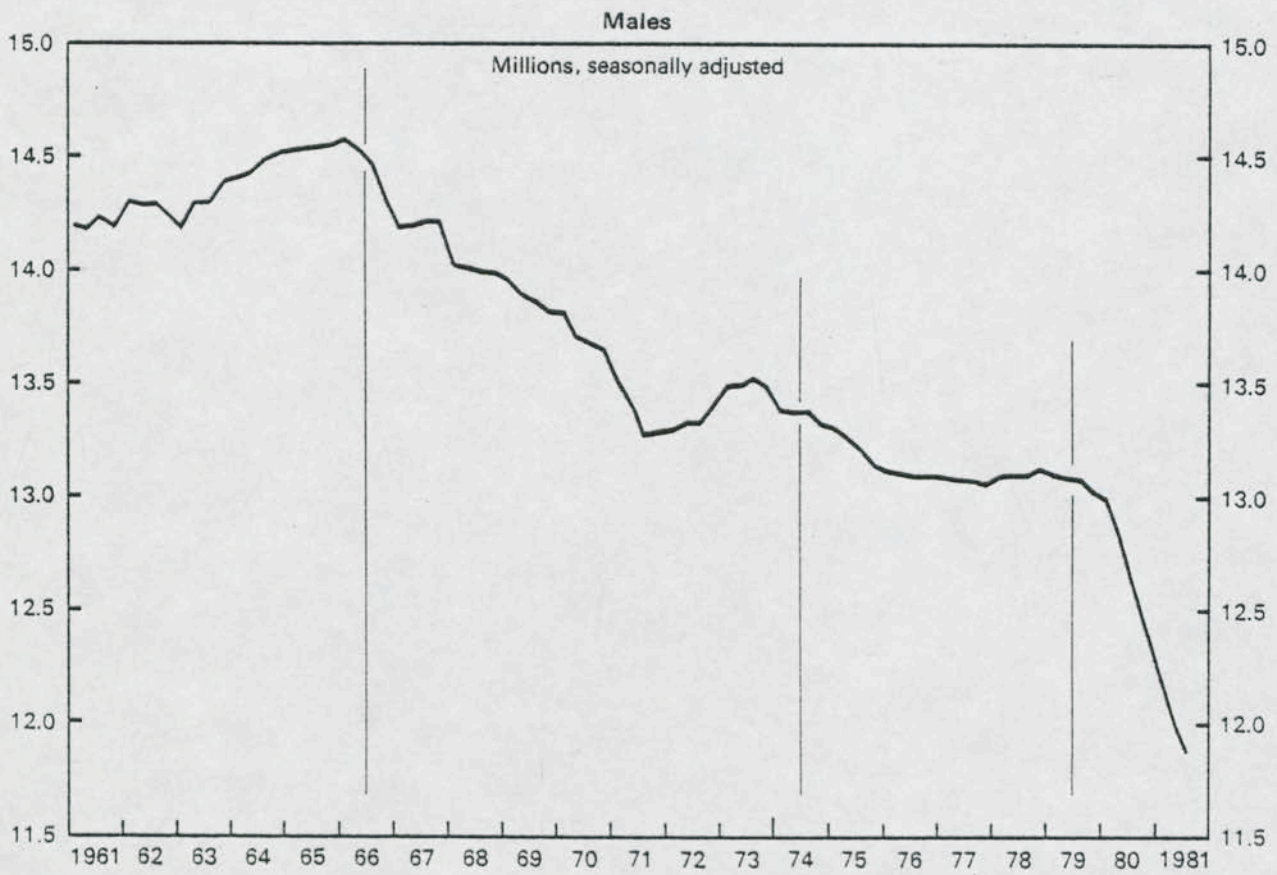
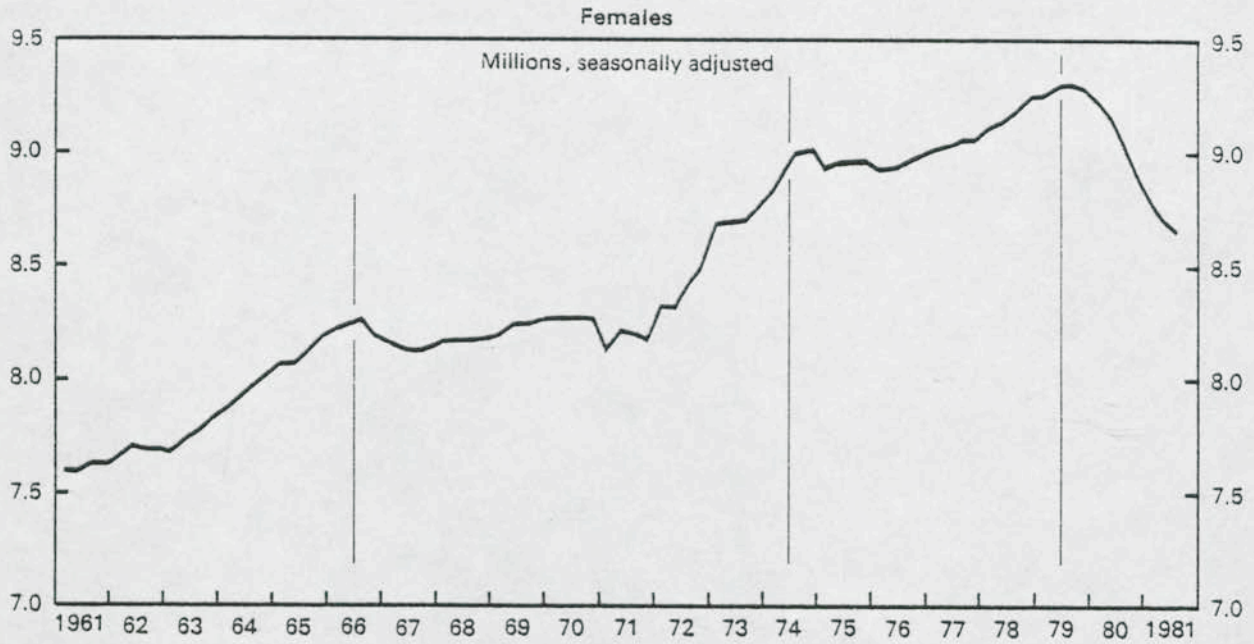
2.24 A further effect of unions which represent the great masses of unskilled workers in the United Kingdom has probably been to reduce pay differentials between the skilled and unskilled. For example, the differential between pay for skilled workers and labourers in engineering narrowed by 10 per cent between 1970 and 1980. Apart from undermining the job prospects of the unskilled, an important effect has been to reduce the rewards to investment in labour skills by individuals and companies. This may have added to the skill shortages which have plagued British industry.

2.25 Such fundamental industrial deficiencies prejudiced trading performance in terms of non-price as well as price competitiveness. In fact, (imperfect) measures of price/cost competitiveness indicate broad stability if not improvement between 1960 and 1978. It is the quality and reliability of British goods which have proved particularly deficient. As a result, there has been a tendency for imports of manufactures to rise disproportionately to increases in domestic output while exports fail to tap the strongest growing overseas markets.

2.26 The general impact of these weaknesses has been two-fold:

a. The inability to compete effectively in international markets has undermined the manufacturing sector's ability to generate jobs directly. There is a close association over time between jobs (especially male jobs) lost in manufacturing and the rise in unemployment in the United Kingdom (figures 6 and 7). The causal link is, however, unlikely to be a simple one: for example, while the older, less adaptable redundant steelworker may remain unemployed, others displaced from the manufacturing sector but with more marketable skills may succeed in finding jobs elsewhere and may thereby "bump down" others into

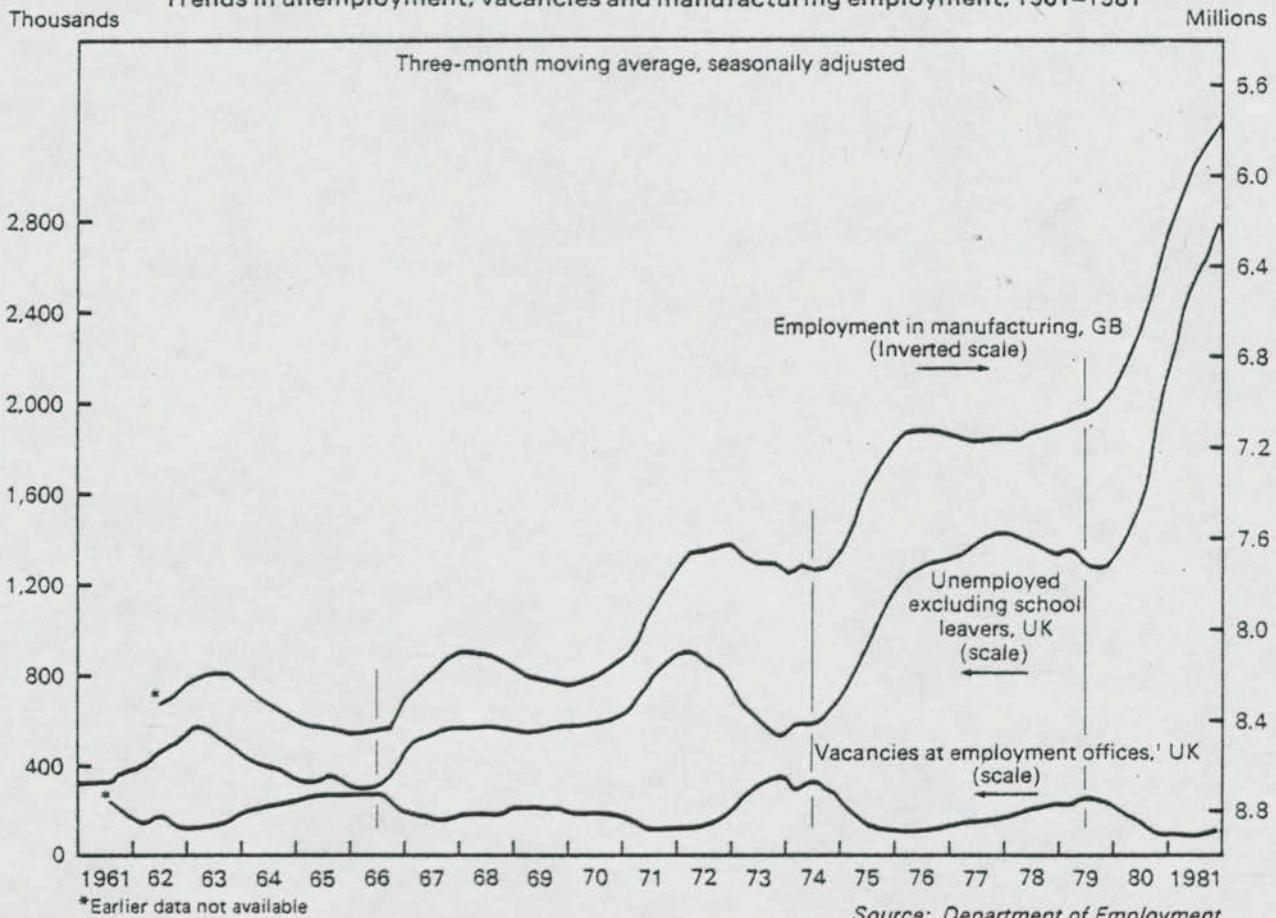
FIGURE 6 Trends in male and female employment, Great Britain, 1961-1981



Source: Department of Employment

FIGURE 7

Trends in unemployment, vacancies and manufacturing employment, 1961-1981



unemployment. The fall in manufacturing employment in the United Kingdom appears particularly severe judged by the experience of other major economies. The fall preceded by a substantial margin the decline in manufacturing jobs in Europe and Japan seen in the 1970s. In the United States, manufacturing employment continued to expand until the latest recession. Moreover, while in other major economies manufacturing output rose between 1973 and 1979, the United Kingdom was unique in experiencing an absolute fall. (Part of this can be attributed to the diversion of resources into the development of the North Sea.)

b. The high import propensity of the economy has meant that it fails to respond adequately when domestic demand increases. Extra spending often simply leaks into imports, creating balance of payments and exchange rate difficulties, and ultimately higher inflation. More generally, the United Kingdom, by its industrial weakness, has been constrained to grow at a rate less than that achieved by competitors abroad. This, in turn, has reduced the achievable growth of real income and employment in all sectors of the economy.

#### **United Kingdom Experience Since 1979**

2.27 After 1979, the last peak year of the cycle, a downturn in activity, here and abroad, added a cyclical component to the trend rise in unemployment caused by the various supply weaknesses described above.

2.28 Between the second quarters of 1979 and 1981 - the peak and trough of economic activity in the present cycle - GDP in the United Kingdom fell by 7 per cent and manufacturing output fell by 18 per cent. Of the 1.7 mn decline in employment, two-thirds was accounted for by falling jobs in manufacturing. Since early 1981, output has stabilized but employment has continued to fall.

2.29 Some of the output and employment difficulties reflect those experienced in the rest of the world in the wake of the second oil price increase, though a rise in the oil price itself should have affected the United Kingdom much less harshly than others who are not oil self-sufficient. The United Kingdom's

real income would not have been reduced directly by the rise in oil prices, although the "oil effect" may have, nevertheless, caused some problems of adjustment and consequential loss of jobs in the trading sector. On balance, however the possession of oil was a substantial advantage for the United Kingdom.

2.30 Nevertheless, the gap in growth performance between the United Kingdom and the OECD economies widened. Annual average United Kingdom GDP growth had been  $1\frac{1}{2}$  percentage points below the OECD average between 1973 and 1979. In the subsequent two years, this "gap" doubled: OECD economies grew at about 1 per cent per annum while United Kingdom output fell by over 2 per cent per annum. As already noted, United Kingdom unemployment also rose relative to that in other main economies. Between 1973 and 1979, United Kingdom unemployment represented typically just over 30 per cent of total unemployment in the rest of the EC (according to national definitions). By 1982, this ratio had jumped to over 40 per cent. Had unemployment in the United Kingdom moved in line with the rest of the EC (maintaining the 1973-79 average relationship) unemployment would now have been around 800,000 less. The increase in unemployment in the United Kingdom relative to abroad would have been considerably greater but for the fall in numbers in the working population.

2.31 Part of the sharp rise in unemployment can be ascribed to the temporary costs of bringing down inflation which was on a rising trend in 1979 due to the previous strong growth in the money supply and in earnings. It was always recognised by the Government that the side effect of squeezing inflation out of the system by containing the growth of the money supply would be a transitory fall in output and loss of jobs. The size and duration of these temporary costs depend on the speed with which inflation adapts to lower monetary growth. This in turn depends in part on how quickly expectations of inflation adapt. Had the mere announcement of a declining path for the money supply caused employers and employees immediately to mark down their price increases and wage demands, the output costs of counter-inflation policy would have been small. If inflation expectations remain sticky, the output/job cost of counter-inflation policies will be high.

2.32 Overseas perceptions of the counter-inflation policies embraced in the Medium Term Financial Strategy caused a strengthening of the exchange rate. Despite the fact that the broad measure of the money supply overshot its target, confidence in sterling was boosted by the commitment to bring inflation down and by the relatively high interest rates of the period. These monetary influences on sterling were reinforced by its petro-currency status and the sudden rise in real oil prices.

2.33 The shift in the behaviour of sterling was quite outside past experience: previously, and over broad periods, the exchange rate had moved downwards maintaining the United Kingdom's price and cost competitiveness. This failed to happen after 1979. Inflation of earnings rose between 1978/79 and 1979/80. Combined with the appreciation of the exchange rate, the surge in domestic wages and prices led to an unprecedented loss of labour cost competitiveness of 50 per cent between end 1978 and end 1980.

2.34 The initial major impact of the deterioration in competitiveness operated directly on domestic demand and output rather than through a worsening trade balance. In order to retain hard-won export markets, manufacturers cut back on their export prices and attempted to compete at home by containing the rise in prices of import-competing products. In both 1979 and especially 1980, export prices of manufactured products rose much less fast than domestic prices. Generally manufactured product prices rose less fast than retail prices or earnings. Added to the rise in real oil prices, the effect was to produce a severe squeeze on manufacturers' profitability and cash flow. Firms reacted by cutting back on stock purchases, investment and employment. This reaction initially had the tendency of reinforcing the cash squeeze as suppliers' stocks of finished goods rose and productivity fell (because output fell more quickly than employment), adding to the rise in real unit labour costs.

2.35 The severity of the recession in the United Kingdom and consequential sharp loss of jobs therefore occurred in part because pay expectations in all parts of the economy did not adjust quickly enough to the new environment, including an unexpectedly strong exchange rate. Employment may not,

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however, respond sufficiently when output recovers from the cycle to secure a fall in unemployment in the short run. The reversal of previously accommodating monetary policies and the sharp squeeze on industry forced management to take hard decisions to rationalise and cut jobs, decisions which had been deferred over the years partly because of the fear of opposition to closure and redundancy. Moreover people will not as a rule return to the actual jobs they have left. Prospects for unemployment to the end of the decade are considered in the next chapter.

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CHAPTER 3: THE OUTLOOK FOR UNEMPLOYMENT

3.1. It is widely accepted that unemployment is a major problem and there are two reasons why it must attract Government attention in formulating policy at this time. First, the chances of unemployment returning to 'normal' post-war levels in the foreseeable future are low so long as the rigidities in the economy remain. Secondly, if unemployment continues at a high level, or indeed rises further, there will be harmful social and economic consequences both for the individuals concerned and for society at local and national levels. This chapter assesses the extent of these problems by describing the prospects for employment and unemployment and some of the major consequences of unemployment for individuals and for society.

Prospects for unemployment

3.2. An economy with zero unemployment is neither feasible nor desirable. For example, some degree of "frictional" unemployment is a necessary component of a dynamic economy: that is people are always changing jobs and moving in and out of the labour force temporarily. Changes in technology and market structures can make some workers "structurally" unemployed. There are some workers who for personal reasons are only marginally employable even when labour demand is high. Finally there are cyclical fluctuations in unemployment caused by variations in world trade. Allowing for these factors Beveridge recommended an average of 3 per cent unemployment as a desirable target for post war Britain. In practice in the 1950s and 1960s, unemployment stayed well below this figure and overheating often resulted. Also higher incomes have led to people being more selective about the jobs they take and this combined with more rapid economic change today requires a higher level of frictional unemployment so that a figure of 3 per cent is probably too low. Getting down to levels of 4 per cent - 5 per cent that is 1 million to 1.25 million could be regarded as a satisfactory outcome. But to attempt to achieve such a level quickly would involve serious inflation problems. At best the transition must be gradual and the figure considered as a long term goal.

3.3. As explained in Annex A (where the composition of unemployment figures is discussed in greater detail), a significant minority of the existing register of 3 million are not genuinely unemployed and would withdraw from the register if obliged to accept jobs. The numbers cannot be quantified with any certainty but our guess is that the number is around half a million (perhaps 300,000 of whom work in the black economy). On the other hand there are probably a greater number of people who do not at present register but who would do so if jobs were available or who participate in Special Employment Measures. Thus to reduce unemployment from 3 million to 1 million requires more than an extra 2 million jobs.

3.4. Looking ahead, the working population will change too and the chances of achieving this outcome over the rest of the decade depend upon -

- the rate of growth of the economy;
- changes in the size of the population of working age;
- the participation rate, (that is the proportion of the population of working age who will be actively seeking work);
- changes in the level of productivity including the effect of technological change;
- levels of wage rates and the interaction of the tax and benefits systems.

3.5. Unless there is a further intensification of the world recession during 1982 the United Kingdom economy should begin to expand and attain growth of GDP of around 2 per cent from 1983 onwards. By the end of 1984 or early 1985 GDP should have returned to the level of 1979. Given a continuing recovery in competitiveness, there is then the prospect of steady growth for the rest of the decade of about 2-3 per cent per annum. However because of changes in the other factors the return to 1979 levels of GDP is unlikely to bring about a return to the 1979 unemployment level of 1.3 million. Nor will growth of 2-3 per cent necessarily bring about a significant decrease in unemployment thereafter.

3.6. First between 1981 and 1991 the total population of the United Kingdom is projected to grow by around 2 per cent. The population of working age between 16 and 65 will rise more rapidly by 4 per cent, or 1.1m, and the largest increase will be in the 20-44 age groups. The numbers in the younger group (16-19) and the group (60-64) nearing retirement will actually be falling during this time.

3.7. Secondly participation rates may change. By 1980 they were higher in the United Kingdom than in most developed countries except Scandinavia but continued high unemployment has since discouraged some people from seeking jobs. For example, more men have chosen earlier retirement and fewer married women try to get jobs: these trends may now continue.

3.8. Because of the uncertainties it is difficult to derive precise figures for the overall increase in the numbers of people who will be actively seeking work by 1990. But taking the increase in the population of working age and allowing for the 'discouraged worker' effect it is likely that by 1990 the number of people actively seeking work will be 500,000 greater than now. If the economic situation improves, this in itself could encourage more people actively to seek work and so increase this number.

3.9. Thirdly, there is the problem of predicting productivity trends. Labour productivity in the 1960s and early 1970s increased at around  $2\frac{1}{2}$  per cent per annum for the economy as a whole, higher for manufacturing. There was a marked slowdown in the mid 1970s associated with lower levels of output growth and changes in relative prices. Then in 1979 productivity fell back as output was reduced and, despite the significant shake-out of labour, employers failed to adjust their labour force immediately to the same extent. The re-adjustment between labour and output followed from 1980 onwards and by 1981 labour productivity began to rise again quite sharply, especially in manufacturing. The question now is whether this rising trend of productivity is a temporary phenomenon or can be considered a more permanent change.

3.10. An improvement in United Kingdom competitiveness is an essential condition for economic growth and a rise in labour productivity an important element of that. The recent shake-out of labour and improvement in working practices mean that the same output is being achieved with a reduced labour force. This trend may continue: anecdotal evidence from some businessmen is that some further labour shedding may take place, particularly in sectors hitherto protected. Also, having gone through the 'trauma' of laying-off workers on a large scale (which was more acceptable to trade unions when output was falling fast and bankruptcy threatened) firms may be reluctant to increase their labour force to former levels: instead it is both cheaper and easier to reduce short time working, increase overtime and also install labour saving investment.

3.11. The other determinant of improved productivity and a further unknown is the pace and dissemination of technological development, (especially the wider use of micro-electronics). Historically technical progress has been associated with improved economic growth and higher living standards. Initial job losses have been offset by the effects of greater efficiency as the lower costs and prices have led to an increase for the demand of products generally and improved market opportunities overseas. It is not clear that current technical changes are of an entirely different order of magnitude from those historically. However a number of commentators have raised this as a possibility, in particular questioning how far increased jobs in the service sector can offset the loss of jobs elsewhere.

3.12. Micro-technology will probably result in job displacement in some sectors. For example, further computerisation and the more extensive use of word processors may cause job losses in routine clerical and typing work. Further use in financial services such as insurance and banking could result in lower need for labour there. And the greater use of computer controlled manufacturing processes and robotics will have a continuing effect on some manufacturing activities. However there is certainly no case for slowing up the introduction of these techniques because of the employment consequences: this could only lead in the longer term to a less efficient and less competitive economy.

3.13. Our general expectation is that new technologies will be introduced fairly slowly because of the high initial costs involved, the need to train staff and supervisors and probably because of some continued resistance. In the immediate outlook, the job displacement effects are not likely to be significant in relation to the current level of unemployment. The importance of these developments lies in the consequences for the pattern of employment, and in particular the further decline of routine, unskilled work; the implications for education and training are considerable. The major growth of employment in the service sector is likely to arise where human care and attention cannot be replaced by mechanisation for example in health and welfare services (in both the private and public sectors) and in other areas such as tourism, leisure and personal services where demand can be expected to grow with increasing prosperity.

3.14. If, as seems likely, productivity growth continues at 2 per cent or more, as it did in the 1960s, an average growth of GDP from now to 1990 of 2 per cent will succeed only in keeping employment at around current levels. Combined with the expected growth in the labour force, and - an important reservation - other things being equal, this could lead to unemployment rising rather than falling for the rest of the decade. A lower growth rate would also lead to further increases in unemployment.

3.15. Other things must therefore not remain equal. The prospect referred to above is based on a continuation of former economic relationships and it is possible to conceive and necessary to achieve a more optimistic scenario. A restoration of business confidence could significantly change the outlook. There are already some signs of this in terms of greater realism on pay, and a reassertion of the will of management to manage (and sweep away inefficient practices). There is also the possibility of a further upturn of world trade as inflation falls and interest rates follows suit. Throughout the industrial world, the adjustment of the capital stock to a regime of higher

energy prices may be complete and this could now be followed by a new wave of investment to take advantage of technological improvements. Rigidities in the operation of market forces should weaken. A further stimulus should follow in the United Kingdom from a reduction in tax burdens in general when we reach the stage of fiscal headroom anticipated in the MTFS. All these factors could gel to provide a period of sustained recovery and rates of economic growth much higher than those of the 1970s.

3.16. The rate of growth would still be constrained by two key factors - the level of productive capacity available, including a labour force with the right skills, and the inflation proneness in the economy. It is not known how much capacity has been lost over recent years and how much has become technically obsolete (particularly at current wage levels). The longer the recession lasts the further the capacity base will be whittled away. Various estimates of excess capacity in the United Kingdom economy have been derived but these vary widely from 6 per cent to around 27 per cent (depending on different definitions and methods of estimating). If it is at the lower end of the range, a rapid expansion of demand would cause shortages and lead to a significant increase in imports.

3.17. To be sure that higher growth leads to more jobs and is not accompanied by higher inflation it is important that wage increases are contained. Lower wage increases from now on would further improve international competitiveness so increasing export opportunities and displacing some imports. Lower rates of inflation would permit a higher level of real growth within a given money supply, though the lags in the process are such that this improvement may take some time to come through unless Government responds promptly to the need to ensure that any headroom available is used to boost economic activity: this aspect is discussed in Chapter 10. Further, in the longer term, a substantial reduction in the cost of labour in relation to capital would result in the substitution of labour for capital and an increased demand for labour intensive activities, opening up the prospect for a new range of jobs.

3.18. The question is how great is the overall effect on unemployment of a lower rate of wage inflation? It is difficult to give precise estimates but on the basis of some simulation work by the Treasury a rough guide is that if, over the next two or three years wage settlements could be held at zero and earnings overall allowed to rise by no more than 2-3 per cent, the level of unemployment should fall by about 500,000, possibly more. Part of this comes from improved competitiveness but the greater part comes from the favourable effects on activity of lower inflation. Such restraint would entail an initial fall in real wage rates which could be offset by fiscal relaxation. As employment then rose, so total employment income would rise too.

#### Consequences

3.19. The prospect of unemployment continuing at or around its present level has profound consequences. In economic terms the cost of paying benefits to the unemployed (£165 million for each extra hundred thousand unemployed) has been one of the main causes of the continuing growth in public spending. In addition there is a substantial but unquantifiable loss of output from leaving human resources idle, together with a longer term loss of productive potential. There is evidence that long spells of unemployment, regardless of age, set workers on a downward trail: they drop down the occupational ladder and are more likely to become unemployed again in future. And it is plausible though unproven that widespread experience of unemployment will weaken the 'work ethic' among young people.

3.20. The depressed state of the labour market and the economy entails other efficiency costs. Employers' cutbacks in skill training and in recruitment foreshadow (despite the general training being given to the young unemployed) a new generation whose employment potential has not adequately been developed. Labour mobility is depressed because workers with jobs lack the confidence to move. Similarly, businessmen may become more risk averse and useable capacity may decline.

3.21. The social consequences arise not only from the level of unemployment but also from its concentrated incidence. Although 300,000 people join and leave the unemployment register every month, well over 1 million have been without work for at least a year\* and many others face recurrent unemployment. One in every 5 young workers under the age of 25 is unemployed at any time, and 265,000 of them have been continuously on the register for a year. One in every 3 unskilled or semi-skilled male workers is unemployed. The picture for these groups is worse outside Southern England.

3.22. The financial consequences of being unemployed are particularly severe for heads of families with children, who however make up under 20 per cent\*\* (ie under 600,000) of the unemployed. Cash benefits and free services ensure that unemployment need no longer cause abject poverty. But families with an unemployed father are much poorer than families with a father in work (partly because unemployed men are much less likely to have working wives) and families with a long term unemployed father are poorer than any other group in society. Households containing single unemployed people are less well off, (relative to their needs) than the average working household, but significantly better off than households where the main breadwinner is unemployed. Assuming household members share their income, under a fifth of single unemployed people in 1980 lived in households whose income was at or below the supplementary benefit level (see table 1).

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\* Just over 1 million have been continuously registered for a year (including 375,000 for 2 years); others have had their spell of unemployment broken only by sickness, or a training course. The reasons for the concentrated incidence are not clear: it is noteworthy that in the United States less than a million people are currently reported to have been continuously unemployed for over a year, even though the total number of unemployed is three times the United Kingdom figure.

\*\* This estimate relates to February 1982.



TABLE 1. INCOMES OF HOUSEHOLDS AFFECTED BY UNEMPLOYMENT\* - 1980

| Family Type of Unemployed Person      | Distribution of Incomes Relative to Supplementary Benefit Levels** (%) |                               |                                           |                                               |
|---------------------------------------|------------------------------------------------------------------------|-------------------------------|-------------------------------------------|-----------------------------------------------|
|                                       | (% of total unemployed)***                                             | Incomes at or below SB levels | Incomes up to 40 per cent above SB levels | Incomes more than 40 per cent above SB levels |
| Single Person                         | (55)                                                                   | 16                            | 20                                        | 64                                            |
| Married Woman                         | (10)                                                                   | 4                             | 4                                         | 92                                            |
| Married Man with children             | (19)                                                                   | 40                            | 37                                        | 23                                            |
| Married Man without children          | (16)                                                                   | 26                            | 26                                        | 48                                            |
| All Households with Unemployed member | (100)                                                                  | 23                            | 20                                        | 57                                            |

Source: 1980 Family Expenditure Survey

Notes:

(\*) One or more member seeking employment, not necessarily registered unemployed.

(\*\*) The table shows the distribution of actual incomes of households, where at least one member ("single person", "married woman", etc) is unemployed, relative to the sum of notional supplementary benefit entitlements of household members. The current SB levels for a married man with non-working wife and two children aged 4 and 6 are £55 plus an average of £20 for housing costs. For married couples without children they are £38 plus an average of £17 for housing. For single non-householders over 18 they are £21 (figures rounded to nearest £)

(\*\*\*) Estimated composition of registered unemployed at February 1982.

3.23. Although they are the poorest of the unemployed those family men who become unemployed tend to have been poor even when in work. The proportional drop in income on becoming unemployed is greatest for those without dependents. The young unemployed tend to feel financially deprived compared with others who have decent jobs and compared with the high material standards of earlier generations of young people.

3.24. Probably the most worrying effect of modern unemployment on living standards is the long term impoverishing and disincentive effects of prolonged dependency on benefit. Supplementary benefit rules encourage people with savings over £2,000 to reduce them. On benefit people have no prospect of bettering their financial position or saving in preparation for setting up a home of their own, or for their retirement. Because prolonged unemployment sets people on a downward path it risks locking them into life time poverty with increased dependence on the state at every stage in the life cycle.

3.25. Financial considerations aside, there is evidence that most unemployed people understandably feel deprived by the loss of interest and activity which employment provides and become depressed and frustrated by their inability to find work. Though individuals differ people who have been accustomed to regular employment, together with young people expecting to make their way in life, appear in general to be more seriously affected than people with an irregular employment history. Other things being equal, men seem to suffer these feelings more than women, presumably because it is easier for women to fall back on a housekeeping role. There is some limited evidence that prolonged unemployment also adversely affects the physical health of unemployed people, particularly men from stable employment backgrounds, but for the majority of the unemployed a link between unemployment and ill-health has not been firmly established.

3.26. The consequences of high national unemployment for local communities are highly variable. Because of the pattern of industrial decline, the incidence of unemployment is nearly twice as high in the old industrial regions as in the South. Moreover, in large urban areas, the unemployed tend to be heavily concentrated in inner city areas and council housing estates where rates of unemployment among the resident working population can exceed 50 per cent. Concern about the social effect of such concentrations of unemployment currently tends to centre on the potential effects on crime and socially disruptive behaviour. While the link between youth unemployment and socially disruptive behaviour is complex and little understood, common sense suggests that it is dangerous for society to have a young generation which feels it has little stake in the future.

3.27. The social effects of unemployment can only properly be understood within the context of particular communities, taking into account their social cohesiveness, notably the strength of family ties, relations between majority and minority groups, the quality of leadership in the community and police community relations. Our 1981 report on Merseyside identified the spiral of decline which characterizes communities whose economic main spring has gone. The most able people leave; people in authority despair of restoring prosperity; local people, including school children, resign themselves to a future of chronic unemployment. The welfare safety net ensures that the communities remain in existence but cannot make them thrive. Such problems have increased in severity and extent because of high unemployment but existed in some areas when unemployment nationally was at a tolerable level. Though it is beyond the scope of this report, working out how to cope with such areas should be a major part of a strategy of living with high unemployment.

CHAPTER 4: REMEDIES FOR UNEMPLOYMENT - GENERAL APPROACH

4.1 A strategy for tackling unemployment needs to meet two basic requirements. First, it must recognise the complexity of the overall objectives: what society wants is not just high employment but worthwhile paid employment which leads to high living standards in a stable society with low and stable inflation. The first part of this chapter discusses the kind of economic structure which could reconcile this mixture of objectives in the long run. Secondly, it is necessary to recognise the length of time which it will take to cure the fundamental causes of unemployment; the strategy must therefore continue to balance longer term cures with measures of relief which do not subvert the longer term objectives. The general approach to coping with unemployment is discussed in the second part of this chapter.

**The Future Shape of the Economy**

4.2 The earlier analysis showed that the achievement of high employment, high growth and low and stable inflation depends fundamentally on improving the general competitive performance of Britain's internationally traded sector and on introducing a much greater degree of flexibility into the operation of labour and product markets, so that the economy can become more resilient in the face of recession and other shocks.

4.3 Trading competitiveness depends on the wide range of factors which make up supply side performance. There is for example a need to improve profitability and to use these profits to achieve the investment in both human and physical capital which will secure new markets and products; to develop and apply innovative ideas effectively; and to improve the quality of management and the level of risk taking. A detailed appraisal of all these issues would be out of place in this report though some are covered in Chapter 5.

4.4 Our analysis of the need for greater flexibility is primarily in terms of the labour market, though there is also a need in product markets for greater flexibility of response to market opportunities (see paragraph 4.12 below). In present circumstances the particular need is for real wages to fall relative to productivity in order to restore profits. Also wage differentials need to reflect and thereby correct imbalances in demand and supply for different categories of labour.

4.5 The aim of increasing real wage flexibility (at a time when the initial flexibility must be downwards) is likely to run into conflict with trade unions and often with the public's sense of fairness. In addition, in important parts of the labour market the idea of lowering wages meets opposition from some employers. Although there are signs of favourable changes in some of these attitudes, they remain strong enough to hinder progress to higher levels of employment, by delaying the process of change. It needs to be made clear that the goal is not a low wage economy but an abatement in living standards today so that the seeds can be sown for future prosperity.

4.6 In considering how change can best be brought about it is useful to distinguish between what for the purpose of this report we call the primary and secondary sectors of the economy. The primary sector comprises the large, well established, more stable employers both private and public often with a high level of unionisation. The secondary sector includes medium and smaller enterprises and new ventures (including those established here recently by foreign companies) where risks and opportunities are often higher where unions are less prominent and where changes in market conditions have a more immediate impact. The boundary between these two is not precise and an individual company would fall somewhere along the spectrum between them. Moreover the de-merging and decentralisation of large companies can result in a number of their activities having the characteristics of the secondary sector. The significance of the distinction is that, whilst it is essential that both the primary and secondary sectors become more competitive, we would not expect this necessarily to lead to higher employment in the primary sector: employment gains will come mainly in the secondary sector.

4.7 In general, firms in the primary sector find it efficient to have highly-trained, well-motivated staff in secure career jobs. To achieve this they would rather have few relatively well-paid people than more people on lower pay. In particular, firms in the trading sector consider that survival in world markets will depend at least as much on having the right products of the right quality as on cost. These quality factors in turn depend on having highly trained staff with low turnover and co-operative working relationships between workforce and management. Managements take the view that their task is to make profits and therefore to improve efficiency, not to maximise employment. There is considerable justification for these views.

4.8 Some trading organisations are consequently reluctant to support radical labour market reforms, designed to free up employment. They fear that these would disrupt working relations and hence undermine other management initiatives to improve efficiency and competitiveness. Moreover, even if statutory employment protection and union power could be wished away and the "wage floor" reduced, providing wage flexibility, many organisations would, for reasons of long run efficiency as well as fairness, be reluctant to employ people at lower wages.

4.9 Lessons from abroad, notably Japan, show that a high wage career job sector operates far more successfully if it has internal and external mechanisms of wage flexibility and adaptability to give it the necessary resilience. Big Japanese firms have a large bonus element in wages and obtain flexible use of labour (eg no demarcation disputes) and consensus about company aims in return for job security. They are also underpinned by a flexible sector of small businesses and sub-contractors and the self-employed. Comparatively few British firms have managed to secure comparable adaptability and wage flexibility from career employees, or developed similar consensus between workforce and management about company aims. There is an external margin of flexibility in the use of sub-contractors and short contract labour but our secondary sector of small businesses and self employed is very small by international standards.

4.10 We must increase the degree of flexibility and competition in our economy if we are to generate growth and employment in a non-inflationary way. It is essential in particular to persist with efforts to import more flexibility into wage setting arrangements of large organisations in a way which recognises the requirements for efficiency of the trading sector. Moreover, in order for the income earned by the trading sector to be effective in generating service jobs there needs to be sufficient flexibility and enterprise elsewhere notably in services and construction, to identify and exploit opportunities offered by current market needs and available labour. Several service sectors (e.g. construction, distribution, catering) do have a greater margin of flexibility in that they have a comparatively high proportion of small businesses, or else part-time or casual employment. But many service industry markets are dominated by public monopolies or by private organisations (e.g. banking) in the primary sector.

4.11 The most promising way of achieving a more flexible labour market and a competitive economy may be to allow the secondary sector to operate and expand in a less regulated environment. Even within the present framework of regulation an expansion of small businesses and self-employed would increase the overall amount of flexibility in the economy because there would be more entrepreneurs, more competition in product and service markets and more people whose wages and working conditions are set by individual rather than collective bargaining. If, in addition, measures are taken to make people cheaper and easier to employ, they are likely to have their principal effect in this sector. The expansion of the secondary sector should be assisted by encouraging de-mergers and greater decentralisation of control in the private sector and by contracting out and privatisation in the public sector.

4.12 This strategy for encouraging the secondary sector offers scope for efficiency gains. The increasing concentration in United Kingdom product markets, facilitated by too many mergers, (as well as too much public ownership) has not brought about the hoped for gains in efficiency. Instead there have been diseconomies of scale, with poor industrial relations and the general inertia which comes with large managerial bureaucracies. In product markets, large scale will still remain important for certain activities eg those requiring heavy pre-production expenditure on research and development. But to meet the rapidly changing patterns of demand in the 1980s there is a need for some shift from large to small scale units of production.

4.13 Moreover expanding the secondary sector offers the best scope for introducing labour market flexibility into the operations of the primary sector while minimising the risks of efficiency losses brought about by disruption and confrontation. Through the supply of sub-contracted services the secondary sector would provide increased flexibility. Also increased competition would pose a challenging effect so that existing constraints are broken down and the efficiency of the primary sector increased. We discuss in Chapter 5 how individual areas of policy (such as policy towards trade unions) can contribute to these ends.

4.14 In one sense the approach suggested here is a restatement of existing Government policy ie to encourage entrepreneurship and small scale business. In another it is a radical reversal of past trends towards the extension throughout the labour market of job security, stable wages (at worst) and constraints on management's freedom of action. The message to be got across is that the mixture of employees' rights which appeared attainable in a historically unprecedented period of steady economic growth is no longer apt for an age which is likely to be prone to economic shocks. In these less certain circumstances working people at all levels will need to be prepared to trade something, whether it is their employment security, the stability of their pay, or adherence to their accustomed tasks. The primary and secondary sectors offer the opportunity for these trade offs to be made in different ways.

4.15 The more the primary sector adapts, the more secure employment there will be and the less concern there need be about the prospect of secondary sector workers being poor and exploited. Low paid or irregular work will usually be a lesser evil than having no jobs at all. But there is a growing problem here which must be acknowledged and resolved if the approach is to be accepted as compatible with social stability. It can be addressed in several ways eg through income transfers to prevent family poverty, safeguards against outright exploitation, flexible patterns of working time which allow careers to be split between primary and secondary sectors, and an education system which provides effective ladders to upward mobility.

#### **Cures and Palliatives**

4.16 The approach discussed above aims to achieve both high employment and lasting growth in the longer run. But this will not cure unemployment in the shorter term. At present, economic policies are supplemented by a variety of Special Employment Measures (SEMs). These already absorb large amounts of public expenditure even in net terms and the constraints on spending more are severe. This strengthens the need to appraise the role of SEMs and to see whether there are more cost effective ways of meeting employment objectives. At present SEMs are designed and presented as temporary measures whose common feature and overriding aim is to reduce the level of



registered unemployment in the short term. They work in a variety of ways. Some promote training and/or lower wages and hence make a positive contribution to the economic strategy. Others, involving such things as labour intensive work outside the normal market, early retirement and job-sharing, tend rather to be seen and presented as temporary deviations from the main thrust of economic policy. Labour intensive activities, reduction in the labour force and work-sharing are not at present regarded as desirable objectives in themselves, because of fears that they may be inconsistent with efficiency and hence with long term growth. They need not have these undesirable effects, particularly if they are introduced on a voluntary basis.

4.17 The need is for a broader view of economic strategy which incorporates measures to reduce and alleviate unemployment for as long as they are needed. Because they will be more than temporary, it will be even more important to minimise any efficiency costs. Measures designed to relieve the pain of unemployment do not necessarily entail an efficiency cost and wherever possible, measures which have no such cost should be preferred. It is also desirable to design measures so that if possible they further the aims of market flexibility discussed earlier.

4.18 There is considerable scope for measures which would alleviate unemployment by removing market rigidities. For example, the level of employment is affected by the higher taxation of labour, relative to capital and by the institutional factors which hold up the wage floor. Labour force participation is affected by tax incentives for working wives, and by the rigid pattern which pension schemes impose on the pattern of working life. The incidence of unemployment on given groups is influenced by the job security afforded to existing employees which leads the "market" to discriminate against new entrants, and by the rigidity of collectively bargained wage structures which prevents disadvantaged job seekers from pricing themselves below other candidates.

4.19 The danger of subsidies to employers is that they can reduce the downward pressure on wages and hence delay the market's adjustment. But wage subsidies can be designed which work with the grain of the market,

notably by incorporating an effective wage ceiling. In this form they need not entail an efficiency cost. Wage supplements for heads of families in low wage jobs will be an important part of the approach. Only by breaking the linkage in the public mind between low pay and family poverty will the public be brought to accept a substantially larger low wage sector.

4.20 Measures which enable people to cope with being unemployed (by providing income, useful occupation and status), currently barely figure at all among the explicit aims of employment measures. Yet they could be both important and cost effective in enabling society to live through a period of high unemployment and thus retaining public confidence in tackling the long term problems.

4.21 The policy proposals which follow reflect the range of objectives and the longer term economic framework discussed in this chapter. Chapter 5 discusses measures to help improve economic performance. Chapter 6 discusses efficient ways of generating more employment. Chapter 7 considers possible changes to the tax and benefit systems which would provide a greater inducement to create and take employment, while preserving a welfare safety net. Chapter 8 deals with the development of more flexible patterns of working time. Chapter 9 considers other possible measures to reduce, and alleviate the incidence of unemployment, particularly long term unemployment.

CHAPTER 5: IMPROVING THE ECONOMY'S SUPPLY SIDE PERFORMANCE

5.1 The analysis in Chapter 2 confirmed the view that supply side deficiencies have been a major limitation to growth of output and employment in the United Kingdom, most evident in the lower level of productivity compared to that of other advanced industrialised countries and in our greater susceptibility to inflation. The Government has already undertaken a number of policy initiatives to reduce the constraints imposed by, for example, the monopoly power of trade unions, excessive taxation and bureaucratic regulations. The purpose of this chapter is to review what scope there is for further action in a number of key areas. In doing so, the chapter adopts the approach of Chapter 4 in reflecting the distinctive roles of the primary and secondary sectors and the different scope which they offer in practice for achieving and exploiting labour market reform to generate employment. Thus, for the policy areas considered, we look for further ways to improve the competitiveness of the primary part of the trading sector and to improve wage flexibility while also recognising the constraints imposed by the bureaucratic tendencies of such organisations. We also look for ways of expanding the flexible secondary sector and encouraging greater employment there.

5.2 The policy areas considered are -

- a. education and training;
- b. trades unions
- c. labour mobility
- d. competition policy
- e. small firms
- f. innovation

A. EDUCATION AND TRAINING

5.3 It is something of a paradox that while Britain's record of scientific and creative achievement is internationally renowned, weaknesses in education and training are an important cause of our poor industrial performance. Basically this is because we give too little attention and status to technical education and to the education of the least academically able. (Also, some problems blamed on education and training arise more fundamentally from social attitudes, including an anti industry culture.)

5.4 In the unemployment context, the role of schools has particular relevance. The 11 years of compulsory schooling should give all young people the basic equipment to cope with adult and working life. At present it does not. The deficiencies are reflected in the fact that the Youth Training Scheme (YTS) for school leavers will include instruction in basic literary, numeracy and spoken English, work discipline and skills in dealing with people, - all things which should be learnt in school. In 1980 nearly 25 per cent of workers aged under 25 with no educational qualifications were unemployed and the present rate will be considerably higher. The younger the age group, the more the employment prospects of the qualified and the unqualified diverge. The problems of the unqualified partly reflect the use of qualifications as a screening device in recruitment and partly the relative decline in demand for unskilled manual labour.

5.5 It is vitally important both for economic performance and for social mobility that ladders should exist for young people, including those from less privileged backgrounds, to progress upward through the educational system. It is a deficiency of the British system that there is no effective ladder through vocational education, partly because of craft and professional barriers and because of weak links between further education on the one hand and school and higher education in the other. At present the proportion of young people continuing their education beyond 18 is lower in Britain than in several newly industrialised countries, for example Hong Kong and Korea.

5.6 Within industry the low output of technicians and craftsmen (half the German level), the low percentage of managers with formal qualifications, and the small percentage of the workforce with any vocational qualifications (one third, counting all degrees and A levels, compared with two thirds in Germany), together with the restrictive practices which surround our apprenticeship system, have all contributed to the overmanning, inflexibility, and inefficiency of British industry. For years there has been a conflict of objectives in Britain between keeping up the number of apprentices trained and reforming the system or replacing it by something more flexible. Apprentice numbers are on a downward trend and the new Youth Training Scheme (YTS) may hasten the demise or reform of the present system. This will ultimately be a good thing so long as YTS achieves its objectives on quality as well as quantity. The Government have said they will review before 1984 how the responsibility for financing YTS should be shared. Given the poor prospect of recovering an adequate return on this training, which will equip people with very general skills, companies are unlikely to accept the responsibility without a clear financial inducement (such as the apprenticeship tax in France).

5.7 The highly specialised nature of many jobs, together with geographical immobility and rigidities affecting access to training and skilled employment, create the risk that skill bottlenecks will emerge as economic recovery gets under way, despite the high level of unemployment and the very slack market for skilled workers at present. Difficulties are more likely at technician and higher levels than in manual grades.

5.8 Some of the training problems outlined here have been addressed by the Government's new training initiative. Others were covered in the CPRS report on Education, Training and Industrial Performance and we are to do further work in this area at Ministers' request. This is not the place for a comprehensive set of policy recommendations. From the particular viewpoint of unemployment, however, the following specific options are worth consideration within the existing budget framework -

- a. a determined effort to improve the standard of education overall to reduce the numbers of academically unqualified, and to fit young people better for a world in which jobs in service occupations will predominate;
- b. the introduction of a balanced school leaver certificate (preferably comprising a profile of achievements relevant to employers) to reduce the problems of those currently unqualified but employable and to exert leverage on the school curriculum to secure the improvements mentioned at a.;
- c. the experience obtained in the Youth Training Scheme is of considerable relevance to schools and DES could take on responsibility for disseminating this;
- d. if resources permit, the introduction of a means-tested scheme of financial assistance to encourage able pupils from low-income families to stay on at school, perhaps introduced initially on a pilot basis in areas of high unemployment;
- e. a low cost programme (described in Chapter 9 paragraph 24b), to address the educational deficiencies of the existing unemployed and improve their ability and willingness to take jobs in service occupations.

B. POLICIES TOWARDS TRADES UNIONS

5.9 Chapter 2 showed that the action and attitudes of trades unions, and the growth and wide extent of unionisation in the British economy are important contributory factors to our historically poor industrial performance and, in particular, to the lack of flexible wage adjustment. Equally important in the analysis are the factors which have permitted the growth of union power - the legislative framework, weak management, lack of competition in product markets, public notions of "fairness" in pay matters, together with the now diminishing role accorded to the TUC in the conduct of public affairs.

5.10 In the primary sector the existence of unions has to be accepted as a fact of life and they can, indeed play a constructive role. Here policies should aim to get management and the labour force working together more effectively. This can be done not only through measures to restore the balance in bargaining power but also by making the unions more aware of their responsibility for the true long term interests of their members, and by increasing employees' commitment to the future of their employer's business. In the secondary sector the direct influence of trades unions should be much less and policies should aim to minimise their indirect influence by preventing the attitudes of organised labour from spilling over into the non-unionised sector and by reducing unions' power to inhibit the sector's expansion.

The primary sector

5.11 Policies to reduce trades union power in the primary sector, and to swing the bargaining balance back in favour of management, can follow two complementary approaches. Some measures can be taken to restrict the activities of trades unions and to limit the damage they inflict through industrial action: other measures can be used to change the internal structures of unions to make them more responsive to the realities of the competitive markets in which their members operate.

5.12 The 1980 Employment Act incorporated measures to reduce trade union power through reducing the immunity of individuals. Subsequently, the 1981 Green Paper extensively discussed the question of union immunities and as a

result the 1982 Employment Bill incorporates further measures to reduce union power. Should this legislation prove inadequate, it may be useful to introduce legislation, eg requiring secret balloting before strike action or imposing cooling off periods, further to reduce unions' abilities to disrupt employers' business through industrial action.

5.13 In parallel with moves to reduce trades unions' immunities, the Department of Employment has been considering measures to make unions more democratic and as a result reflect their membership's views more accurately. Such measures as the election of union officials by secret ballot will be comprehensively discussed in a forthcoming Green Paper, and subsequent legislation considered.

#### The secondary sector

5.14 The power of unions to inhibit the growth of the secondary sector arises first from the power to take industrial action to prevent the use of non-union contract labour and to delay the contracting out and privatisation of public sector functions to the private sector. The 1982 Employment Bill takes some first steps to reduce the problems by outlawing trade union labour only contracts and by removing immunities from unions and individuals taking industrial action against the use of non-union labour.

5.15 Unions can also use their influence to extend the concepts of job security and collectively bargained wage rates throughout the labour market. This has been much reduced recently, although the vein of thinking still influences some European initiatives, the most recent examples being the proposals to regulate part-time and temporary work. The TUC's presence on the MSC also imposes a constraint on the development and implementation of policies to secure employment opportunities through labour market reform.

#### Employee awareness

5.16 In parallel with moves to reduce trade union power, measures to increase individual employees' awareness of and commitment to their employers' business should be encouraged. There is a need for greater understanding of the effects on the business of excessive wage claims, and restrictive practices. Also individual employees should have information about developments which will affect substantially their jobs and area of work.



This can be brought about by better, effective, and more regular communication between management and workforce, and not only through established trades unions channels. Encouraging moves to link pay more closely to the overall performance of companies will also help.

5.17 Action the Government could take includes -

a. if they prove necessary, further legislative measures to reduce trade union immunities;

b. measures, including legislative changes, to make unions more responsive to their membership's views;

c. encouraging firms to increase their employees' sense of commitment to the business through moves to increase employee understanding of financial results and factors affecting the business as well as linking pay more closely to performance.

C. LABOUR MOBILITY

5.18 The amount of job changing in the British labour market has declined considerably over the past decade. This appears to reflect the growth in company labour markets and job security, the increasing effect of pension schemes, and the reduced growth and dynamism in the economy. Uncertainty about job opportunities has made voluntary job changing particularly sluggish at present.

5.19 Geographical mobility in Britain is generally regarded as low, especially by North American standards, but there is no firm international evidence to support this. The obstacles are well known. These relate to the cost and ease of finding housing, the standard and continuity of children's education, the availability of a job for the other partner in two-job households and also the general reluctance of people to leave familiar surroundings - the rest of their family and friends - to live elsewhere.

5.20 The CPRS studied ways of overcoming the obstacles to geographical mobility in a report for MISC 14 in 1980. The main area which is amenable to Government action is housing and the Government have taken a number of steps to encourage mobility in all housing sectors. The remaining options mostly entail major financial or political costs and these seem hard to justify at present when the demand for housing to attract mobile workers is comparatively low. Some unsatisfied demand exists, however, in a few local labour markets in southern England and more local problems could quickly emerge in an upturn. Given the large supply of unemployed unskilled workers in most areas, it appears improbable that the expansion of the secondary sector advocated in Chapter 4 would be unduly constrained by geographical immobility, though ultimately the limited supply of, and problems of access to, low-cost housing in more affluent parts of the country could become a problem.

5.21 The following are some of the main measures (most of them already considered and rejected) which could be taken to free up the housing market for mobile workers:

- a. Remove the power of local authorities to deny non-residents access to council houses.
- b. When it becomes possible to spend more on housing, allocate more investment funds to housing associations to build houses and hostels for mobile workers in areas of buoyant labour demand, and induce associations to give a higher priority to mobile workers when reletting existing dwellings.
- c. Outside London, remove Rent Act controls from new private lettings of existing dwellings, substituting an arbitration arrangement in cases of dispute about rent increases but allowing the initial rent to be arrived at by agreement between landlord and tenant.
- d. Simplify the legal arrangements for house purchase and remove the solicitors' conveyancing monopoly, so as to reduce transaction costs and delays.
- e. Consider tax relief for job-related removal costs (as in the United States).

## D. COMPETITION POLICY

5.22 In the United Kingdom concentration of production in the hands of a few large firms has increased significantly in the post-war period and is generally reckoned to be greater than in other countries, for example compared to the United States and West Germany. Greater concentration does not necessarily mean less competition, especially where there is freedom to import. However many mergers have reduced competition without bringing any return in the shape of greater efficiency or higher employment. In addition trade policy has in general become more restrictive in recent years (for example, the proportion of trade of manufactured goods subject to one of a number of non-tariff barriers or "voluntary" agreements has increased). The effect of these developments on employment is not clear but they have probably contributed to a generally lower level of efficiency, greater proneness to inflation (because costs can be passed on in higher prices) and a bad distribution and utilisation of resources, especially of investment. The most pernicious effect on productivity growth is in situations where lack of competition in product markets is associated with a lack of management incentives, with strong trade union power and restrictive labour practices. These have been most evident in the sheltered part of the public trading sector (eg energy industries, railways and water) though they also exist in some parts of the private sector.

## 5.23 Actions the Government could take include -

- a. a more rigorous mergers policy by requiring the OFT to impose tighter criteria and to appraise offsetting benefits more fully and, perhaps re-consider the earlier proposal to require a "neutral" presumption;
- b. further encouragement to large firms to de-merge to form more flexible units: the formation of new firms and the ability to spot profitable activities would also be encouraged by requiring diversified companies to publish disaggregated details of the profitability of their separate trading activities;

c. more references of abuse of monopoly power to the MMC (under the Fair Trading Act): each year since 1979 there have been two such references and there is scope for increasing the number of these;

d. further steps to weaken the monopoly position of parts of the public trading sector by decentralisation, privatisation of subsidiaries and liberalisation of private sector competition.

e. whenever specific proposals for subsidy or for trade protection are revised, greater attention should be given to the consequences for the level of competition and in turn the long term efficiency of the economy as a whole.

E. SMALL FIRMS

5.24 One of the main themes of this report is the importance of the secondary sector: this will benefit from expanding the role small firms play in the economy. The significance of the Black Economy is covered in a separate CPRS report. In this section we consider the legitimate small firms sector and the scope for further action, covering -

- enterprise zones
- enterprise allowances
- public purchasing, contracting out and privatisation
- enterprise agencies.

The objectives are to encourage the growth of existing enterprises and to encourage the creation of new ventures.

Enterprise zones

5.25 The Government has decided that enterprise zones have been sufficiently successful to justify creating eleven more. Much of the success of the existing zones stems from the preferential tax reliefs which have been marketed by public development bodies as an additional locational inducement to mobile enterprise. However, in general enterprise zones have not been used specifically to promote the secondary sector as originally envisaged in the Chancellor's "Isle of Dogs" Speech. Incentives should be concentrated to provide help for smaller, enterprises especially where the zones are located in run down urban areas. Guidance from a local enterprise trust and financial support by the enterprise allowance scheme would enable the local, unemployed people to develop new activities.

Enterprise allowance

5.26 The pilot enterprise allowance scheme, currently being run by MSC in 5 areas, provides £40 a week (taxable) for a year to people wanting to start their own small business, provided that they have been unemployed for at least 13 weeks and can show that they can lay their hands on £1,000 business capital. The scheme is a special employment measure, designed to reduce registered unemployment as well as expand the supply of successful

entrepreneurs. Provisional assessments of the register effect of the pilot schemes have been disappointing because most participants say they already intended to go into business. But no account has yet been taken of the scheme's effect in transferring people from the black to the white economy, nor of the effect on the success of the enterprises. There must be some positive effect of both kinds and these should be taken into account when the future of the scheme is decided.

5.27 No doubt the pilot studies will reveal a number of deficiencies and opportunities for abuse. If these can be ironed out in this autumn's review, and a workable and effective national scheme devised, we believe this should have high priority when the balance of employment measures comes to be renewed. Eventually, consideration could be given to extending the scheme to people already in employment, perhaps as a variant of the existing Job Release Scheme. Thus, people would be eligible for a year's enterprise allowance if they gave up their full time job and were replaced by someone from the unemployment register.

#### Public purchasing, contracting out and privatisation

5.28 It remains extremely difficult for a small business to become eligible to tender for work for large public and private bodies. Often centralised purchasing results in substantial discounts and so saves public money. But where this is not so the purchasing authority should be decentralised.

5.29 The Government are committed to extend the area of public purchasing by contracting out the provision of goods and services currently provided in-house by Government bodies. Until now, contracting out has been seen primarily as a way of exposing the public sector to competitive pressures and thus eliminating waste. When it fulfils these conditions, it can also be seen as a tool for encouraging the secondary sector. The work contracted out would provide a regular income for small businesses, which would then have a sounder basis on which to identify and meet further market opportunities in the private sector. In some cases, management and the employment of labour could be contracted out ahead of the transfer of premises and plant, which could be sold to the contractor when established. Where private sector

capacity is unavailable, because there is currently no demand for it, the problem would be reduced if encouragement were given to the equivalent of "management buy-outs" whereby the public employees currently providing a service were given an incentive to move into the private sector and contract for their previous work.

5.30 The breakdown of public monopolies and/or exposing them to private competition is viewed primarily as a way of improving efficiency, extending choice and reducing public expenditure. Ministers are interested in extending privatisation into the public services eg health and education. Privatisation could also increase the scope for expansion of the secondary sector, where the activities transferred to the market sector were capable of being picked up by entrepreneurs operating in a competitive environment. In time, this would generate extra job opportunities by enabling demands to be met which are currently suppressed by public spending constraints and the high cost of public provision, and (like contracting out) by providing a launching pad from which the entrepreneurs concerned would develop new market opportunities, including wider opportunities for international trade.

#### Enterprise agencies

5.31 A distinguishing feature of small firms is the desire for independence - the black economy is the extreme example of this. However, lack of expertise in every aspect of business means that small business owners can often benefit from the large number of agencies which are available to offer advice, both at national and local levels. Government help from a number of agencies is further supplemented by local authorities and also a number of private sector organisations. This multiplicity of agencies can become counter-productive and it is not necessarily in the national interest to have a large number of organisations "competing" to give finance and other facilities on subsidised terms. Thought should be given to rationalise the support for small businesses, without dampening initiative.

5.32 Local organisations, particularly enterprise trusts drawn from the local business community, are probably better suited than national bodies to provide help to small businesses. In particular these have the flexibility to provide informal help covering such matters as form filling, planning and fire regulations, tax and national insurance. Such informal help is often more useful than formalised training and other forms of assistance.



5.33 The Government is already doing a great deal to help the growth and viability of small firms. When considering further action, the following should be taken into account -

- a. enterprise zones should be organised to give special encouragement to the secondary sector, especially by the development of new small firms in urban derelict areas;
- b. the aim of this autumn's review of the pilot enterprise allowance scheme should be to develop a cost-effective national scheme for implementation when it becomes possible to allocate resources for this purpose;
- c. public purchasing, contracting out and privatisation proposals should include an objective of increasing the opportunities of small firms to increase their share of the business where it is cost-effective;
- d. the system of providing help for small firms needs to be rationalised: preference should be given to local enterprise trusts which are the most effective help at the local level.

F. INNOVATION

5.34 Innovation to provide new products and increased productivity in the manufacture of existing products is vital if industry in the United Kingdom is to improve its competitive performance, halt the decline in our share of world trade and resist imports in our home market. A poor record of innovation has cost us dearly in a number of sectors, for example electronic equipment and consumer durables. We have also failed to develop a significant sector of new technology-based companies which has been one of the most dynamic areas of new employment opportunities in other countries, especially the USA.

5.35 Our scientific excellence and inventive capacity is recognised world wide (many highly innovative companies, especially in the USA and Canada, have British scientists and engineers in key positions). Our failure has been to translate these qualities into successful innovation in the market place. It is unlikely that this failure is due to insufficient total spending on R & D which, at least as a proportion of GDP, is at roughly the same level as in other countries. However, much of our R & D is in non-traded areas such as defence and contributes little to industrial performance. There is often a 'development gap' between R & D and commercialisation where typical R & D funding levels are inadequate but project financing is too risky. Financial assistance has too often been given to prop up older declining industries rather than speed the growth of newer industries.

5.36 Government action is best taken to lubricate the role of market forces in stimulating natural innovation rather than attempting to force innovation where the will or incentive does not exist. Action the Government could take includes:

- a. Enhancement of the industrial effectiveness of the large Government expenditure on R & D, particularly in defence, by promoting commercial awareness and incentives in Government R & D establishments.

b. Greater financial assistance to industry and independent R & D organisations for technology transfer (including 'demonstrator' projects) especially for technology originating from abroad and for new high growth/high risk technologies such as robotics, microelectronics, fibre optics and opto-electronics, and biotechnology.

c. Reassessment of the role of the British Technology Group as an agent for technology transfer, especially its performance as a monopoly holder of the right of first refusal to inventions made through public expenditure on R & D.

d. Improved protection for intellectual property through a reformed system for patents, design copyright and trademarks.

e. A request to the University Grants Committee and the National Advisory Body for local Authority Higher Education to identify future shortages of skills for innovation in areas of new technology and to divert resources to increase selectively the output of our education and training system to meet these shortages.

CHAPTER 6: ENCOURAGING EFFICIENT WAYS OF GENERATING MORE EMPLOYMENT

6.1 The level of employment in the economy depends not only on the economy's efficiency and trading performance. It also depends among other things on the responsiveness of wage levels to labour supply and demand; the indirect costs of employing people, relative to other factors of production; and the presence of adequate market mechanisms for matching available labour and unmet market needs.

6.2 In this Chapter we consider ways of increasing the economy's potential to offer employment, without sacrificing efficiency. We cover ways of:

- a. lowering the wage floor;
- b. reducing or compensating for the administrative burdens of employing labour, especially for small employers;
- c. reducing the taxation of labour relative to capital;
- d. providing incentives to domestic households to provide employment;
- e. providing public goods and services in a more labour intensive, but efficient, way.

a. Lowering the Wage Floor

6.3 It is easier for small firms than for larger organisations to vary their wage rates according to the state of the labour market. However, this freedom is curtailed, in the industrial sectors in which small businesses chiefly predominate, by the existence of statutory minimum wages set by wages councils. At present, there is widespread public suspicion that the abolition of wages councils would lead to the impoverishment of low-paid workers without any appreciable compensatory increase in employment. Public unwillingness to believe that "a good thing like high wages can cause a bad thing like unemployment" (Beveridge, 1931) or the corollary, is a long standing phenomenon. We believe it will be desirable to abolish wages

councils when international obligations permit but this will not be politically acceptable unless it is accompanied by complementary measures. These should aim to expand the market opportunities available to the secondary sector and to remove other obstacles to the provision of employment (see below) together with changes to the tax and benefit systems so as to provide an effective and acceptable safety net for people with families in low-paid employment.

6.4 It would be best to precede the introduction of such measures by a campaign of public education, directed not least at employers, which would address people's genuine fears about the consequences of low wages. An immediate purpose of this campaign would be to seek to persuade members of wages councils (while they still exist) to set more realistic minima. The campaign would emphasise the fact the most people in low paid jobs do not come from poor households; that the great majority (80 per cent) of the unemployed do not have children to support, and a considerable proportion are single with other earners in the household; and that only a minority (16 per cent) of all jobs are filled by people with children to support on a single wage. It would point out that family income supplement (FIS) is available to support the wages of breadwinners whose responsibilities are large relative to the wage their skills command. It would argue that, if society insists that all jobs must carry a family wage then the effect is to prevent jobs from arising which would meet the needs for income and occupation of very many of the unemployed.

6.5 The State system of unemployment benefits can exercise an upward influence on wages in the secondary sector, while benefit rules affect people's preparedness to take secondary jobs. Chapter 7 discusses the extent of these problems and how they might be dealt with.

b. Reducing or Compensating for Administrative Burdens

6.6 On top of the intrinsic difficulties of employing people the state imposes a series of administrative burdens on employers. These responsibilities are particularly burdensome for small firms. There are in principle two complementary ways of reducing these:

- a. make the obligations on employers lighter for small businesses than for larger ones;
- b. give small businesses special help in meeting their obligations.

The Government has made progress on both these fronts. For example, employees of small firms (with up to 20 employees) now have to be employed longer (2 years) before unfair dismissal legislation bites and there are various schemes of training and advice to help small employers to cope with their administrative burdens.

6.7 So far there has been a reluctance to go much further down the first road, for fear of creating a second class of employee with inferior conditions of employment. However, a secondary market of irregular less attractive jobs already exists and indeed it forms the employment background of many of the unemployed. If the minimum standards for employment set in the primary market are applied across the full economy, then the effect is to squeeze secondary employment out of the system altogether or into the black economy. It may be a lesser evil to provide (at least for small firms) lower minimum standards for conditions of employment than emerge from the shared values and interests of managers and organised labour in the primary sector. If Ministers agree with this conclusion they might want to reconsider options which have previously been rejected eg to relieve small firms of statutory obligations to provide redundancy payments, to permit employees to opt for non-protected employment contracts and to relax small firms' obligations under equal opportunity legislation. In addition, it will be essential to continue resisting EC initiatives to regulate part-time and casual employment in the same way as full-time jobs.

c. Capital subsidies and labour taxes

6.8 The present system of taxation in the United Kingdom provides substantial inducements to capital investment combined with various taxes on the employment of labour. Examples of investment incentives include the 100 per cent first year tax allowances for expenditure on plant and machinery, the deductibility for tax purposes of interest payments and, in regions of high

unemployment, the payment of grants for capital expenditure. Employers' contributions to national insurance and the national insurance surcharge are measures which have the effect of labour taxes by adding directly to labour costs though, in principle, a case can be made for so regarding all taxes (direct and indirect) which have the effect of raising the wage at which people are willing to work.

6.9 A characterisation of the tax system as one which simply subsidises capital and taxes labour is of course an over-simplification. A variety of reliefs on personal incomes mitigate the full effect of direct taxation on the supply of effort. And, to a certain extent, capital allowances (and stock relief) can be seen as a way of confining taxation of the corporate sector to "real profits" as distinct from the "paper profits" which result from inflation. Nevertheless, despite these and other complications, there is little doubt that present tax arrangements are biased in favour of capital: making it more worthwhile, at the margin, for a company to invest in machines rather than men.

6.10 The rationale for this bias in tax arrangements was, in our view, poorly founded and it is even less compelling in today's conditions of high unemployment. Various grants and incentives were introduced over the years in the belief that this would stimulate investment, particularly in manufacturing industry. The underlying reasoning was that Britain's problems stemmed from inadequate investment. Even at its best, this argument was weak. More investment, embodying the latest technology, to develop new products and processes is certainly desirable but unlikely to be achieved in a cost-effective manner by indiscriminate capital subsidy. Moreover, the same incentives made it easier to live with, and may have encouraged, low rates of return and an inefficient use of capital, which, as noted in Chapter 2 is a feature of the United Kingdom's productivity record. Jobs, especially unskilled jobs, may well have been prejudiced as a result of excessive labour-saving investment and by the encouragement of capital-intensive rather than labour-intensive activities.

6.11 For these reasons, the CPRS believes there is a good case for reconsidering the balance of present taxes and incentives. The general approach would be to reduce capital subsidies and labour taxes together in a way that leaves industry no worse off overall but nevertheless helps to arrest and reverse any tendencies towards an excessive substitution of machines for labour. The juxtaposition of higher-than-average levels of unemployment and of rates of subsidisation for capital investment in depressed regions makes this change particularly desirable in the context of regional policy.

d. Encouraging Private Households to Offer Employment

6.12 Notwithstanding the mechanisation of many household tasks there ought in principle to be a considerable unmet demand by domestic households (notably among two income couples and single working householders) for labour to carry out work (including child minding) in and around the house. There are many constraints which prevent this demand from being fully translated into jobs for the unemployed. These include the level of wage rates in the regular economy, competition from the black economy, the present benefit rates, and the difficulty of arranging the supervision of work during normal working hours, of finding suitable workers and checking their reliability.

6.13 It is worth considering seriously how to overcome these obstacles and encourage private households to offer work opportunities to the unemployed. Options to be considered include a tax allowance for accredited expenditure on household services (a system of spot checks would be required) together with exemption from employer national insurance contributions. Since many of the jobs would be for odd hours, this might lead to the development of a network of agencies (perhaps provided by the private sector on a franchising basis) to package odd jobs into worthwhile part or full-time job opportunities, to arrange back-up facilities such as transport and to act as a trouble shooter. Already firms like Dynorod franchise individual entrepreneurs and centrally provide a well-known name, advertising promotion, a telephone number to ring, and assurance of quality. We believe that a study should be made of ways in which the private sector could be encouraged to do more in this area.



6.14 Support for employment by the domestic household sector might be a cost-effective alternative to some existing special employment measures. Bearing in mind the substantial resources that are to be consumed in running the new Youth Training Scheme and the Community Work Scheme, it might be cost-effective to shift some of these resources of manpower and publicity into marketing the services of the unemployed, particularly those who do not need a family wage, among small firms and the domestic household sector. We understand that the Secretary of State for Employment is considering whether to extend the scope of the Young Workers' Scheme, by making it available for jobs in domestic households. We support this. We would see merit in repackaging the Young Workers' Scheme to cover young people up to the age of 25 with a wage limit of perhaps £60 for the over 18s. In any event we recommend that the scheme should be marketed more vigorously.

e. Labour Intensive Patterns of Public Spending

6.15 A large part of the nation's income is recycled through the tax system in the form of central and local government spending. Public spending priorities and the mix of inputs to individual spending programmes thus have a considerable influence on the level of employment in the economy at any given level of national income. Given the necessary information about the employment effects of different spending options, government can therefore in principle adjust the pattern of public spending so as to increase employment. This is already done to some extent on an ad hoc basis and we cover the scope for doing so more systematically in the discussion of palliative measures in Chapter 9.

6.16 The difficult question is to decide what scope, if any, there is for increasing the employment generating capacity of the public sector without loss of efficiency, within planned spending totals. We see the following opportunities:

- a. The ranking of public spending priorities is always arbitrary to some degree: where options appear equally worthwhile in other respects, preference could be given to the option generating most employment: this could apply particularly to capital projects. We suggest examples in Annex C.

b. Sometimes there is a choice of ways of meeting the same public need and one is more labour intensive but no more expensive than the other. The House of Lords Select Committee quoted examples relating to the choice between conservation of energy and water on the one hand and the construction of new supply capacity on the other.

c. Departmental manpower targets and local government head-counts are the most effective way of cutting back overmanning. They may also be a convenient way of keeping up the pressure to eliminate unnecessary Government functions and to reduce bureaucracy and waste. However, they may also have an effect (similar to labour taxation) of unduly depressing the balance between labour and capital inputs. They also prevent staff from being offered a direct trade off between pay moderation and jobs. Once overmanning has been eliminated targets expressed in terms of annual running costs ought to be equally effective in securing efficiency and would avoid the risk of harmful effects on employment.

#### Conclusions

6.17 This chapter discusses a number of ways of increasing the supply of jobs in the economy by encouraging, without loss of efficiency, the development of more labour intensive activities. The main points are:

a. The Government should decide in principle to abolish wage councils and should prepare for this by introducing other measures to increase the supply of jobs in the secondary sector and by mounting a campaign of public education to address public fears about low pay.

b. Allowing small firms to provide lower minimum standards of employment conditions and job security is a lesser evil than mass unemployment; previous decisions eg to retain statutory redundancy payment obligations for small firms should be reconsidered.

c. Present tax arrangements, which subsidise capital extensively and tax labour, are a hangover from a time of labour shortage. They have accommodated the inefficient use of capital and probably led to excessive labour saving investment. It is desirable to correct the imbalances without making industry worse off overall, by reducing capital subsidies and labour taxes together. There is a particular need to achieve this in the regional context.

d. It seems probable that there is a considerable unmet demand for labour to carry out household tasks. Ways should be found of translating these unmet demands into jobs for the unemployed. We make a number of suggestions, including when they can be afforded a tax allowance for expenditure on household services, and development and promotion of the Young Workers' Scheme.

e. The share of labour intensive activities in national output is considerably influenced by the pattern of public expenditure. Systematic account should be taken of employment effects when priorities are decided. Where other factors are equal there should be a preference for options which generate more jobs. We favour the use of limits on annual running costs, rather than manpower targets, as a means of eliminating bureaucracy.

## CHAPTER 7: THE TAX AND BENEFIT SYSTEMS

7.1 In Chapter 2 of this report we identified ways by which the personal tax and benefit systems affect the efficiency of the economy in general and unemployment in particular. As a broad generalisation, the higher the rate of taxation of work income at the margin, and the higher the level of benefits paid to those out-of-work, the less the incentive to seek work and the higher the wages that have to be paid to attract workers. One way of reducing these effects is to change the levels of direct personal taxation and benefit payments: the other possibility is to change the structure of the tax and benefit systems.

7.2 Annex B provides a discussion of background data, including material on the previous earnings of unemployed people, which need to be taken into account in considering any reforms. For example, of the total men out of work, 53 per cent are single, and 76 per cent are without children. Less than one in ten fits the much quoted stereotype of a married man with two children. Moreover the proportion of the unemployed with dependent children has declined steadily over the last 10 years.

7.3 In this chapter we consider three particular ways in which the present system is detrimental to employment -

- a. the effect on the "wage floor";
- b. lack of incentives to seek and take work;
- c. the disincentives, once-unemployed, to take part-time work.

(The question of the taxation of labour relative to capital was discussed in Chapter 6.)

7.4 The disincentives and complexity of the present system argue strongly for radical reform. However, radical proposals run into difficulties both on grounds of cost and because their introduction is judged not to be administratively feasible before income tax is fully computerised. While both arguments are reasons for delaying the implementation of major changes, neither should be a barrier to the planning of a reform strategy. In particular we note that PAYE computerisation is well under way.

7.5 The details of a radical strategy would take us well beyond our terms of reference. But we would offer three observations. First, history and the experience of other more prosperous countries suggest that to wait for economic growth alone to reduce marginal tax levels and to end unemployment and poverty "traps" will be to wait a very long time. The time could be shortened if there was a deliberate plan to reduce tax allowances and reliefs and introduce instead lower tax rates which rose in small steps over narrower income bands. Secondly, because of the high cost, it is unrealistic to expect to be able to "buy out" the main means tested benefits for those in work through the development of universal benefits such as child benefit. Income tested benefits for the employed have grown significantly in the last few years, in terms both of cost and of their potential importance for work incentives. If there is to be greater readiness to accept low and variable wages and work sharing, in-work benefits will have to become more effective. The key question is how to use the income tax system to improve the receipt and visibility of income related in-work benefits. Finally, a smooth transition from benefit recipient to taxpayer is not dependent on the introduction of tax credits or a negative income tax system: if the Government decided upon the desired pattern of transition (for example no marginal tax rates over 90 per cent) it could then seek to adjust the various elements of the present tax and benefit systems to conform broadly to such a pattern.

7.6 For the short term, we consider various piece-meal changes.

### The "Wage Floor"

7.7 One way by which the tax and benefit systems could diminish the supply of low paid jobs is by raising the "wage floor". Because some employees expect, and some employers feel obliged to pay, a wage rate which covers the 'family wage' (interpreted as the gross wage necessary to match the basic supplementary benefits a married man with two children would receive out of work) the benefit levels could put upward pressure on wage negotiations. In so far as this keeps wages higher than they would otherwise be, this in turn limits the number of low paid jobs - even for single people who might be willing to work for less than the 'family wage'.

7.8 There is no strong evidence of this effect (see Annex B), but as can be seen in figure 8, for a man with two children (and a wife who is not in work and lives in a council house) there has been a marked narrowing of the gap between the 'family wage' and earnings in a low paid job (ie earnings at the lower quartile of the earnings distribution). As noted above, such families continue to be given prominence in official statistics, and in turn in wage bargaining, but in fact they represent less than 2 per cent of all families with a head below pension age.

7.9 The simplest solutions are to adjust the levels of taxes and out-of-work benefits. For example -

a. the uprating of the supplementary benefit scale rate could be held back. Apart from a once-and-for-all increase for many families with children in 1980 (following the Supplementary Benefit Review) there has been no significant real increase in the scale rate in recent years. One way of achieving a real reduction if wages are expected to fall in real terms, would be to link benefit changes to prices or earnings whichever rose the slower (or fell more) or, more equitably to earnings alone: alternatively indexation could be abandoned completely;

b. the unemployed on supplementary benefit could be given less generous help with housing costs. The main element in the rising level of supplementary benefit has been the automatic increase given for

housing costs (which have risen substantially as the result of the move towards economic pricing for council rents). If rents are expected to continue to rise faster than earnings, there is a case for offering benefit recipients less than 100 per cent of housing costs;

c. the tax burden on the low paid could be lessened. Increases in the burden imposed on the low paid by income tax and national insurance contributions caused a third of the rise in the gross 'family wage' in the last three years. The British married man now faces a marginal income tax rate of 30 per cent at one-third of average earnings. His peers in France, Germany and the USA do not enter such a rate until their earnings are between 120 per cent and 260 per cent of average earnings. The re-introduction of a lower rate band would help to reverse the trend, though it is strongly opposed by Inland Revenue for administrative reasons. Increasing the tax threshold for everyone or ending national insurance contributions for earnings below the floor (or the first £29.50 earned) for everyone would be very expensive.

7.10 An alternative approach is to strengthen the contribution of in-work benefits. The above analysis of the 'family wage' ignored the effect of in-work means tested benefits (primarily Family Income Supplement and housing benefits) because take-up is low (50 per cent or less) and their influence on pay negotiations appears to be limited, or sometimes perverse. However if these problems could be overcome and in-work benefit were generally accepted as an earnings subsidy, the gross 'family wage' employers would be expected to pay would be reduced to a level below earnings in even the lowest paid jobs (see figure 8). The new Housing Benefit Scheme to be introduced from November 1982 should improve take-up of rent and rate rebates. For FIS to become more automatic and to be regarded as part of the wage, it will be necessary to bring employers more fully into its administration.

7.11 Forty years ago the forerunner of Child Benefit ("Family Allowances") was introduced because it was seen as an effective means of reducing wage pressures for family men. An increase in Child Benefits would help families with low incomes in work, but the universality of the benefit makes such an

increase expensive: a 10p increase costs about £55 million (net of savings on other social security benefits). To concentrate assistance just on low paid families in work would require an income tested second tier child benefit similar to the Canadian Refundable Child Tax Credit.

#### Incentive to work

7.12 As described in Annex B evidence from the 1978 DHSS Cohort Study of the Unemployed shows that about 5 per cent of men becoming unemployed received benefits as high as their previous net earnings and so had no financial incentive to return to work, and a further 10 per cent had only a limited incentive. Since then some benefits have been made subject to tax and with the other changes to taxes and benefit levels, there has probably been a reduction in the proportion of the unemployed with no or little financial incentive to re-enter employment, though with 3 million now unemployed the absolute numbers may have increased. The main explanation for the minority of unemployed with such high "replacement ratios" is that the means-tested benefits for those in work (particularly benefits for children and rent and rate rebates) are less generous and are less frequently claimed than is supplementary benefit for those who are out of work.

7.13 A general reduction in the level of supplementary benefit for the unemployed, designed to reduce the disincentive effect for the minority would also have the effect of making the majority (for whom the disincentive effect does not apply) worse off. Additionally, it would be necessary to de-couple benefit levels for the unemployed from the levels applying to other supplementary benefit recipients: the sick, disabled and single parents. Moreover the most recent research findings on the impact of benefit levels on unemployment suggest that, in a time of slack labour markets as at present, the effect of reducing benefits would be small - smaller than indicated by earlier research. The more direct way of ensuring that no one is better off out of work is to reintroduce the 'wage stop' on supplementary benefits at a level equal to say, 90 per cent of the claimants' net income when previously employed. The wage stop was abolished in 1975 mainly because it was administratively expensive and reduced the benefits of so few people (8,000 in 1974). These arguments still apply but the re-introduction of a wage stop would ensure that those in work did not believe that they would be better off unemployed.



7.14 An alternative approach is to improve the take-up and the value of in-work benefits. For example the value of FIS could be increased by raising the limit on eligibility or by relating the benefit to children's age (at present there is a fixed sum regardless of age), and housing benefits could be improved by increasing the "needs allowance" or changing the "income tapers."

7.15 In most other European countries, and in North America, benefit rates fall considerably with increased duration of unemployment, particularly for people without children. In the United Kingdom the effect is less marked, especially since the abolition of earnings related supplement. A sharper fall in benefits in the United Kingdom would improve incentives but it might be politically difficult to make such a change in a period of high unemployment. This problem could be eased, but not removed, by confining the change to people without families.

7.16 People's incentive to work can also be influenced by the terms on which unemployment benefits are available as well as the level of those benefits. So long as benefit is available to meet basic needs, many may prefer to remain unemployed and search the market for a decent "primary" job rather than accept a less attractive vacancy. Under the present benefit rules nobody can be penalised for declining an "unsuitable" job, ie one which offers pay and conditions which are inferior to those provided by collective agreement or which are typically provided by "good employers" (sic) in the area concerned. These rules have their origin in the contributory national insurance scheme which was initially designed to cope with transitional unemployment among workers with an established trade. It seems wrong that the same principle should apply to the non-contributory means-tested supplementary benefit scheme. A better approach would be to expect people after a specified reasonable period of job search to accept any job offered to them which was not unsafe or unhealthy and which avoided exploitation by providing a net income (allowing for in-work benefits) no worse than their income from benefits when unemployed.

7.17 In present labour market circumstances, the introduction of this new rule would not lead to the offer of jobs to patently unenthusiastic applicants. However, it could have a useful psychological effect, and could guard against the danger that young people who now have extensive experience of claiming benefit since leaving school, may be less likely than previous generations to take unattractive jobs. We understand that changes confined to supplementary benefit rules do not require primary legislation but would involve some administrative problems.

#### Part-time work

7.18 At present an unemployed man on supplementary benefit (and/or his spouse) may earn up to £4 a week without loss of benefit ie work 2 or 3 hours. But if he commands a low wage rate (eg £2 an hour) he enjoys no further net gain unless he can work for more than 20 hours (if he is a single householder) or 30 hours (if married with two children). Thus there is no incentive to take part-time work (except in the black economy). The impact of this disincentive on the behaviour of unemployed people is difficult to assess but any disincentive is hardly consistent with attempts to encourage part-time work. Furthermore there is now good evidence that present benefit rules discourage the wives of the unemployed from working.

7.19 The danger, however, is that if changes are made to significantly improve incentives to work part-time, this may create dis-incentives to move from part-time to full-time work. If this risk is accepted (as seems reasonable at present levels of unemployment), there are various possibilities for increasing the incentive to take part-time work -

- a. supplementary benefit recipients (and their spouses) could be allowed to retain more of their earnings as their hours of work increase: such a concession might be confined initially to the long term unemployed;

b. supplementary benefit levels for unemployed could also be reduced overall (though unless a way could be found of ensuring that all benefit recipients had access to part-time jobs, very large numbers of claimants would suffer a loss of income);

c. eligibility for FIS could be extended to those in part-time work (for example by a limit of 16 hours instead of the present 30). To avoid eliminating the incentive to move from part-time to full-time work this would have to be accompanied by a reduction in the 50 per cent tax rate which applies to FIS as income from work rises. The major advantage of such a combined measure is that it would not only provides an incentive to take part-time work but would also remove the most severe aspect of the "poverty trap" where, at present people are not able to raise their own living standards by working harder. The cost could be less than £100 million per annum.

#### Conclusions

7.20 Through their impact on incentives and wage levels the tax and benefit systems affect the scope for reducing unemployment. There are broadly three ways out of this problem -

- a. reduce benefits for the unemployed;
- b. raise net incomes of people in work through reducing income tax or increasing child benefits;
- c. improve selective benefits aimed at lower income families in work.

7.21 A general reduction of benefits would reduce living standards of many for whom benefits do not act as a disincentive. We recommend consideration of more narrowly targeted measures -

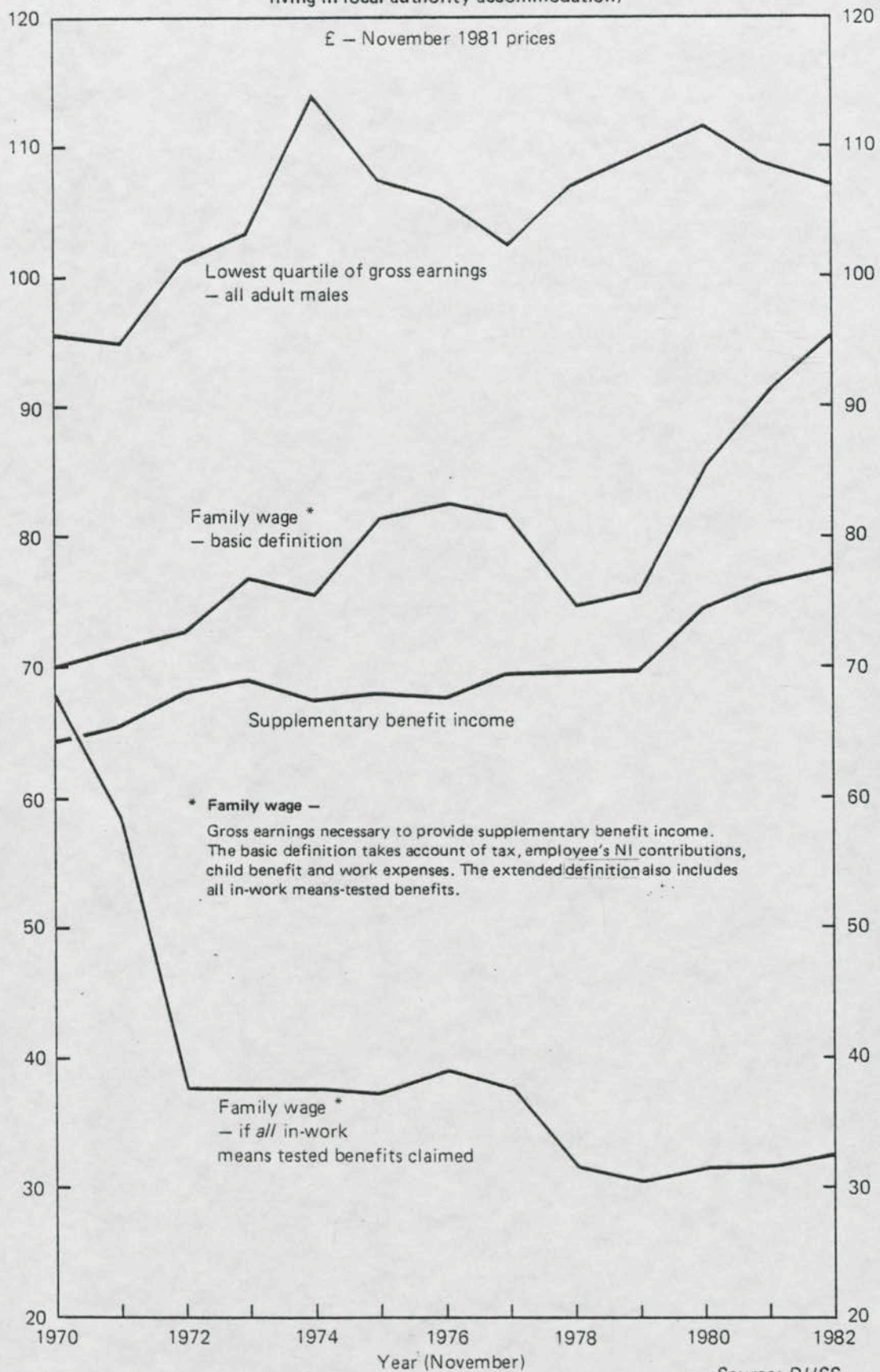
- a. on the assumption that wages are expected to fall in real terms, the linking of increases in supplementary benefits for the unemployed to prices or earnings, whichever rose the slower, or (and more equitably) to earnings alone;

b. a change in the "job availability rule" to require people unemployed for some time to accept any job offered which pays (with in-work benefits) no less than income from benefits when unemployed.

c. re-introduction of a wage stop (or benefit limit) so as to ensure that benefits out of work could not exceed, say 90 per cent of the claimants net income in work;

7.22 General measures to raise net incomes in work by increasing tax allowances or increasing Child Benefit are very expensive and extremely slow to make much impact. Instead, selective benefits for lower-income families in work are a more cost-effective way forward. An effective mechanism for subsidising the earnings of low income families could encourage the acceptance of low paid jobs, reduce upward wage pressures for family men, increase incentives to seek work and facilitate the growth of part-time employment. The present income tested in-work benefits (particularly Family Income Supplement and housing benefits) fill this role inadequately, if at all. The new Housing Benefit Scheme may bring some improvement but we recommend that a new way be sought of subsidising the earnings of low-income families that is more effective than FIS in its present form and less expensive than increasing universal child benefit or raising tax floors. In the meantime the take up of part-time work can be encouraged by allowing people on supplementary benefit to retain more of their earnings as their hours of work increase.

FIGURE 8  
 Comparison of lowest quartile of gross earnings with 'family wage'<sup>\*</sup>  
 (For married man with non-earning wife and two children,  
 living in local authority accommodation)



## CHAPTER 8: NEW PATTERNS OF WORKING TIME

8.1 It is a paradox that, while the United Kingdom has one of the highest rates of unemployment among OECD countries, British workers also work one of the longest working weeks. In addition, the number of hours of overtime worked in British manufacturing industry has increased by a fifth in the last year, while employers' ability to increase pay remains tightly constrained and unemployment continues to rise. Less paradoxically, part-time employment in the United Kingdom has fallen considerably less steeply than full-time employment in the present recession. This represents a somewhat faltering move in the direction of job-sharing, away from the often excessive costs and rigidities of the standard week plus overtime. This chapter examines ways of widening and accelerating this trend, while maintaining the efficiency of British industry. We do not here consider a shorter working life, which is dealt with in Chapter 9.

## Cutting Working Time

8.2 This approach would be unfruitful if the length of the working week, or the number of hours worked in a year, were already set by considerations of efficiency. But there is a good deal of evidence that this is not so. The fundamental objection to a shorter standard working week, is that workers often expect to be paid as much, say, for a 39 hour week as for a 40 hour week. In more favourable circumstances in the past the potential loss in competitiveness that this entails has been offset by a gain in productivity. But the consequence of this approach, as studies show, has been that there has been very little extra employment, or even reduction in job cuts. In principle, this could be circumvented by gaining management and union acceptance of the principle that, in present circumstances, there must be a fall in weekly earnings commensurate with the shortening of the working week. Even if this could be achieved for basic wage rates, the likely result, especially for companies dependent on intensive machinery use or customer demand, would be an increase in overtime at premium rates. This would not help unemployment or international competitiveness.

Cutting Overtime

8.3 Some overtime is economically justified, for example to meet peaks of demand or emergencies. Also one of the effects of the Employment Protection Act and of redundancy payments is to act as an incentive for even efficient employers to increase output by maximising overtime rather than by taking on additional staff. But, on the other hand, since 1945, high levels of regularly worked overtime have developed and persisted in the United Kingdom to a greater extent than in most other countries. Overtime is especially prevalent among low-paid manual workers, and among those with family responsibilities. The evidence of the twenty years after 1945, summarised in a research paper for the Donovan Commission, was that "much of British overtime now seems to arise out of a desire to waste time at work in order to obtain a living wage". Nothing that has happened since 1967, when this judgement was made, leads us to suppose that the situation has changed for the better.

8.4 We believe, therefore, that the exceptional length of the British working week reflects, not the most efficient pattern of work, but rather a deep-rooted tradition of inefficiency. In the 1950s and 1960s a partial justification was the need to hold on to staff against labour shortages. With high and continuing unemployment, it is now the unemployed who suffer when employers increase overtime instead of taking on more workers. Yet the unemployed are in no position to undermine the long-established behaviour of management and unions. Both of them react badly to proposals for change, such as the efforts by the European Commission to obtain agreement on a limitation of overtime.

8.5 We do not believe that a statutory solution is appropriate. However the effect of the Employment Protection Act and redundancy payments is often exaggerated in employers' minds. Efforts should be made, in conjunction with the CBI (and perhaps NEDC) to bring out the efficiency and employment gains from cutting overtime and to correct misapprehensions.

More shifts

8.6 Another possible advance would be a greater use of shifts, and a shorter length of shift at an appropriately reduced earnings level. For continuous processes needing 168 hour operation a week, there could be five groups of workers doing 34 hours a shift, rather than four groups doing 42 hours. This would raise shift-worker employment by 25 per cent and probably increase productivity, though there would also be extra costs on administration, etc. The possibility of an initial subsidy to meet the employers' extra costs, perhaps as part of the development of the job splitting scheme discussed later, should be examined. For less than continuous operation, similar principles should be applied.

Encouraging part-time work

8.7 The Government have recently announced a job splitting scheme (JSS) to encourage employers to split existing full time jobs into half time jobs. A subsidy will be paid to employers for each additional half time job to which an unemployed person, receiving benefit, is recruited. The scheme will include cases where existing full time workers switch to half time and release the other half to a registered unemployed person. The immediate purpose of the scheme is to get unemployed people into jobs for no net increase in public expenditure. In addition, the Community Enterprise Programme is being replaced by a Community Work Programme with part time as well as full time options.

8.8 We welcome these developments, not only because they are cost effective ways of getting unemployed people back to work but because they may have wider economic benefits in breaking down the rigidities of the standard working week. Compared with full time work, part time work often has the following advantages for the employer -

- a. Lower wage rates per hour, lower contributions to pensions, if any, and less employment protection.



b. More flexibility: two part-timers can work simultaneously during peak demand, and neither need be paid when there is no work to be done. Hours can be increased as needed without paying premium overtime rates;

c. Less absenteeism and sickness, and lower labour turnover.

8.9 But part-time work also has the disadvantage for the employer of higher recruitment, training and administration costs. (The first two occur once, and a subsidy to cover them, if needed, could be paid as a lump sum rather than over a period.)

8.10 The advantages of part-time work may well outweigh the disadvantages more often than employers realise; sometimes they do not consider the possibility, because it is not how work has been organised in the past. In this case, drawing attention to it may lead to not only the splitting of existing jobs but the creation of quite new part-time jobs. The crucial step is to remove the rigidity of thinking only in terms of the standard working week.

8.11 At present there is a tendency for people to believe that part time work must be a poor second best to full time work, except for women with young children and people nearing retirement age who do not want to stop all work but would like gradually to work less. These are certainly the groups most likely to want part time work, but there are others who might see positive attractions in it, eg people with second jobs, (including budding entrepreneurs), shift workers, and two career couples who would be prepared to trade some income for leisure.

8.12 It is likely that more people would be prepared to switch from full time to part time work if they could choose their own pattern of reduced working hours. There seems no reason in principle why the job splitting scheme should not subsidise extra jobs created by converting 2 jobs into 3, or 3 jobs into 4 and this might be considered as a refinement of the scheme if it proves a success in its initial form. Another development might be the changes in shift working suggested above. Some employers and employees might find it mutually more convenient to arrange other types of job split eg 'week about' or split years. The Government might attempt to pioneer such arrangements in the public sector.

8.13 In the shorter run, the scope for helping the unemployed through part time work lies in the fact that part time work at prevailing wages is likely to offer a better income than benefit for the single workers and people without dependents who make up the majority of the unemployed. Moreover the income is being earned and there is access to the other benefits of work: a sense of personal worth, the discipline of regular timekeeping, and companionship. Under present benefit arrangements, however, there is no incentive for unemployed family men or their wives to take part time work. The proposals in Chapter 7 to improve benefit disregards and to extend in-work benefits to part timers would enable JSS and similar schemes to provide jobs for the unemployed with families.

8.14 It has yet to be decided whether JSS will apply to jobs of at least 15, or 16 hours per week. The choice has great significance since jobs of 15 hours do not qualify for redundancy payments and employment protection measures, but jobs of 16 hours do. A lower limit of 15 hours should therefore encourage a bigger take up by employers, because the burden of employing part timers will be significantly reduced - though this could encounter union resistance in the primary sector. There could be safeguards for full time workers whose jobs are split; they should participate voluntarily and they should be warned of the loss of job security which dropping to 15 hours might involve.

8.15 It is equally important to continue resisting the EC proposals for Directives on part-time work and temporary work. There can be no doubt that these proposals, particularly those requiring proportional rights, will inhibit employers from recruiting or retaining part-timers as well as making them more reluctant to use temporary labour, instead of, say, overtime working.

#### CONCLUSIONS

8.16 This chapter examined the possibility of increasing the number of people in employment by changing the conventional patterns of working time. We conclude that there is unlikely to be much benefit in employment terms or reducing the standard working week. However we note that excessive overtime working is far more prevalent in the United Kingdom than in many

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other developed economies. A reduction in overtime working is likely to create more jobs and we recommend consultations with industry about the implications. Changes in the pattern of working and the introduction of more part time working also offer the prospect of more jobs. We welcome the introduction of the scheme proposed by Department of Employment to create more part time jobs through job splitting and feel that it should be developed to encourage other, different, patterns of working, eg shorter shift working, which will create more jobs. If applied to part time jobs involving less than 16 hours per week, for which employment protection measures need not apply, such schemes may prove more popular because the burdens of employing part timers will be reduced.

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CHAPTER 9: OTHER MEASURES TO COPE WITH UNEMPLOYMENT

9.1 This Chapter considers the role of measures which ease the distress of unemployment, for people and for society. Such measures rightly form part of the strategy for tackling unemployment, for if society cannot accept the pain it may reject the treatment. At the same time, they must not subvert the long run aims of the present strategy and must be capable of being unwound as employment prospects improve.

9.2 The level of expenditure which should be devoted to such measures, within the broad policy objective of reducing public expenditure, is not something which can be determined objectively, because it depends on a political judgement of the seriousness of the consequences of unemployment and of the proper balance to be struck between the relief of unemployment and other objectives. A great deal is already being spent on special employment measures and large resources are committed to existing or planned measures for some years ahead.

9.3 Against this background the aim of this chapter is to suggest how the arrangements for deciding priorities in this field could be improved, and to offer some views, arising from the earlier analysis, on future priorities and on options which might be effective alternatives to, or adaptations of, existing measures. The Chapter starts with a general discussion of the approach to employment measures (paragraphs 4-9) and then considers in more detail the role of three types of measure -

- to reduce the size of the labour force (paragraph 10-17);
- to reduce the concentrated incidence of unemployment (paragraphs 18-21)
- to help the unemployed use their time productively (paragraphs 22-24).

Employment measures

9.4 Special Employment Measures (SEMs) are a collection of measures undertaken with the primary aim of reducing the number of registered unemployed in the short run. We have not conducted a detailed study of the existing Special Employment Measures for the purpose of this report. We looked in detail at the principal measures - the Youth Opportunities Programme and the Community Enterprise Programme - in our 1981 report on "Unemployment and Young People" and several initiatives since taken, notably the introduction of the Youth Training Scheme and the new Community Work Scheme, are broadly in keeping with the recommendations of that report.

9.5 On this occasion we have looked more generally at the part which employment measures play in the Government's approach to unemployment. Table 1 (at the end of this chapter), provides a list of existing SEMs, classified according to the labour market mechanisms by which they reduce registered unemployment. These mechanisms include safeguarding and inducing jobs in the private sector, training, temporary work of value to the community and early retirement. As Table 1 shows, nearly all SEMs have counterparts in other Government spending programmes and instruments, which also have an effect on employment or unemployment. The overlap arises particularly with measures which create, induce or preserve employment and output. SEMs which have this effect (for example the Community Enterprise Programme, parts of the Youth Opportunity Programme, the Temporary Short Time Working Compensation Scheme) are paralleled by a large number of conventional instruments of Government policy which influence employment.

9.6 What chiefly distinguishes SEMs is that they are directly targeted on the registered unemployed - often on particular priority groups. It is the reduction of the number of unemployed that has priority rather than the amount and quality of work (or other output) which accompanies it. SEMs are more cost effective in reducing registered unemployment, than conventional instruments. "Cost per job" considerations also feature in the design or appraisal of several other instruments, notably selective aids for industrial projects, but in these cases the primary criterion is usually the expected long run viability of the project. In other activities such as public investment

programmes the employment effect is recognised only in a general way and it is rare for projects to be designed so as to maximise employment impact, far less their impact on the registered unemployed. The aim, naturally enough, is to choose the projects which offer the highest return in terms of the objectives of the particular programme, and to design them in the most economical way. Similar observations apply to the other classes of instruments in Table 1 eg training and education measures.

9.7 This "ring fencing" of SEMs has some practical benefits. It is a simple way of putting a limit on the extent to which the Government is prepared to skew its public spending priorities and abate its drive for efficiency, in the interests of increasing employment and reducing unemployment. But it also has disadvantages. It would be an oversimplification to say that within the ring fence only cutting unemployment matters and outside the ring fence only efficiency matters. But the present arrangements will tend to rule out intermediate options which would perhaps offer a better trade off between employment and other output objectives, especially if attempts were made to increase the benefit to the register of conventional measures.

9.8 For example, the idea has been floated in the past of offering some construction contracts on condition that a high percentage of unemployed labour is engaged and labour intensive methods used. At present such ideas tend to be viewed as a source of inefficiency. They are not judged by the same yardsticks as, for example, community work. What is needed is a consistent basis of comparison, taking account of the relative value of output, the contribution which could be made to unemployment, and other factors such as effects on wage levels and opportunities offered to the secondary sector. A comparison of output value might not necessarily be disadvantageous to community work which, despite allegations of "make work", produces (according to some assessments) highly valued output. The facts about this need to be explored more thoroughly as a basis for future decisions on priorities when the scheme comes up for review in 1984. In addition the scope for matching unmet needs and unemployed labour through the mechanism of the private sector, particularly small entrepreneurs, ought to be thoroughly explored as an alternative to community work. We suggested examples in Chapter 5.27 (a national enterprise allowance scheme) and Chapter 6.14 (an expanded young workers scheme).

9.9 In view of the large number of programmes which could affect employment and because high unemployment is unlikely to be a short term problem, there is a case for reviewing public expenditure procedures to see how effects on employment and unemployment could more systematically be taken into account. A simple way would be to document the job (and labour supply) consequences of spending bids and options for cuts. A ceiling could still be kept on the amount of public spending which would be used positively to reduce unemployment, if it were undesirable or impracticable to do this across the board.

9.10 In addition, existing public spending programmes and policy objectives could be implemented in ways which would be more helpful for employment and unemployment. One example is labour intensive ways of carrying out given public needs (as mentioned above and in Chapter 6). Another would be a review of the scope for relaxing the rules governing recruitment to the civil service to allow some preference to unemployed recruits. There are always problems in mobilising the spending power and influence of many Government departments, with their disparate aims and priorities, towards a cross-departmental Government objective. It does not happen without determined effort. The "bending" of main programmes towards a particular objective has been tried, not with outstanding success, in the case of the urban policy. Nevertheless our diagnosis can be seen as pointing to the need for machinery for reviewing systematically the scope for each Department's activities to do more to increase employment and reduce unemployment. If such an exercise were not to run into the sand it would need firm Ministerial leadership.

#### Reducing the labour force

9.11 Measures, such as the Job Release Scheme, to reduce the labour force are sometimes criticised on the grounds that they could offset the downward pressure on real wages. However at current levels of unemployment this effect is likely to be small. And in the light of the prospects for unemployment there is a case for reviewing the balance of financial incentives and opportunities affecting labour market participation, as it affects young people, two income couples and older people's retirement.

(i) Further and higher education

9.12 The financial disincentive of continuing in education compared with getting a job or being unemployed with supplementary benefit still acts as an obstacle for young people from less well off families. If financial assistance were available on a family means tested basis to children of proven ability, those staying on would improve their potential and the less able would face less competition for the available jobs. If an effective scheme can be devised at reasonable and affordable cost it could be launched initially in selected areas of high unemployment, and could act as a trial for a possible national scheme.

(ii) Two job couples

9.13 A married man with a non-working wife receives the married man's tax allowance, whereas his counterpart with a working wife who choose to be taxed together receive both this and the single person's tax allowance. We continue to take the view, expressed in our report on "Unemployment and Young People" and subsequently endorsed by the Manpower Group, that this fiscal bias in favour of two income couples promotes a higher level of participation in the labour market than would be found under a more neutral system. We repeat our recommendation that full weight should be given to the implications for unemployment when decisions on the taxation of married couples are taken. A minor additional suggestion is that the MSC might (without discriminating against women) adopt more limited objectives for positively attracting women into training and hence employment. In future assistance might be limited to women with the potential to acquire scarce skills and women from low income families.

(iii) Retirement

9.14 The Government are committed to the abolition of the earnings rule for State pensioners, when this can be afforded. While recognising the considerations of equity which underlie this, at present unemployment levels it would undesirably increase competition for jobs and there are thus better uses for the resources which implementation of the commitment would entail.



9.15 The main questions in this area are whether early retirement should play a bigger part in Government policy, and if so in what form. Quite apart from the major costs involved there is a view that early retirement is undesirable, because it creates no extra output, may create income problems for the elderly, and may reduce productive potential by substituting green labour for skill and experience. The last of these fears is often exaggerated: while circumstances vary, it is very often the case that older workers hold on to their jobs at the expense of new entrants because of rigidities in the labour market rather than because of higher productivity. Moreover early retirement could be a lesser evil than the present level of unemployment among young people, which is likely to damage productive potential in the long run, and which may entail bigger individual and social costs than bringing forward retirement by a few years. For all those reasons early retirement is worth considering as part of the strategy for tackling unemployment.

9.16 One solution would be to introduce a common pension age of 60 (which would incidentally respond to EC pressure for removal of the discrimination inherent in allowing women to retire 5 years earlier than men). However, this would be extremely costly and would permanently transfer over 1,300,000 men from the working to the dependent population. A change of this magnitude could be contemplated only if it was certain that unemployment would remain at present levels, or if the nation felt rich enough to offer retirement at 60 so as to increase the leisure of the elderly. In our view neither of these applies.

9.17 A more flexible approach, which we recommended for consideration in "Unemployment and Young People", would be to reduce the male pension age to 63 combined with flexible retirement provisions from 60 to 65, with reduced pension for those retiring early and enhanced pension for those retiring later up to 65. This would combine some of the benefits of earlier retirement for men with the flexibility to cope with uncertain labour market conditions. However, because a great deal of early retirement is occurring voluntarily only about half the workers receiving an earlier pension would release jobs. The scheme would thus be cost ineffective, costing at least £800 million a year net to take a quarter of a million people out of the labour force.

9.18 In present circumstances the more cost-effective approach, if Ministers accept the general argument in favour of flexible early retirement, is to develop the Job Release Scheme, which targets on people who release their jobs to the unemployed. Options which might be considered, when priorities in the employment field are next reviewed, include lowering the minimum age for Job Release from 62 to 60 and the introduction of a part-time option. Another option would be to enforce retirement at 60 more widely in the public sector.

Reducing the concentrated incidence of unemployment

9.19 Chapter 3 mentioned the particular social and economic problems which result from long duration unemployment, from heavy geographical concentrations and the high incidence among the young, and unskilled. Regional disparities are being addressed in the current inter-departmental review of regional policy, and we have not therefore covered them here, though they are among the most worrying and intractable aspects of the unemployment problem.

9.20 In the past, unemployed job seekers as a group were often discriminated against; many employers preferred to recruit people who already had jobs or new entrants to the labour market. Such attitudes are less prevalent in present circumstances. Instead employers are now said to discriminate against the long term unemployed, assuming that they must be poor candidates. In view of the large number of unemployed relative to the resources available to help them, we believe that these special measures which find work for the unemployed should concentrate in future on the long term unemployed in the "12 months plus" group. This should become a formal criterion of effectiveness.

9.21 There are a number of options for giving help to the long term unemployed which should be considered. We have concentrated on options which are cost free (a.), could be incorporated into existing schemes (d.), or which might prove effective alternatives to existing programmes.

a. Employers and unions could be encouraged to negotiate "starters' rates" whereby adult recruits would start below the rate for the job and progress to the full rate over a period of perhaps 18 months. (There are recent precedents for this in the USA.).

b. Long term unemployed workers could be given vouchers, cashable as a wage subsidy by employers engaging them for a minimum period. To ensure that the subsidy encouraged rather than impeded wage flexibility, there could be a wage ceiling or a requirement to pay starters' rates. This would be a convenient way to overcome employers' resistance to the idea of taking on the long term unemployed.

c. There could be an increased emphasis on improving educational attainment, both through a work preparation programme on the lines described below and as part of existing schemes for the long term unemployed.

d. Spells of work experience "on employers' premises", if incorporated towards the end of training and community work attachments on existing programmes could help adults establish a track record with a real employer, as young people do on YOP.

e. The new job splitting scheme might incorporate a two tier subsidy with a supplement (perhaps in voucher form) for recruiting the long term unemployed.

f. Private employment agencies could be paid a fee for finding jobs for the long term unemployed.

9.22 In addition there are a couple of options which would help the unemployed as a group. (The first involves extra costs but the second offers savings.)

a. The public employment service could increase its knowledge of vacancies in the secondary market, including part-time and casual work, and bring them to the attention of the unemployed. Or, perhaps better, private agencies could be contracted to do this.

- b. Employers using the employment service to select job candidates could be charged for the service, except where the successful candidate is unemployed.

Helping the unemployed to use their time productively

9.23 It is useful to try and distinguish how far particular groups of the unemployed need employment as such, as distinct from the benefits obtained from work which might be provided in other ways. For most of the unemployed, a regular job will be the best solution and this is particularly likely to be true for young adults, both from the viewpoint of society and that of the individual. But others might be readier to accept substitutes. Workers with family responsibilities seem primarily in need of extra income and the choice whether to provide this through extra benefits, through created work projects or through more generous rules for supplementing benefit by part-time earnings rests primarily on what society finds most acceptable. Among older people, whose chances of getting jobs are particularly poor, the most useful approach may be to provide alternative forms of useful activity, status and companionship.

9.24 These questions are rarely addressed in the context of special employment measures, because the emphasis there is on reducing the numbers actually unemployed and on the needs of the unemployed as workers, not as individuals within families. We understand the importance of reducing the numbers of unemployed. But the prospect that these numbers will remain high for some years makes it all the more important to ensure that effective ways of meeting the needs of unemployed people are not overlooked.

9.25 There are several ways in which it might be possible to help more people from existing resources if a broader approach were adopted. We suggest that when existing programmes come up for review the following ideas should be considered:

a. The need of family men for work to raise their household income could be met by applying to them and their wives the more generous rules about earnings disregarded for benefit purposes which currently apply to single parents. The employment service could give special help to long term unemployed family men to find them (or their wives) part time jobs.

b. The educational standards of the unemployed and their general employability could be improved in a variety of informal ways, using voluntary tutors and counsellors wherever possible, and including mutual help arrangements among the unemployed themselves. Participants without formal qualifications could be helped to compile a profile of their achievements gained through voluntary work and other activities, for use in job applications. Use could be made of educational, voluntary and recreational activities to develop and sustain many of the qualities needed in work (eg concentration, stamina, fitness, discipline, working in a team). A particular aim would be to widen the horizons of men from a background of manual work, by helping them overcome their resistance to "womens work". Existing full time courses in education and training institutions are not suited to provide this range of needs. The main benefit of meeting the need for work preparation via full time courses is that it enables people to come off the register. The price for achieving this gain can be too high. Hence, instead of the adult work preparation courses currently run by the MSC, we would prefer consideration to be given to ways of stimulating informal and voluntary provision. On the face of it, this is more a task for the informal education departments of local education authorities (LEAs) than for the MSC, though the Job Centres could play their part in publicising the kind of help locally available.

c. Within the new Community Work programme, comprising full time and part time options, the balance could progressively be shifted so as to organise a few hours of work, most weeks, for those who cannot find any for themselves. This may be a more cost-effective way of reducing human misery than the present aim of providing a part time

or full time job for a full year, since more could be helped. This would be particularly appropriate for the many workers among the long term unemployed who have rarely had (and therefore may not miss) a steady job but who are depressed by the enforced inactivity of continuous unemployment.

d. The role of voluntarism both in meeting the needs of the unemployed and in engaging their energies is the subject of a research project currently being sponsored by the MSC. Voluntary work could be particularly important for middle aged and older people, particularly those made redundant from steady jobs who feel the loss of a settled role in life, satisfaction and status. The Health Departments run schemes to promote the use of unemployed volunteers. The MSC's new Community Programme will seek to organise paid and voluntary opportunities within a single programme. Though we have not studied the subject closely we have some doubts whether this is the approach best calculated to engender the growth of genuine volunteering given the different values which surround market work and voluntary work.

e. Finally, there are the people whose age and/or unfitness put them well below the margin of employability in their local labour market for the foreseeable future. Such people are unlikely to be in demand even for casual work. Requiring them to keep up the fiction of looking for work, and denying them the somewhat higher level of supplementary benefit available to invalids or retired people serves no economic purpose and appears inequitable. Unemployed men over the age of 60 are already permitted to claim the long-term rate of benefit and stop registering as unemployed. But the problem extends further down the age range. An option for consideration when resources permit would be to extend the arrangement to workers in their fifties who have been unemployed for two years.

Conclusions

9.26 The extent to which public expenditure should be used to reduce and relieve unemployment is a matter for Ministerial judgement. A great deal is already being spent. Within the total resources available, ways should be sought of bringing into consideration a wider range of government spending programmes and instruments which could contribute to increasing employment and reducing unemployment. We suggest two changes in Government decision-making machinery to help achieve this. The first is to ensure that the effects of unemployment and labour supply of all significant spending options are systematically documented, together with the real outputs of special employment measures. The second proposal is to create inter-departmental machinery to identify ways of improving each Department's contribution to employment objectives.

9.27 The primary requirement will continue to be for measures with a low net cost to the PSBR. Within this constraint we recommend the following priorities -

a. It is right to give top priority to options which increase both employment and output. To assist longer term objectives the emphasis should be on the private sector and in particular the secondary sector. Specific options include labour intensive construction contracts, a national scheme of enterprise allowances, and an extended young workers scheme.

b. Measures which reduce labour supply (voluntarily) are - along with job sharing - a good second-best because they increase the unemployed's chances of getting regular jobs. Options include: extension of the job release scheme; removing the tax bias favouring two job couples; and selectively encouraging staying on in education.

c. Measures to help the unemployed into work should concentrate on those who have been unemployed for at least a year. Options include: encouraging "starters' rates" for new entrants at less than the rate for the job; work experience attachments and educational help in

existing schemes; a higher rate of subsidy within the new job splitting scheme, for recruiting the long term unemployed. Reduction of the numbers who have been on the register for 12 months should become a formal criterion of the effectiveness of special employment measures.

d. Measures to help people for which no regular work can be found should concentrate more on cheap and effective ways of helping people use their time effectively, while unemployed. Options include: encouraging people to find legitimate casual work eg by better benefit "disregards"; improving their employability through informal education, training and self-improvement programmes, using voluntary tutors; shifting the emphasis of community work towards less regular employment for more people; and allowing workers in their fifties who have been unemployed for two years to leave the labour market.



TABLE 1

Special Employment Measures: a classification according to the mechanism used to reduce registered unemployment, listing the secondary outputs of the programmes and other public programmes or instruments with similar (or potentially similar) effects\*

| Special Employment Measures                                                                                                                               | Secondary outputs                                                               | Similar programmes                                                                                                                                                                                                        |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1. Publicly organised temporary work of community value                                                                                                   |                                                                                 |                                                                                                                                                                                                                           |
| Community Enterprise Programme(CEP)**<br>Community Industry; Youth Opportunities Programme (YOP)**<br>Community projects<br>[Voluntary service scheme]*** | Value of work done; occupation for young; improve individual employability.     | Labour intensive construction and maintenance (housing, energy conservation etc). Health and social services. Support for voluntary social services and amenity groups. DHSS and MSC schemes for unemployed volunteers*** |
| 2. Extra employment in the private sector                                                                                                                 |                                                                                 |                                                                                                                                                                                                                           |
| a. Extra trainees                                                                                                                                         |                                                                                 |                                                                                                                                                                                                                           |
| YOP employer attachments                                                                                                                                  | Better stock of skills plus 'real job' experience and (unintentionally) output. | a. Public sector recruitment and training policy (including HM Forces). Skill training grants                                                                                                                             |
| b. Other jobs                                                                                                                                             |                                                                                 |                                                                                                                                                                                                                           |
| Young workers scheme; Enterprise allowance (pilot);                                                                                                       | More output. Lower wages; more entrepreneurship. More people in "real" jobs.    | Construction contracts; selective financial assistance; regional and urban aids; public purchasing; tax options; Enterprise packages; employment transfer scheme [benefit disregards for casual work]                     |
| 3. Avoid or defer job losses                                                                                                                              |                                                                                 |                                                                                                                                                                                                                           |
| Temporary short-time working scheme                                                                                                                       | Prevents skill wastage. Perhaps more output                                     | Public and private sector 'rescues'; tariffs; subsidised export contracts                                                                                                                                                 |

4. Work-sharing

Job splitting scheme

Higher productivity.  
More in real jobs.  
Labour reserve for firms against future expansion of demand: may produce net expenditure saving.

Public sector recruitment policy

Special Employment Measures

Secondary outputs

Similar programmes

5. Early retirement (see also 7)

Job release scheme;

More young workers into real jobs; perhaps productivity gains

Public sector retirement and recruitment policies

6. Increase training, outside employment

YOP (education and training modules)

Better stock of skills; improved individual employability, worthwhile occupation

Training opportunities scheme; Post-compulsory school, further, higher and continuing education. [Benefit rules re availability for work effect scope for self help]

7. Remove inactive or marginal job seekers from register

Option for "60+" age group to withdraw and claim higher benefit

More income; less stigma

DHSS policing of benefit fraud; rules re dividing line between invalids and unemployed

Notes

\* The list of other similar programmes is not comprehensive

\*\* CEP will shortly become the Community Work Programme and YOP will be replaced by the Youth Training Scheme (YTS) which will continue to provide community work and training modules as well as employee attachments.

\*\*\* Entries in square brackets can produce the secondary outputs but do not reduce the register.

## CHAPTER 10: SUMMARY AND CONCLUSIONS

10.1 Unemployment is not a new problem: the United Kingdom has been through periods of heavy unemployment before. Nevertheless we have to learn the lessons again. Because current attitudes and expectations were formed over 25 years of unprecedented growth and prosperity the re-learning process is all the more painful. For unemployed individuals, living standards are reduced and aspirations thwarted. For the community as a whole, there is a significant waste of valuable resources and a potential threat to its stability.

10.2 The causes of high unemployment are not clearly understood. Indeed no simple uncontroversial explanation is possible because unemployment is the result of many disparate yet inter-locking factors, some of which can be traced back a decade or more. We have described in Chapter 2 how the post-war boom ended in the 1970s, with a slower growth of real incomes. Rising oil prices and increasing competition from newly industrialised countries called for structural changes in the economy as well as adjustments to the growth of incomes. Pressures for higher pay, the growth of public expenditure (and the rising tax burden) and reluctance to adjust to changed circumstances resulted in high and unstable inflation combined with poor growth. Unemployment was already rising before 1979: since then it has more than doubled, both because of the recession and as a result of policies designed to reduce inflation and correct fundamental deficiencies built up over the years.

10.3 Unemployment is a phenomenon common to most of the developed world and we in the United Kingdom cannot expect to solve our problems in isolation. Much depends upon the growth of world trade. But unemployment is higher in the United Kingdom than most other comparable countries because in many respects our economy is more rigid and unresponsive than elsewhere. Whilst it must be the object of policy to reduce the rigidities, the process could be long and slow. It follows that high unemployment is likely to persist for some time ahead.

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10.4 In the long term, an economy which is growing healthily with low and stable inflation will generate full employment, in the sense that there will be only a limited number of people (we postulate 1m to 1½m) unemployed at any given time, for personal reasons or because they are changing jobs. The main objectives must therefore be to remove the obstacles to sound economic development. But since a return to full employment cannot be achieved quickly, there is a case for shorter term measures to ease the transitional problems. It would be desirable for these shorter term measures to work in the same direction as long term policy: it is essential that they should not work against it.

10.5 The first requirement is public acceptance of a medium term macro-economic framework aimed at reducing inflation. Mere announcement of good intentions is insufficient. Attitudes will not alter for the better unless people are convinced that there will be resolute execution of the policy in the medium term and see more evidence that it is working.

10.6 The second requirement is for a faster rate of deceleration of pay so that there is headroom for real growth within a tight monetary environment. This entails continuing to press for lower wage settlements in the public sector and in private sector firms where the Government has influence (eg lame ducks), reducing public expenditure and thus the overall tax burden and using fiscal headroom to cut taxes to reduce costs.

10.7 The third requirement is to improve the flexibility of the economy, removing rigidities to the workings of product and factor markets. Externally, this means avoiding protectionism. Internally, it involves the removal of distortions created by Government and an increase in competition in product and labour markets. One key area of Government responsibility is the tax and benefit systems which create numerous distortions: in financial markets, in industry and in personal decisions.

10.8 We noted in Chapter 4 that many of the rigidities in the economy arise in the "primary sector" comprising large, well-established firms. Here the requirements of technology and the associated need for a highly-trained, well motivated labour force have led to the development of large, sometimes unwieldy corporations, often highly unionised which may have been well suited to the stable, full employment, high growth world of the 1950s and 1960s but are less able to adapt to today's highly competitive, more uncertain world. There is a need now for quick response to market opportunities and a more sensitive adjustment of pay to labour market conditions. Although the requirements of "scale" will remain for many capital intensive processes, the general drift will be towards smaller scale via decentralisation, de-mergers and the selling-off of subsidiaries.

10.9 The Government can contribute to this by breaking up the public sector via de-centralisation, privatisation of subsidiaries, and contracting-out and by a more vigorous competition policy. At the same time, a more flexible labour market and more efficient competitive economy will come about mainly by growth in the secondary sector (comprising not only small firms but also decentralised parts of larger organisations and in-coming firms). Improved management incentives, better labour relations and greater flexibility in this sector contribute directly to the efficiency of the economy (and so help the primary sector). But also the greater competition with parts of the primary sector should, in time, break down rigidities there too. The economy as a whole will then become more thrusting, aggressive and responsive to change.

#### **Policy Options**

10.10 Policies to restore economic growth and trading performance must first improve industrial profitability. Part of the cost burdens on industry arise from high taxation, both national and local, and to reduce these (without significant increases in personal taxation) requires continuing constraint on public expenditure. Resources for new initiatives to tackle unemployment are therefore limited and can be found only by re-ordering spending priorities.

10.11 Within these constraints, the Government should give greater attention to developing the nation's "human capital". It has a direct role in education and training and, because it funds universities, research councils and is an employer of technological manpower, has an influence over innovation. We make a number of initial suggestions for policy in Chapter 5 but these require more study. They could be developed either as part of the current CPRS study for MISC 14 on education and training or by the relevant departments. Further exploration of the suggestions on innovation policy in Chapter 5.36 could usefully complement work on university - industry links which the Prime Minister has recently commissioned from the Advisory Committee for Applied Research and Development.

10.12 In other areas of supply-side performance a number of policy initiatives have already been taken to reduce constraints imposed by trades union power, excessive taxation and bureaucratic regulations. Further developments are possible though the effect of any one on economic efficiency is modest, and the immediate gain to employment small (or even negative in the short run). But in total they have an important contribution to make.

On trades union power we offer our views on possible courses of action in Chapter 5.17.

For greater geographical mobility we identify some proposals in Chapter 5.21.

Ways to strengthen competition policy are discussed in Chapter 5.23.

10.13 There are also ways to create greater flexibility of product and labour markets and to increase the scope for labour intensive activities within an efficient economy. These include -

- a. developing existing policies for small firms (Chapter 5.33) to stimulate the vitality of the secondary sector;
- b. reducing capital subsidies and labour taxes together to leave the company sector no worse off overall but more inclined to employ labour (Chapter 6.8);

c. lowering minimum wages in the economy by the abolition of wages councils when obligations permit: this should be accompanied by a campaign to explain the beneficial job creation consequences which follow from lower wages (Chapter 6.3);

d. providing incentives for households to employ regular labour on domestic services and extending the Young Workers Scheme up to the age of 25; (Chapter 6.12)

e. altering the system of personal taxation and benefits so that, while retaining a safety net against family poverty, employers are more ready to offer and workers more ready to take low paid jobs (Chapter 7). This requires a more effective and visible system of supplementing incomes of heads of families in low paid jobs;

f. recasting benefit availability rules so that after an initial period claimants are expected to avail themselves of job opportunities in the secondary sector (Chapter 7.15);

g. extending the notion that small firms can offer jobs with minimum standards (Chapter 6.6) and especially to expand the scope for part-time work.

10.14 A shorter working life - in terms of the working week, year or career span - will be the reward of higher economic growth: but in the short run people should be given the opportunities of more flexible patterns of working time so long as they are not at the expense of efficiency and do not increase hourly pay.

**We recommend -**

a. the new job splitting scheme should be carefully monitored and possibly extended to cover a wider range of work-sharing options (Chapter 8.20);

b. within resource constraints, the Job Release Scheme should be extended as the most cost-effective way of using voluntary early retirement to help the unemployed (Chapter 9.18);

- c. supplementary benefit recipients should be allowed to retain more of their earnings as they take on part-time work (Chapter 7.18);
- d. in-work benefits should be extended to part-time workers (Chapter 7.18);
- e. consultations with industry should be initiated to see whether overtime can be reduced and more workers employed instead (Chapter 8.9);

10.15 Within existing public expenditure constraints, there is a case for reviewing priorities in terms of the extent to which different programmes generate employment or reduce unemployment. Major spending options should have their employment consequences documented and Special Employment Measures should have their real outputs evaluated so that the two kinds of activities can be compared. Ministers can then choose the best trade-off between employment and other objectives (Chapter 9.25). In particular labour intensive construction contracts should be considered. Also bureaucracy and waste in the public sector might be more effectively controlled by annual running cost targets rather than manpower targets (Chapter 6.16).

10.16 Within the general requirement for measures with a low net cost we favour, in descending order of priority, those which -

- a. increase private sector employment, for example, labour intensive construction contracts, a national scheme for enterprise allowances and an extended young workers scheme (Chapter 9.8);
- b. help the long term unemployed find jobs, by, for example, the use of vouchers within a wage ceiling; by encouraging "starters' rates"; including work experience in training programmes; paying a higher job-splitting subsidy for long term unemployed recruits. Reducing the numbers on the register for 12 months or more should be a formal criterion of effectiveness of employment measures (Chapter 9.21);



c. help people to use their time constructively while unemployed, notably through informal education and training, and also through shorter spells of community work for more people (Chapter 9.25);

d. allow workers in their fifties who have been unemployed for two years to leave the labour market on higher benefit (Chapter 9.25).

10.17 There are constraints to the early implementation of some of the above measures. For example, wages councils cannot be completely abolished until international obligations permit in 1985. Also considerable financial resources to alleviate unemployment are committed for some years ahead notably on the Youth Training Scheme and the Community Work Programme. This means that many of our proposals can only be implemented gradually.

#### **Scope for immediate action**

10.18 A short term programme must focus on measures to speed the upturn and to get the best outcome for employment. The economy should move out of recession in 1983, though recent reports from industry suggest a downgrading of earlier views on prospects. There is a danger that the longer the recession lasts, the more companies (especially in manufacturing) will lose faith in the possibility of a return to high levels of economic activity and remain ultra-cautious about extending plant, recruiting additional labour and training for the skills required in the upturn. At the same time there will be growth of new activities, though the strength of this and its employment consequences are difficult to estimate.

10.19 Given the uncertainties of the immediate outlook, it is not clear what headroom there is for real output growth within the broad confines of measures to reduce inflation and create conditions for sound and stable long-term growth. If, as now seems possible, the rate of inflation were to fall faster than previously forecast, this should result in higher headroom. If the Government takes no positive action this would be reflected in lower interest rates. But it can also consider active steps. The possibilities include -

- lower costs of employment;
- lower direct taxes;
- additional investment in labour intensive public works.

The choice between these depends upon the strength of their effects but also on the balance of employment and other objectives being sought.

### Interest Rates

10.20 The MTFSS targets for the growth of the money supply from now to 1984-85 look like being met and may indeed be improved on. Other things being equal, this should be associated with lower interest rates and, if we can be confident of this basic trend, should enable the monetary authorities to assist the reductions.

10.21 Lower interest rates help reduce the costs of the corporate sector and improve cash-flow across a wide range of industry. In turn increases in investment should follow, initially in stocks. As interest rates in real terms have recently been at historically high levels, this would be a welcome development and should pave the way for longer term economic recovery.

10.22 The constraint on hastening this process at present is that a fall in United Kingdom interest rates, compared to those abroad may cause the effective sterling exchange rate to fall. Whilst this may further help output recovery, it also feeds through into higher domestic prices. And in domestic terms, the scope for lower interest rates will be limited as demand expands and an equilibrium level is reached. The indirect short term effect of lower interest rates on employment may be relatively small since the level of interest rates does not directly influence the costs of employment. Indeed lower interest rates reduce the cost of capital. Higher investment should lead to greater employment overall via higher output, but there is no particular inducement to invest in processes which are labour intensive.

**Lower Employment Costs**

10.23 An alternative is to use fiscal headroom to increase employment directly, by reducing the costs of employment. Among these an important non-wage element is the National Insurance Surcharge. A reduction in NIS affects the whole range of employers. In the last budget NIS was cut to 2 per cent, but in the absence of any further action it will rise again to 2½ per cent. An announcement to the contrary needs to be made in the autumn at which time consideration should also be given to whether there is scope for lowering the rate further.

10.24 If the scope for reducing NIS is limited, a cheaper (though administratively more complicated) possibility would be to exempt companies from paying NIS in respect of additional workers employed compared with a given base date. Another possibility is to finance part of the reduction by cuts in capital subsidies (see Chapter 6.17):

**Lower direct taxes**

10.25 Lower direct taxes would increase demand (though part of this may go into imports and higher savings) and, given the awareness of take-home pay, should also help to bring wage settlements down. It would be important to use any scope for lower taxes to ease the problems of the unemployment trap. Raising the income tax threshold is one possibility: others are discussed at greater length in Chapter 7.9c.

**Public Works and Other Building Programmes**

10.26 A further approach is to devote part of any fiscal headroom to public works which meet important social and economic needs and which are also labour intensive in their application. The advantages of such programmes are that they have a low import content and will promote employment to the extent that they are labour intensive. Experience suggests that there will be some delay caused by the necessary administrative arrangements before a programme can get under way. For this reason if this option is to be pursued, work should be commissioned urgently to explore the possibilities.

### Priorities

10.27 It is for the Treasury to advise on the scope for any fiscal headroom at the present time. Of the measures just discussed, the CPRS view is that the highest priority should be given to reducing the NIS because of its direct impact on the cost of employing labour. Lower direct taxation, by raising the threshold would make jobs more attractive at the margin and would also boost demand generally. Lower interest rates are not wholly within the direct control of Government but have their most immediate effect in the business sector. Reducing taxes and lower interest rates both have the presentational advantage of being the rewards of success in the battle against inflation and high public expenditure. Although increasing public expenditure has corresponding presentational disadvantages, the possibility of an accelerated programme of labour intensive public works should nonetheless be explored to see if it could secure worthwhile economic and social improvements as well as create additional jobs. (Possibilities are discussed in Annex C).

10.28 Whichever macro-economic measures are taken could be accompanied by the early pursuit of a number of the proposals suggested earlier. Options which should be comparatively cost-effective include -

- a. active promotion of the job-splitting scheme, to include jobs of 15 hours per week which do not qualify for redundancy payments or employment protection measures (Chapter 8.14);
- b. reconsideration of a part-time Job Release Scheme (Chapter 9.18);
- c. extension of the Young Workers Scheme to the household sector (Chapter 6.14)
- d. extension of the enterprise allowance for self employment "start-ups" (Chapter 5.26);
- e. changes to social security benefits to increase the disregards for part-time working and an effort to increase the take-up of FIS (Chapter 7.18)
- f. an informal work preparation programme for the long term unemployed (Chapter 9.25).

CONCLUSION

10.29 Unemployment is a major problem and it cannot be wished away overnight. It is not a problem simply for Government, because its solution demands both action and changing attitudes from employers, trades union leaders and employees. Nonetheless, there is scope both for the Government to act and to lead and we have attempted in this report to suggest directions in which they might do so.

10.30 There have been two major themes to this report. One has been the importance for employment prospects of a vigorously growing secondary sector of the economy and many of our recommendations have that particularly in mind, whilst recognising that it is also important that the primary sector should thrive by becoming more competitive.

10.31 The second theme has been the need for real wages temporarily to fall. In the longer term healthy economy, real wages will be high, as a reflection of the material progress that will have been made and of the growing efficiency and productivity of the economy. But in the immediate future real wages have to fall to a level at which potential employers can afford them. The process will be slow and difficult but it has to be undergone. In the longer term we must aim to adjust our economic environment so as to achieve higher standards of living. In the short term we must be more modest and adjust our standard of living to the economic environment that we have.

## CATEGORIES OF THE UNEMPLOYED

**Measuring unemployment**

1. This annex focuses on how successfully the unemployment register measures the level and trend of unused labour resources in the economy. For this purpose, unemployment figures need to count people who are capable of work, without work, available for work and looking for work.

2. These concepts pose difficult problems of measurement, whatever the method used. "Work" is not a standard commodity and very few people are totally unrestricted in the kind of work that they seek or can do. Thus the economic significance of unemployment figures depends on how selective job seekers are about the work they want, how wide a range of work they are capable of performing and how hard they try to find a job. The answers to all these questions depend on subjective judgments. Hence the concept of a completely accurate and objective measure of unemployment is not obtainable in practice. The most that can be aimed for is a consistent measure which enables patterns and trends of unemployment to be identified.

3. There are two ways of measuring unemployment. The first, used by Britain and most European countries, is linked to an administrative process, either claims for unemployment benefits and/or registration with state employment services. The second, used for example in North America and Japan, relies on regular household surveys which question people about their employment status. Both methods have their advantages and disadvantages and there is much to be said for making use of both. Administratively derived figures provide a complete count, free from the sources of error associated with sample surveys, and a particularly convenient way of obtaining up to date figures for small geographical area. Their main disadvantage is that they are prone to "benefit" and other administrative distortions; eg they may include people who are not available for work but register in order to obtain benefits, and exclude people who are available for work but have no benefit

entitlement. (Non claimants of benefits currently count in British unemployment figures if they register for full time work with the employment service but from November 1982 only benefit claimants will be included in the unemployment count. Also, the coverage of job seekers may change over time or differ among countries because of changes in rules or differences in coverage of benefits, thus obscuring trends and international comparisons.

4. Survey based figures have the advantage that they are free from "benefit" distortions, can be designed to facilitate international comparisons and can obtain more detailed qualitative information eg about the intensity of people's search for work, which can shed extra light on the administration-based figures, and about household income.

5. Britain has in fact collected a limited amount of survey information about unemployment since 1970, in the annual general household survey (GHS). The GHS confirms the existence of a rising trend and a high level of unemployment in 1980 but the rise is less steep than indicated by the register and the level in 1980 not so high. The difference partly arises from the fact that the GHS only counts people who actively looked for work in the previous week, thereby excluding people who were actively seeking work but less frequently. This is thought to be a common pattern of behaviour for long term unemployed people who have already searched the local market. Many in this position rely on friends to tell them about new job openings. It would be necessary to cross check the GHS findings with other surveys and investigate in more detail the differences between them and the register before conclusions could be drawn about which source gives the better measure.

6. The following paragraphs discuss the main sources of over and under counting on the unemployment register. Where figures are given they are designed solely to suggest rough orders of magnitude. Their high degree of uncertainty must be stressed.

#### **Sources of overcounting**

7. The register may overstate unemployment because it includes the following categories.

A. "Hard to employ"

8. People who are virtually unable to produce useful work for reasons of health, or physical or mental disability should not appear in the unemployment figures because they ought to be classified as long term sick or severely disabled registrants who are excluded from the count. However, the dividing line between the unemployed with health problems who are counted and the long term sick and severely disabled who are not is bound to be arbitrary. Subjective assessments made by employment offices in the mid-1970s suggested that the number of men with poor prospects caused mainly by age, physical or mental condition or a combination, remained around the same level, about 135,000, between 1973 and 1976 (though unemployment overall rose markedly). A proportion of these subsequently did find work, a fact which illustrates the problems of defining "employability". There is no reason to believe that this group of unemployables has grown. Indeed, the number of long term sick of working age has increased by over 100,000 since the mid-1970s and it is plausible that some of these would previously have been classed as unemployables among the unemployed.

B. "Working while signing"

9. This category comprises people who are not unemployed because they are already working in the black economy. Information about the black economy among the unemployed has improved recently as a result of the work of DHSS's newly formed Specialist Claims Control (SCC) teams. These teams visit local offices and typically investigate perhaps the most suspicious 5 per cent of the unemployed who are receiving benefit in that area. Typically between 30 and 70 per cent of the people investigated withdraw their claims or have their benefit stopped or reduced. In the majority of cases the amount of revealed earnings exceeds the total amount of benefit entitlement. A minimum estimate of the registered unemployed who are secretly working is thus around 2½ per cent of the total. The full extent of "working while signing" is unknown but it is likely to be larger than this minimum, and probably much larger, due to activities among the 95 per cent of unemployed benefit recipients who are not investigated by the SCC teams. It is quite plausible that, say, 10 per cent of these receiving benefit as unemployed are not entitled to it. In this case the unemployment register would be inflated by some 300,000.



C. Not available for work

10. This group are not working but would de-register rather than take a job, if deprived of benefit. They primarily include older workers who have retired on an occupational pension, or on ground of health and redundancy, but sign on to claim benefits or preserve state pension rights. There are also others - mostly but not exclusively married women - who have withdrawn from the labour force for domestic reasons but sign on for a period to draw NI benefits. Survey evidence suggests that about 150,000 registrants may regard themselves as having retired. There may also be workers who want and can afford a short rest between jobs, but sign on for benefits in the expectation of not being offered a job rapidly. We have no idea how many people, if any, are in this category, but the opportunity to behave in this way is greater when vacancies are scarce.

D. Not looking for work

11. This is a category who would need to work if deprived of benefit but do not look for work. Surveys up to 1980 tend to show 10-20 per cent (equivalent to 300-600 thousand if applied to the present register) not seriously looking for work in a given week. Taking the upper limit and allowing for categories B and C would suggest that there are up to 150,000 in category D. Special surveys suggest that the most common reason for not looking is that people believe (perhaps mistakenly) there are no jobs available for them. This phenomenon of discouraged workers is bound to have risen at current levels of unemployment. The people concerned would begin looking again if the market improved. This leaves the "workshy", people who prefer living off benefits to working. It is often argued that people with high benefit/work income ratios will fall into this category. Yet evidence suggests that such people look harder for work than others. They are more properly regarded as selective job seekers.

E. Selective job seekers

12. There are probably considerable but unquantifiable numbers of people who are genuinely unemployed, but who contribute to a higher than necessary level of unemployment by being selective in the kind of work they will accept, with the result that vacancies remain unfilled longer. The rules for unemployment benefit and the aims of the employment service, with their emphasis on "suitable employment", sanction a considerable degree of selectivity.

13. Lower benefits and stricter rules on refusal of job offers would probably lead to faster job filling. In present circumstances, however; getting some people back to work more quickly would, to a considerable event, displace others into unemployment. Econometric studies suggest that in present circumstances a 10 per cent cut in benefits would reduce the register by perhaps 100,000.

Summary of overcounting

14. Allowing for considerable overlap between the unfit and the inactive, the estimates in paragraphs 8 and 11 would prima facie suggest that somewhere around half a million of the register would not meet a strict interpretation of the definition in paragraph 1, ie of being without work, available for and capable of work and seeking. The uncertainties surrounding this figure are great. Moreover overcounting is only one side of the story.

Sources of undercounting

A. Uncounted registrants

15. Students registering for vacation work (up to 200,000 at the seasonal peak), and people laid off temporarily (10-20,000) are excluded from the regular count. None of these is in the market for regular full time jobs and their exclusion is consistent with a view of the register being primarily a measure of people seeking permanent full time jobs. But the register does include claimants seeking only part time work (numbering a few tens of thousands).

B. Non-claimants

16. At present the count excludes about 50,000 registrants for part-time work (mostly married women) who have no claim to benefits. (Non-claimants seeking full time work - some 100,000, excluding school leavers - are currently included but will be excluded from October 1982.)

C. Unregistered job seekers

17. The Department of Employment estimates (from household surveys up to 1980) that about 300-350 thousand people are looking for work but not registered with the employment service. Three quarters are women, two in three of whom are seeking part time work. Their value to potential employers will be limited in many cases by their need to find hours and conditions of work which fit in with domestic responsibilities. This category probably includes only a few of the 380,000 single parents who receive supplementary benefit but are not required to register for work.

D. Special measures

18. An estimated 305,000 people (net) are currently kept off the register by special employment and training measures. They are a labour supply in the sense that the schemes reduce the register artificially.

E. Discouraged workers

19. The recession has led to increased staying-on in school, a fall in married women's participation rates and a sharp increase in early retirement. The Department of Employment is unable to estimate precisely how many have withdrawn from the labour force or have been discouraged from entering it. The figure is, however, likely to run into several hundreds of thousands. Between early 1979 and early 1982, the "working population" - the employed labour force plus the registered unemployed - fell by 600,000 despite a rise in

the population of working age. (Mid-year estimates for 1979 and 1982 show an increase in the population of working age - aged 16 or over, but under retirement age - of 500,000.) Discouraged workers represent a hidden labour reserve which is likely to re-emerge as and when job prospects improve. In past periods of recovery, every extra four jobs generated has brought one extra worker into the labour force.

Summary of undercounting

20. The register excludes about 150,000 unregistered people seeking full time jobs, around 300,000 people on special employment measures and, at the present time, several hundreds of thousands of "discouraged workers". The register is a very inadequate measure of the labour supply for part time work, partly because it excludes the categories at A-E above, but also because large numbers of retired people, housewives, students, school children and those already in work are potentially available for part time work, without necessarily registering or looking regularly for work.

**Net effect of under and overcounting**

21. In terms of the strict definition of unemployment the register appears to be exaggerated by a few hundred thousands but if discouraged workers are taken into account, the register probably now understates the numbers wanting jobs. But the uncertainties on both sides of the equation are large. On balance, the register provides a reasonably unbiased measure.

Implications for the trend of unemployment

22. Similarly, the deficiencies in the register do not appear to obscure the general underlying trends in unemployment. On the one hand the register may exaggerate, perhaps by up to half a million, the rise in the numbers unemployed and actively seeking work since days of full employment: higher benefits probably induced about 50,000 extra frictional unemployed by the early 1970s (the shortage of vacancies to test availability may have had a bigger effect); at least 100,000 of the increase reflects an increase propensity of job seekers (mostly women and girls) to register as unemployed; laxer administration coupled with shortage of notified vacancies may have

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allowed more people to participate in the black economy. On the other hand, the increase would have been 300 thousand greater but for the introduction of special employment measures. The upward trend in unemployment was moreover accompanied by the withdrawal of several hundreds of thousand of workers from the labour force in the present recession.

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## THE SOCIAL SECURITY SYSTEM AND UNEMPLOYMENT

1. This annex considers whether the tax and social security system imparts a "floor" to wages. (This impact is separate from the long-recognised relationship between the level of benefits and the time taken in job search by the "temporarily" unemployed, though arguably it is an extreme form of this relationship.) There are two possible mechanisms. First, the tax and social security system may affect the behaviour of the unemployed: when wages begin to fall people cease looking for work and de facto drop out of the labour force because they find flat-rate unemployment benefits more attractive than the jobs and wages on offer. Second, the tax and social security system may influence the behaviour of employees and employers. Even with very large declines in demand employers may be unwilling to recruit at significantly reduced wages because they believe taxes and benefits define the minimum level of wage that it is socially acceptable to offer. At the same time employees may resist reductions in real wages on the grounds that they would be better off unemployed. Both these mechanisms may operate together. Below we review the evidence in relation to each.

2. Until recently there has been very little hard evidence on the relationship between incomes in work and out of work for people experiencing unemployment. Most discussion has centred on illustrative family types and has, perforce, been based on a range of assumptions about the normal earnings levels, family characteristics, other sources of income and benefit take-up rates of the unemployed. In the last year or two the position has improved mainly because of the results coming out of the DHSS cohort study of the unemployed. Tables B1 and B2 draw on these results to provide a more comprehensive picture of "income replacement ratios" ie incomes out of work as a proportion of incomes in work -

Table B1 uses the best information on the actual previous earnings of the unemployed to show the position in November 1981 of the average man experiencing unemployment in each family type, on the assumption first

that there are no other sources of family income except his own earnings (when in work) and various social security benefits, and second that all social security benefits for which he is eligible are claimed. It therefore shows the 'theoretical' replacement ratio for an illustrative example within each family type.

Table B2 shows the distribution of actual replacement ratios for men of each family type becoming unemployed in the autumn of 1978. It takes account of the presence of other sources of family income, such as wives' earnings and occupational pensions, and of the incomplete take-up of social security benefits.

3. With one important exception both tables take into account all the major elements relevant to comparisons of incomes in and out of work.\* Allowance is made for all the main means tested benefits - housing benefits, free school meals, free welfare milk, family income supplement, as well as supplementary benefit. The tables exclude free prescriptions and assistance with dental and optician bills but their value is likely to be highly variable and generally small. Moreover they are also available to low income families in work. Both tables also include travel to work costs - the actual reported costs in the case of table B2 and national average costs for Table B1. They do not include the costs of special clothing required when in work or the extra costs of meals. On the other hand, no allowance is made for in-kind benefits provided to those in work; the DHSS cohort study found that about half of the men becoming unemployed received free meals or other in-kind benefits in their last job. It seems reasonable to conclude that the extra costs of work and the extra "perks" roughly cancel each other out. Finally, the calculations make no allowance for the effect of unemployment on tax obligations. They therefore understate replacement ratios prior to the taxation of benefits in June of this year. However, in practice only a minority of the unemployed

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\* For obvious reasons they do not incorporate earnings in the "Black Economy". The little information available suggests that these will be significant for only a small proportion of the unemployed (see Annex A). In some areas (eg moonlighting) the earnings may affect both sides of the comparison.

TABLE B1 ILLUSTRATIVE INCOME REPLACEMENT RATIOS FOR THE MALE UNEMPLOYED:  
NOVEMBER 1981

| FAMILY TYPE             | % of male unemployed (Nov 1981) (3) | Average Gross Earnings(1) (2) | Total Income Support in work (4) | Total Income Support out of work on Sup Ben (4) | Replacement ratio (columnn 4 as % of column 3) (5) |
|-------------------------|-------------------------------------|-------------------------------|----------------------------------|-------------------------------------------------|----------------------------------------------------|
|                         | 1                                   | 2                             | 3                                | 4                                               | 5                                                  |
|                         | %                                   | £                             | £                                | £                                               | %                                                  |
| Single man, under 20(5) | 14                                  | 66                            | 44.6                             | 21.2                                            | 47                                                 |
| Single man, 20+ (5)     | 39                                  | 107                           | 70.1                             | 38.1                                            | 54                                                 |
| Married man, 0 children | 23                                  | 130                           | 88.9                             | 52.6                                            | 59                                                 |
| Married man, 1 child    | 8                                   | 125                           | 91.0                             | 65.4                                            | 72                                                 |
| Married man, 2 children | 9                                   | 147                           | 110.0                            | 76.5                                            | 70                                                 |
| Married man, 3 children | 4                                   | 139                           | 110.3                            | 90.6                                            | 82                                                 |
| Married man, 4 children | 3                                   | 128(2)                        | 114.6                            | 107.2                                           | 93                                                 |

Notes:

1. Based on 1978 DHSS Cohort Study figures, updated to November 1981
2. Based on men with 4 or more children in Cohort Study.
3. Males represented 72 per cent of the unemployed.
4. Illustrative values for householders (except single men under 20).
5. On the assumptions that single men under 20 are non-householders but receive the Sup Ben rate for men aged 18 or over, and that single men aged 20 or over are householders.

Total Income Support in Work: Gross Earnings, minus income tax, NI contributions and fares to work, plus FIS and Child Benefit, free school meals, free welfare milk, and housing benefits.

Total Income Support out of Work: Total Supplementary Benefit payable including housing element and water rates, plus free school meals and free welfare milk.



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TABLE B2 ACTUAL INCOME REPLACEMENT RATIOS\* FOR MEN BECOMING UNEMPLOYED IN 1978 - EARLY PART OF SPELL\*\*

|                              | % of male unemployed stock (Nov 81) | Income Replacement Ratios |           |            |       | Total |
|------------------------------|-------------------------------------|---------------------------|-----------|------------|-------|-------|
|                              |                                     | Up to - 50%               | 50% - 80% | 80% - 100% | 100%+ |       |
| Single men                   | 53                                  | 67                        | 28        | 3          | 2     | 100   |
| Married couple no children   | 23                                  | 30                        | 43        | 16         | 11    | 100   |
| Married couple 1 child:      | 8                                   | 18                        | 48        | 21         | 11    | 100   |
| Married couple 2 children    | 9                                   | 22                        | 46        | 22         | 9     | 100   |
| Married couple 3 children:   | 4                                   | 13                        | 47        | 25         | 14    | 100   |
| Married couple 4 + children: | 3                                   | 12                        | 32        | 33         | 24    | 100   |
| Total                        | 100                                 | 45                        | 36        | 12         | 7     | 100   |

\*All sources of regular family income while out of work, including unemployment benefits, housing benefits, free school meals, wives earnings and occupational pensions expressed as a proportion of total weekly family income prior to unemployment.

\*\* Ratios relate to the first three months of unemployment.

appear to have claimed tax refunds before they returned to work, suggesting that the majority were not fully aware of the tax advantages of the past position. Under the new regime tax rebates will generally be very small and will not usually be paid until the return to work. The tables are therefore a reasonable representation of the position that obtains since benefits were brought into taxation.

4. The main points to emerge from the tables are that-

- most of the male unemployed (about 75%) are single men or married men without children. Less than one in ten fits the stereotype of a wife and two children. (Family men with children have been a steadily declining proportion of the register for the last ten years);
- taking account of the actual earnings of men experiencing unemployment, calculations of illustrative replacement ratios suggest that only for men with three or four children is the typical ratio high, ie over 75% (Table B1). For the great bulk of the unemployed without children the "typical" ratio is 60% or lower;
- the actual family income replacement ratios found by the DHSS cohort study are broadly consistent with the illustrative examples, though there is a wider dispersion than the simple averages might suggest. Early in their spells of unemployment about a fifth of all men had replacement ratios of over 80%, including 7% with ratios of over 100%. A little under half had ratios below 50%, (Table B2). While only 5% of single men had ratios of over 80%, the proportion rose to 27% for married couples without children and to 31% for married couples with two children.

5. A number of comments should be made on the significant proportion of men (20 per cent) with actual income replacement ratios of over 80 per cent. First, the main cause was a combination of low earnings - about half of the men with ratios over 80 per cent were in the bottom decile of the earnings distribution - and high benefits. Second, another contributing factor was the possession of other sources of income, apart from benefits and the man's

earnings. The presence of working wives or occupational pensions serves to raise replacement ratios, particularly for married couples without children. In such circumstances the ratios exaggerate the implicit tax rates involved in a decision to return to work; a rough adjustment suggests that about 15 per cent of all men becoming unemployed in 1978 faced tax rates of 80 per cent or more. A third factor was the low receipt of means tested benefits in work, in contrast to the assumption of 100 per cent take up in the illustrative comparisons. For example, in the DHSS sample less than a quarter of those eligible appeared to receive the housing benefits to which they were entitled while in work. A final point is that high replacement ratios did not stop most of the men returning to work fairly rapidly: 9 months after becoming unemployed over three quarters of those with replacement ratios of 80 per cent or more had returned to work.

6. Since 1978 the numbers and characteristics of the unemployed have changed and there have been important tax and benefit amendments, including the phasing out of earnings related supplement (ERS). On balance, on the basis of their earnings prior to unemployment, the proportion of men becoming unemployed for whom a return to work involves an implicit marginal tax rate of 80 per cent or more is now probably less than 15 per cent. However, it can be argued that at a time of deep recession past earnings are not a good guide to current choices; the available job opportunities, predominantly in the small firm non-unionized sector, may offer wages that are well below the previous earnings of those unemployed who have lost jobs in the large unionized establishments. This will certainly be true for some of the unemployed. But the DHSS cohort study and the more recent (May 1980) MSC cohort study both suggest that the unemployed come largely from low wage employment in small establishments. Nearly half the DHSS sample reported fewer than 25 employees at their usual place of work and although the MSC cohort was selected at a time when redundancies were beginning to rise rapidly, only 40 per cent of the men reported union membership in their last employment. For many, and possibly most, of those currently becoming unemployed, earnings in their last employment may therefore not be a bad guide to the earnings opportunities they face once unemployed.

7. The information on replacement ratios needs to be put alongside evidence on job search behaviour. Surveys of the unemployed have consistently shown that -

- most of the registered unemployed are actively searching for work, though there is a minority who, for a variety of reasons, do very little to help themselves; for example, a survey in 1980 of men and women who had been out of work for about four months found that four-fifths were using one or more of the "normal methods of job search" (as defined by the MSC), but about a fifth reported using none of them;
- many of the unemployed indicate a willingness to accept a real wage below their earnings in their last job, though again there is a minority who are inflexible. For example, in a 1978 survey of men who had been on the unemployment register for about one month, half reported a willingness to accept a significant drop in their real pay. About a third, mainly men with previous very low wages, appeared to require an increase in their pay. In practice, over 80 per cent returned to work within a year, at least half of them for a wage below their original "reservation wage";
- in current circumstances few of the unemployed report turning down job offers. A national survey in mid 1980 found that 12 per cent of people unemployed for about a month had turned down a job offer, but the proportion rose with socio-economic group from 4 per cent of unskilled manual workers to 16 per cent of professional and managerial workers. Men in the same sample who had already returned to work reported a rather higher turn-down rate.

8. At the same time information on vacancies does not indicate that many low paying jobs remain unfilled for an extended period. A 1977 survey found that 90 per cent of the unskilled vacancies that were notified to be filled by Job Centres were filled within 6 days. Since then there has been a large fall

in the number of unskilled and semi-skilled manual vacancies on the Job Centre books, down from 90,000 in December 1978 to 35,000 in December 1981, and a large rise in the ratio of unskilled and semi-skilled unemployed people to such vacancies, up from 9 to 1 to 44 to 1. A small scale exercise earlier this year indicated there were only about 2,000 vacancies on the Employment Service's books that were proving difficult to fill for reasons of low pay. Studies of the residue of jobs that remain unfilled or are difficult to keep filled (for example, traffic wardens in London), have usually identified low pay as only one among several contributing factors, including unrealistic qualification requirements, vacancies that are purely "theoretical", poor working conditions, unsocial or long hours, and difficult locations.

9. It seems reasonable to conclude that although a small minority of the register show little active interest in finding work and a rather larger number are selective about the kinds of work sought, current social security benefit levels are not causing large numbers of the adult unemployed to choose to remain permanently out of work. Hence this mechanism is unlikely to be seriously constraining wage flexibility. This is not, of course, to deny that benefits and taxes will influence the time taken over job search by the great bulk of the unemployed who regard themselves as temporarily out of work: in Annex 5 to MISC 14(82) 1 it was estimated that in present United Kingdom conditions a 10 per cent cut in social security benefits might lead to a fall in unemployment of some 100,000 in the short term. More recent work is consistent with this estimate.

10. The second mechanism through which benefits might act as a wage "floor" - by influencing the behaviour of employees and employers - is more difficult to test. One possible approach would be to ask employers what determines their minimum wage levels and whether the tax and benefit system inhibits them from offering less. Similar questions could be put to employee representatives about the determination of wage demands. We are not aware of any surveys that directly address these questions, though some useful information should be obtained from monitoring the Young Workers Scheme and from forthcoming research on Wages Councils.

11. In the meantime there is piecemeal evidence that employers see 'the going rate', 'collective agreements', 'the unions' and 'Wages Council awards' as the main explanations for their minimum wage rates. Social security benefits reportedly do enter into discussions about Wages Council awards from time to time. The ceiling on eligibility for Family Income Supplement (the 'prescribed amount') has been used by employees as an argument for larger awards. On the odd recent occasion on which supplementary benefit levels have been quoted they have apparently been referred to by employers as arguments for recommending smaller rises. Social security benefit levels have also featured in the wage claims of low paid workers in the public sector for many years. For example, Family Income Supplement prescribed amounts have been treated as defining "poverty wages" in recent claims by both civil servants and National Health Service auxiliary workers. There are also regular references to some workers, usually family men, being better off out of work. While benefit levels for families obviously make good, if misleading, bargaining points (very few workers in the lowest wage grades are family men) it is not clear that their role in wage negotiations has become any larger over the last ten years.

12. If any conclusion is possible from such impressionistic evidence it is that the benefit and tax system is just one of several elements that contribute to setting a 'floor' to wage settlements and to employer wage offers. For most of the unemployed, even the lowest wage levels are well above the level of benefits. Moreover, in 1979, the latest year for which we have information, only 4 per cent of single people and family heads in full time work were estimated to have incomes less than 40 per cent more than their supplementary benefit entitlement (and the proportion had fallen since 1975). The numbers of full-time employees with incomes that provide only a small margin over their benefit entitlement will have risen since 1979, reflecting the developments discussed in Chapter 7 (see particularly, Figure 8). But the overall numbers will still be very small. Therefore if benefit levels do significantly influence wage offers and wage settlements it must be because employers are consciously or unconsciously aware of the benefit entitlements of families with children and assume the need to provide a 'family wage'.

LABOUR INTENSIVE PUBLIC WORKS

1. In recent years there has been a significant cut-back in all public sector capital programmes, partly because it is much easier to postpone a decision to carry out investment than to reduce current expenditure. Furthermore, the effects of such cuts are not felt immediately. However this decline in public sector capital programmes, coupled with the effects of the recession on private sector capital works, has now worked its way through, and is giving rise to very high levels of unemployment among building and construction workers - not least among the unskilled labourers.

2. A boost to the construction industry could be made to provide more real jobs (at least in the short term) while at the same time it would provide useful and productive output. These are major advantages over 'make work' schemes. Furthermore -

- the sector can respond quickly to stimulus
- there is little import penetration (about half that of manufacturing industry)
- it is relatively labour intensive,
- a high proportion of the labour is unskilled (about one third) for whom there is often no alternative employment
- wage rates are not dominated by national agreements, but are more responsive to local market conditions (about 90 per cent of the firms employ less than 25 people).

3. Some types of construction work are more labour intensive than others. The table below gives estimates of the number of man-days of site labour per £1000 worth of contract (1970 prices) for various types of new construction

|                             | Public<br>Housing | Private<br>Housing | Education | Hospital | Other | Industrial | Commercial | Roads | Water | Sewerage |
|-----------------------------|-------------------|--------------------|-----------|----------|-------|------------|------------|-------|-------|----------|
| Skilled and<br>Semi-skilled | 41.2              | 39.8               | 42.8      | 40.3     | 38.3  | 34.8       | 28.8       | 14.3  | 16.0  | 14.2     |
| General Labourer            | 14.5              | 16.8               | 15.5      | 12.6     | 16.3  | 15.5       | 9.7        | 13.2  | 8.1   | 14.3     |
| Total                       | 55.7              | 56.6               | 58.3      | 52.9     | 54.6  | 50.3       | 38.5       | 27.5  | 24.1  | 28.5     |

Employment of site operatives: site man-days per £1000 contract value at 1970 prices  
 (Source: How flexible is construction, HMSO 1978)

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work. This shows that the labour content of building work is about twice (£ for £) that of civil engineering work, although the latter requires a higher proportion of site supervisory staff. Within building, there is little to choose between the types as far as labour intensity is concerned. There is also evidence that the labour content of building (or at least of house building) has been declining by an average of about 3 per cent per annum over the last 20 years or so. This is due partly to design changes, but partly to methods of construction and in particular the greater use of prefabricated materials. Although there is little hard evidence, it is believed a similar fall has taken place in civil engineering works primarily due to the increased sophistication of plant.

4. For house improvement work the labour content is very similar to that for new house building (£ for £ but not per dwelling unit). This somewhat surprising fact is due to the high value of materials used in improvement work (eg fitted kitchens) compared with the bulk of materials used in new construction (eg bricks). However the skilled component of the labour is about 25 per cent higher for improvement work than for new building.

5. For repair and maintenance work, in both building and civil engineering the labour content is significantly higher than for new work, and the difference between building and civil engineering is narrowed.

6. For all types of construction work there is of course an indirect employment effect associated with the materials used. Only about a quarter of the total materials used are imported (mainly timber), about half the proportion for manufacturing industry. One estimate suggests that the figures may be as high as an additional 30 per cent employment for housing work and 50 per cent for civil engineering.

7. To increase employment in the construction industry, there are three possible approaches. First the Government could seek to increase demand from the private sector for the products of the construction industry; the budget measures on housing were examples of this. Secondly improvement grants for private housing have for some time been designed to increase

rehabilitation: it would be possible to extend these, by for example relaxing the conditions on which they are given, or increasing the grant percentage. A similar grant system could be developed to encourage renovation and/or conversion of industrial premises.

8. Thirdly, the public sector nature of much of the work offers a very direct way of increasing employment while improving some of the physical infrastructure. There are a number of advantages -

- there is no shortage of valuable work which needs to be done
- much of the output is infrastructure which can increase the effectiveness of industry in an economic recovery
- any boost can be targeted at geographical areas of high unemployment
- even though the expenditure would be public sector, the employment would, on the whole, not be (only around 10 per cent of public sector work is done by direct labour).

9. The simplest and most direct way of doing this would be to expand selected public sector capital programmes. We consider four examples. Public sector housing is mainly the responsibility of local authorities. Because of the block allocation of capital to local authorities, there is no guarantee that any increase would in fact be used for housing. Furthermore the local authorities have underspent their capital allowances for housing for last year.

10. Government capital funds for the Housing Corporation are better able to be steered than those for local authorities; they cannot leak through to revenue spending and the Housing Corporation could be advised to allocate funds only to those housing associations with a proven track record. Because of the heterogeneous nature of housing associations there would be policing problems requiring some extra administrative staff in the DOE and in the Corporation. The capital budget of the Corporation is around £600 million now, and it might prove possible to increase it by, say, £100 million per annum over each of the next three years. There would, of course, be presentational problems associated with extra money for housing associations and not for local authority housing.

11. As this would be new money it could, with little difficulty, be channelled to those associations that were prepared to give a degree of priority to applicants seeking to move home for employment reasons. In the CPRS study on labour mobility, we recommended that Ministers should consider using housing associations to provide the flexibility of allocation so manifestly lacking in most local authority allocation schemes.

12. For roads the very long lead time for new construction means that attention should be concentrated on ways of increasing repairs and structural maintenance. Not only is there a large backlog of such work anyway, but as noted above it is more labour intensive. Some roads come directly under Government control, but even for those that are the responsibility of local authorities, the Transport Supplement Grant system offers a more powerful lever to direct spending.

13. For sewers, again there is a very large backlog of repairs and maintenance in many areas. Here Government has powers of direction under the Water Act 1973, to make funds available to water authorities for specific purposes.

14. In health there is a massive backlog of maintenance repairs and redecoration. The financial allocation mechanism would allow funds to be earmarked for such purposes: the health authorities could be invited to draw up programmes for the work and put in bids for money through the normal channels.

15. We have not sought to estimate the scope for increases in labour intensive capital programmes in the immediate future: this will depend upon the amount of fiscal headroom available and other measures which are allowed to have priority. The merit of these schemes is that they lead to an increase in real jobs in a cost effective way and constitute replacement or refurbishment tasks which are going to have to be done anyway at some point in the near future.

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