From: The Rt. Hon. Peter Walker, M.B.E., M.P.

MCS c/f 3

HOUSE OF COMMONS

(2)

Prime Minister

Mr Walker forwarded his Chequers paper to you under this letter.

MCS 2/9

SECRET & CONFIDENTIAL

16th August 1983

Dear Margaret

I enclose a paper for our consideration at the Chequers meeting in September.

I leave you to decide to whom it is circulated.

Yours ever, Peter

The Rt Hon Margaret Thatcher, MP,
The Prime Minister,
10 Downing Street,
London, S.W.1.

I hope you have had a good holiday.

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10 DOWNING STREET

From the Private Secretary

5 July 1983

Dear Julian,

STRATEGY FOR UNEMPLOYMENT

The Prime Minister plans to hold meetings at Chequers on Tuesday 6 and Wednesday 7 September, to consider what the next steps should be in the Government's strategy for creating a more enterprising and prosperous British economy, and thus reversing the growth of unemployment.

Mrs. Thatcher has asked, in letters addressed separately to each of the Ministers concerned, for papers for discussion at Chequers under the following headings:

Chancellor of the Exchequer

1. What changes should be made to the taxation system, to tax rates, thresholds, allowances and other aspects of tax legislation or administration to reduce costs for industry and to stimulate the creation and expansion of new enterprises and to reduce unemployment?

2. Can the resources currently devoted to regional policy be better deployed to encourage the growth of lasting jobs?

3. What further progress can be made in the lifetime of this Parliament in privatisation, contracting out, and, generally, the opening up of the public sector to market forces?

4. Could public expenditure policies be altered to bring more to the fore the improvement of employment prospects?

5. Can an affordable scheme for portable pensions be devised? As an input to a paper on the subject, I am sending you, under separate cover, a paper produced by the CPRS.

6. Passport for a Job (secret and personal minute to the Prime Minister of 1 July by the Chancellor of the Duchy).

Secretary of State for Trade and Industry

1. What more can be done to eliminate or reduce restrictions on the wealth-creating part of the economy - e.g. building, planning and environmental regulations?

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2. What can the Government do, without higher expenditure, to encourage growing industries rather than support declining ones, and in particular to help industry to adapt to, and to exploit, new technology?

Secretary of State for Employment

1. How can we reduce more quickly barriers to employment, for example, Wages Councils, and some of the requirements of the Employment Protection Act?

2. What changes should be made, in trade union law and otherwise, to reduce trades unions power to obstruct changes, reduce labour mobility and generally to damage employment prospects?

Secretary of State for the Environment

What changes should be made in the Government's housing policies to assist labour mobility?

Secretary of State for Education and Science (in consultation only with the Department of Employment)

How can the efforts of schools, higher education, the MSC and industry be best deployed to give workers and managers the skills and enterprising approach they require? Should we, for example, shift support of first degree students from the mandatory grant system to employers' sponsorships? How can we best give teachers a better insight into the requirements for success in industry and commerce? What extensions are required to the present arrangements for technical education?

The Prime Minister would also be grateful for any papers which the Secretary of State for Energy might wish to offer on any of the above topics, or in any other areas in which he believes decisions are required to encourage enterprise, wealth creation and employment opportunities.

Mrs. Thatcher particularly hopes that each paper will avoid generalities and will concentrate on the specific decisions which need to be taken.

The Prime Minister would also be grateful if you would ensure that any papers which the Secretary of State for Energy may present are sent to the Prime Minister by Friday 26 August at the latest. Mrs. Thatcher has asked me to emphasise that she wishes the fact of the Chequers meetings, and of the papers prepared for those meetings, to be closely guarded, and that she hopes that the Secretary of State for Energy will prepare his papers on a personal basis without departmental or inter-departmental advice and consultation.

I enclose two notes by Alan Walters about recent academic work on unemployment, supplementary benefit and relative wages, to

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which reference was made during last week's Ministerial discussion; and a wide-ranging note which the Prime Minister believes will form a useful background for the Chequers discussions.

Yours sincerely,

Michael Scholar

J.D. West, Esq.,
Department of Energy.

PAPER 20, by

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From: The Rt. Hon. Peter Walker, M.B.E., M.P.

HOUSE OF COMMONS

SECRET AND CONFIDENTIAL

16th August 1983

Our objective must be to compete successfully with our major competitors so that when the world moves firmly out of recession the British economy obtains a permanent advantage. If the world moves out of recession and it is primarily our competitors who benefit unemployment will become a permanant feature and one that will certainly create considerable social divisiveness.

It is important therefore to analyse objectively our current economic situation as compared with that of our competitors.

PRODUCTIVITY

The following table shows that output per person over the last five years has increased in manufacturing industries by a lesser degree than in the previous decade.

Manufacturing Output Per Person - Average Annual Change		
1963-72 3.6%	1972-77 2.3%	1977-82 1.5%

It is true that in 1981 and 1982 there were substantial improvements in productivity although not as great as in the years 1967 and 1968 or the years 1972 and 1973. A substantial part of the improvement has been due to the drop in productivity per person in 1980. (See Chart 1).

The reality is that with all the pressures of the recession and with the massive changes in labour saving technology the performance of productivity has not been good.

INVESTMENT

Investment throughout the recession has been at a lower level than that of our competitors and has shown a substantial fall as illustrated by the attached Graphs 2 & 3.

There is a great deal of unused capacity which results in firms clinging on to this unused capacity rather than installing the most updated machinery. As the world economy recovers we will find ourselves at a distinct disadvantage compared with the United States, Germany and Japan where

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substantial new investment has taken place in a diversity of industries. In France key sectors such as electronics and the food industry are enjoying substantial investment with strong Government incentives.

% Change in Volume of Gross Fixed Investment 1979-82

France	0.8
Germany	- 6.3
Japan	6.2
U.S.A.	- 8.0
U.K.	- 8.4

UNEMPLOYMENT

I fear a complacency that because we won the election with 3½ million people unemployed and no one has predicted any substantial fall there is the belief that we will continue on that sort of level for several years to come.

We need to recognise the numbers of people who are becoming unemployed for a period of more than a year; a figure that will rise by more than 250,000 this year. There will also be a substantial number enjoying temporary employment under various Government schemes who will be unable to find employment when those schemes end. A projected growth rate of between 2% and 2½% would be needed to start a downward drift to unemployment and anything less than that would result in a deterioration.

INFLATION

We obviously obtain benefit from the lowering of inflation compared to the previous heights, but it is a benefit that is being shared by most of our competitors. (See Graph 4).

The improvement in inflation has not brought about the lowering of real interest rates that were originally predicted. The real rate of interest has increased and remains a heavy deterrent against investments. (See Graph 5).

The following table shows our current unfavourable position.

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Real Interest Rates** at August 1983				
	Using GDP deflator*		Using CPI deflator*	
	3 month commercial rate	10 year public debt rate	3 month commercial rate	10 year public debt rate
USA	5.7	7.6	7.4	9.3
UK	5.0	7.0	4.7	6.7
France	1.9	2.8	0.9	1.8
Germany	2.1	4.8	3.1	5.8
Japan	4.9	6.2	4.3	5.7
Italy	1.6	2.0	2.1	2.6

PUBLIC SECTOR BORROWING REQUIREMENT

Different combinations of public expenditure can have markedly different effects both on the demand side of the economy and on the level of supply in both the short and the long term. Equally different types of taxes affect demand and supply differently. It follows that in itself the PSBR is an inadequate guide to policy though in combination with other measures it may retain a general usefulness.

The PSBR is most distorted as a tool for economic management when considering the effect of direct shifts between public sector borrowing requirement and the company sector borrowing requirement. A large reduction in the rate of corporation tax, for example, would raise the PSBR but reduce the CBR by a directly corresponding amount and without imposing any shift in the overall balance between sources and uses of investible funds so that interest rates and money aggregates would be unaffected by the direct effects.

Clearly different types of government expenditure have different effects on the economy. The demand-side (or output) effects of expenditure will vary according to the leakages into savings and net-imports, e.g. recipients of transfer payments will tend to save part of the extra income and spend some on imports whereas government capital expenditure is likely to involve smaller first round leakages. A "demand weighted" PSBR total can therefore be constructed by weighting the components of expenditure and revenue according to their multiplier effects. The demand-side impact of public investment compared to transfers or current expenditure therefore depend in the first instance mainly on the import content of the investment, since the second round effects will be broadly similar. Latest Treasury estimates suggest that given a flexible monetary policy, an extra £1 billion

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"basket" of Nationalised Industry investment each year would raise GDP 50% more than an increase in social security transfers etc. of equivalent PSBR cost.

The supply-side effects of government spending are relevant to the trade-off between current and capital expenditure. A recently revived view is that the government, like a company, should borrow for investment purposes only rather than for current expenditure. If this view is accepted then the fact that public sector investment has been substantially higher than the PSBR in eight out of the last ten years would justify the PSBR levels of the last decade. This would however be a misleading conclusion, since investment is compensated for by future profits (higher output and consumption). The public sector's record in identifying profitable investments is not good: average rate of return on public sector investment has been around zero for many years. There is good reason to suppose that the private sector is better at identifying profitable investment opportunities, which will be exploited provided finance is available at the right price, and this is a major argument for the maximum privatisation.

I consider the failure in public spending to discriminate between capital investment and current expenditure to have considerable disadvantages as I deplore the continuing technique of looking at public expenditure in terms of the gross impact of a decision as opposed to the net impact of a decision. The range of our decisions have positively resulted in substantial increases in expenditure ~~and~~ for unemployment and social security benefits. The cost of the unemployed is now £12 per week for every person who is employed. Whilst we argue that the demanning of British industry has made firms more competitive we need to put against the calculation the fact that British industry and all those at work have to continue to meet the cost of those previously employed in industry and now unemployed. This cost is a substantial burden on the economy. It is significant that whilst from 1979-82 output per person employed went up 1.1% output for the working population it went down 3%.

I wish to make a number of proposals which I consider to be necessary in the current situation.

TIME DATED INVESTMENT GRANTS

We need to equip industry to meet an upturn in demand, especially when world trade picks up. Present tax rules do not encourage industry to invest when activity and profits are low. The incentives are greatest when times are good. Result: they accentuate whatever stage of the business cycle we are at.

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Productive investment

Time-limited grants, however, would be counter-cyclical and designed to generate a surge in investment over the next two years. The Government would announce that all investment undertaken before, say, 1st April 1986 would qualify for a 10% grant (an alternative would be increased allowances, but that would not help companies in the red and paying no tax).

Small firms engineering grant.

Such a grant would encourage industry to bring its investment plans forward and boost beleaguered capital goods firms. I estimate the net exchequer cost at around £1.3 billion in 1984/85. More jobs, higher growth and better productivity would be the gains.

It is important to detect a number of areas where these grants are particularly applicable. The investment scheme for small engineering firms has been highly successful in providing orders for the machine tool industry. This scheme should be extended to include larger firms and to take up further the slack in the machine tool industry.

There are very attractive investments to be made in energy saving devices, the replacement of old boilers and the provision of variable drive-on pumps and fans are investment measures that are highly attractive in themselves. Industry would recognise the need to do this if a specific time-dated scheme was applied. If the variable drive processes were applied to industry as a whole energy saving to industry of something like £500 million a year could be achieved.

It might also be possible to devise a time-dated investment grant scheme which would link with established productivity gains. This would positively encourage the new technologies.

WAGE RELATED INVESTMENT PROGRAMMES

A wage explosion would be disastrous for the economy and it is vital that in the major areas wages are restrained. There are sectors where wage negotiations could clearly be related to investment programmes illustrating to the unions and the country that the lower the wage increases the higher investment and the greater the number of jobs. This ullustration and method of wage negotiation can certainly be used in:

i) the construction industry
ii) the engineering industry
iii) the nationalised industries
iv) the health service ?
v) various spheres of local government

cont....

Such an approach is urgent if we are not to drift into a series of bad wage increases following one generous settlement. With a public sector wage bill (excluding nationalised industries) of £37 billion wage policy dominates public expenditure. 1% on public sector wages is equal to the cost of 40,000 jobs.

TRADING POLICY

We have never succeeded in having a dynamic trading policy. I rejoice that the Department of Trade has been reunited to Industry but we need to organise a three year trading programme dynamically and positively directed.

The Department of Trade and Industry should analyse the major target markets for all the major products and a programme of ministerial-led missions should be arranged over the next three years to see that the major markets are visited frequently and important minor markets are visited by those most appropriate to take advantage of them. To do this we should mobilise each government department and the product ranges connected with them which could provide major export penetration. Health and Social Services should organise a series of export missions for all of the products connected with the Health Service. Education, Transport, Energy, and, of course, Defence are in a position to have a policy of export drives coordinated by the Department of Trade and Industry. Careful consideration should be given to certain countries and the potential of barter deals. The Foreign Office should review its staff in accordance with the trade campaign to see that in all of the major areas there are personalities who can really assist with the trade offensive.

The activities in ECGD and overseas aid must be coordinated into this campaign.

NET INVESTMENT

A totally new look should be made to the Invest in Britain Bureau which I believe to be fairly ineffective. We should decide on a growth centre approach to Britain and then a coordinated campaign should take place to procur investment into growth centres. A much higher calibre of person is required with a far more professional approach.

CONSTRUCTION INDUSTRY

Substantial jobs can be created in the house repair, decoration and improvement markets. A great deal of activity follows council house sales.

REGIONAL POLICY

We need to move to an industrial policy rather than a regional policy but for those regions of past deprivation a positive examination should be made as to their extra need in terms of environment and transport. A five year programme should be prepared to tackle the major transport and environmental disadvantages.

BALANCE OF SAVINGS

? We must examine whether or not we can leave the balance of savings to free market forces. If the strength of the building society movement enables them to pay higher interest rates in order to finance enhanced house prices rather than new house building the detrimental effect on the manufacturing industry could be considerable.

If massive privatisation switches the need from savings in the government to the private sector we need to know what impact this will have on the capital market. It may create a situation where that market becomes less effective for the financing of the small and medium sized firms.

Most assets sold by the government end up in the hands of the financial institutions. These institutions are financially astute; they see the asset sales as being basically in substitution for gilt sales and they will bid a price for the assets at which they are content to switch their portfolio balance between gilts and the assets.

Large discontinuous sales of assets give the financial markets a digestion problem compared with the smooth release of gilts via the tap. This requires either a similar tap system to be set up for the asset sales or else some alternative arrangements to cope with the build up of liquidity in advance of any issue and its conversion at the time of issue.

Some asset sales might form a close substitute for overseas assets (e.g. BP shares) and either encourage some diversion from portfolio investment abroad or some capital inflows.

Sales of equities by the government could crowd out equity financing by the industrial and commercial sector if the sum of PSBR plus the asset sales rises. There would also be crowding out of particularly close issues and if the government sales are heavily bunched in the calendar.

A combination of strong building society movement and a weakening capital market due to large privatisation schemes could be detrimental to the economy.

YOUTH UNEMPLOYMENT & PAY

There are those who have ascribed the rise in youth unemployment to a combination of union power and the level of unemployment and social security provision.

This is too simple an explanation by far and it fails to explain:

i) Why highly unionised economies such as Sweden, Norway and Austria have been able to avoid the rises in unemployment despite generous social security levels.

ii) Why economies such as the United States, Canada and Australia have suffered similar rises in unemployment without having fall-back social security provisions.

iii) Why relatively ununionised economies such as Germany and France have had rises in unemployment on a similar scale and timing to those in the United Kingdom.

Countries fall broadly into four categories:

(A) Those that have used income policies, wage restraint and social cohesiveness rather than monetary restraint alone in keeping down or turning round inflation.

(B) Those that have combined tight money restraint with highly flexible labour markets so that any inflationary momentum was dissipated with little or no rise in unemployment.

(C) Those countries that made a late start to the process of tackling inflation and whose unemployeemnt is typically continuing to rise sharply in 1983.

(D) Those countries like the United Kingdom that have combined a fairly sharp turn around in monetary growth with relatively inflexible wage settlement patterns.

I set out below the international percentage rates of unemployed in 1982 of each of these categores.

A		B		C		D	
Norway	2.5	Switzerland	0.4	Italy	8.4	UK	11.3
Sweden	2.5	Luxembourg	2.0	Israel	5.0	USA	9.7
Finland	6.2	Japan	2.4	France	10.0	Belgium	13.8
Australia	7.1	Korea	4.4	Canada	11.0	Germany	7.7
Austria	3.7			Ireland	12.4	Holland	12.4

cont....

THE ENCOURAGEMENT OF SMALL FIRMS

Much has been done in this sphere. The only further actions that might be considered would be:

i) Permitting new entrepreneurs to claim tax relief against losses over the first three years of business on tax paid on earned and unearned income in the three years prior to the start up.

ii) Removing the small new employer from the purview and minimum wages set up by Wages Councils.

iii) Revising the bankruptcy legislation in an endeavour to remove some of the social stigma attached to failure where there is no criminal offence.

iv) Introducing favourable company tax provisions for technologically new products. Singapore under their "Pioneer Products Scheme" has been very successful in this regard.

MANAGERIAL REWARD

We have a taxation system that means that if you are a successful proprietor you become rich but a successful manager is normally unable to obtain any substantial wealth. Some progress has been made on share options but this does not apply to many of our managers. I believe that we should carefully consider a radical change in this sphere whereby companies could pay out of their capital reserve capital sums in return for management contracts. A top manager could then negotiate a substantial capital payment out of the already taxed reserves of a company and for taxation purposes this payment would be treated as capital gain.

NEW PATTERNS OF WORK

We have machines that can replace much of the unsatisfying, dirty and unrewarding work previously carried out by men; machines that can produce with greater speed and efficiency than in any previous era.

We should rejoice that this can give us the opportunity of creating a society in which the machine works 24 hours a day, seven days a week, 52 weeks a year whilst man toils less and has available to him the time for leisure and pursuits more congenial to human happiness.

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We must decide whether we are now entering a phase of economic development where working from 16-65 for 49 weeks a year is no longer going to be necessary for substantial numbers of the population.

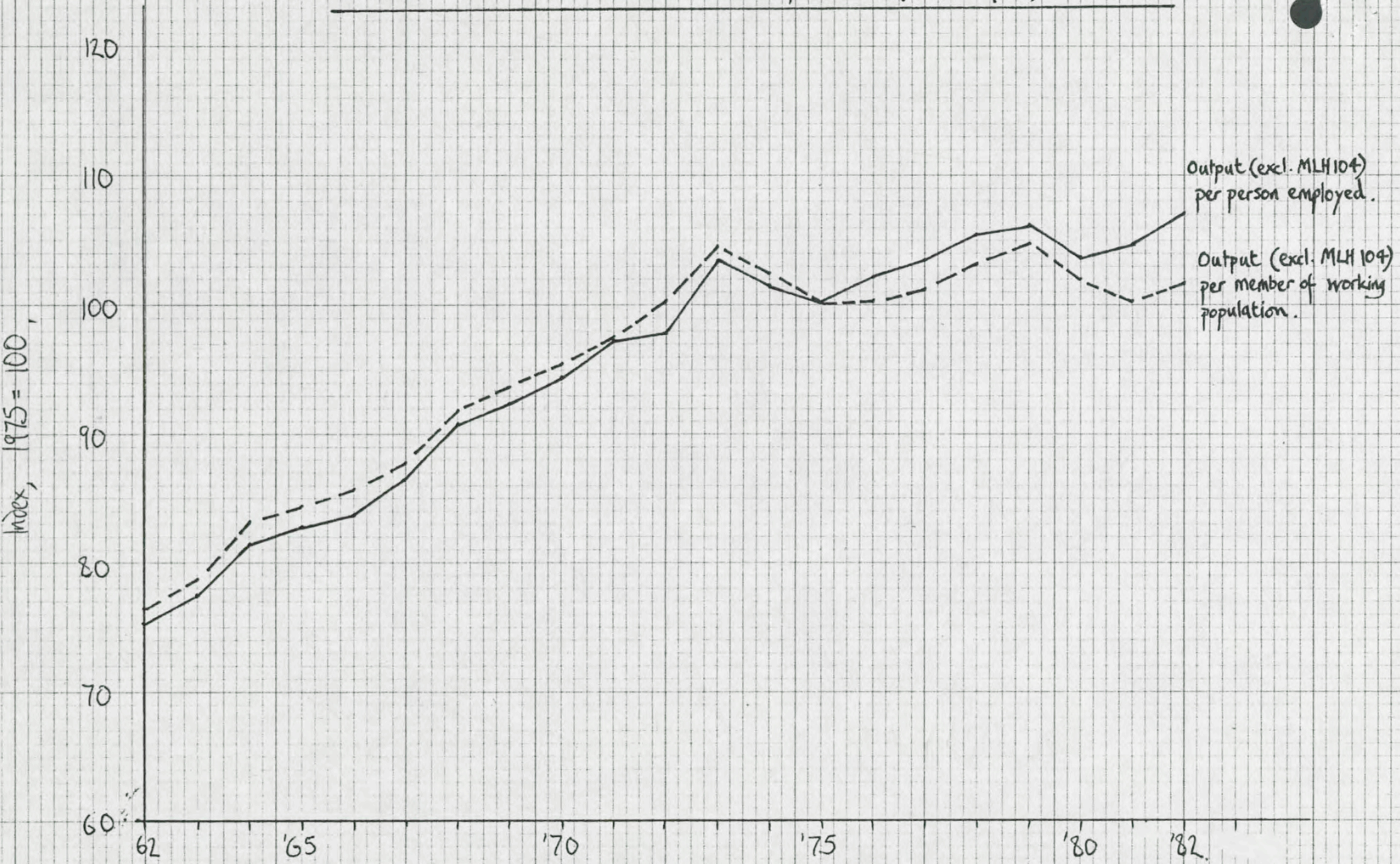
Already the police, the armed forces, top officials of banks and insurance companies and oil companies retire way before they are 65. It may be correct for us now to find ways in which those involved in hard manual work - miners, fishermen and construction workers - can move to similar options.

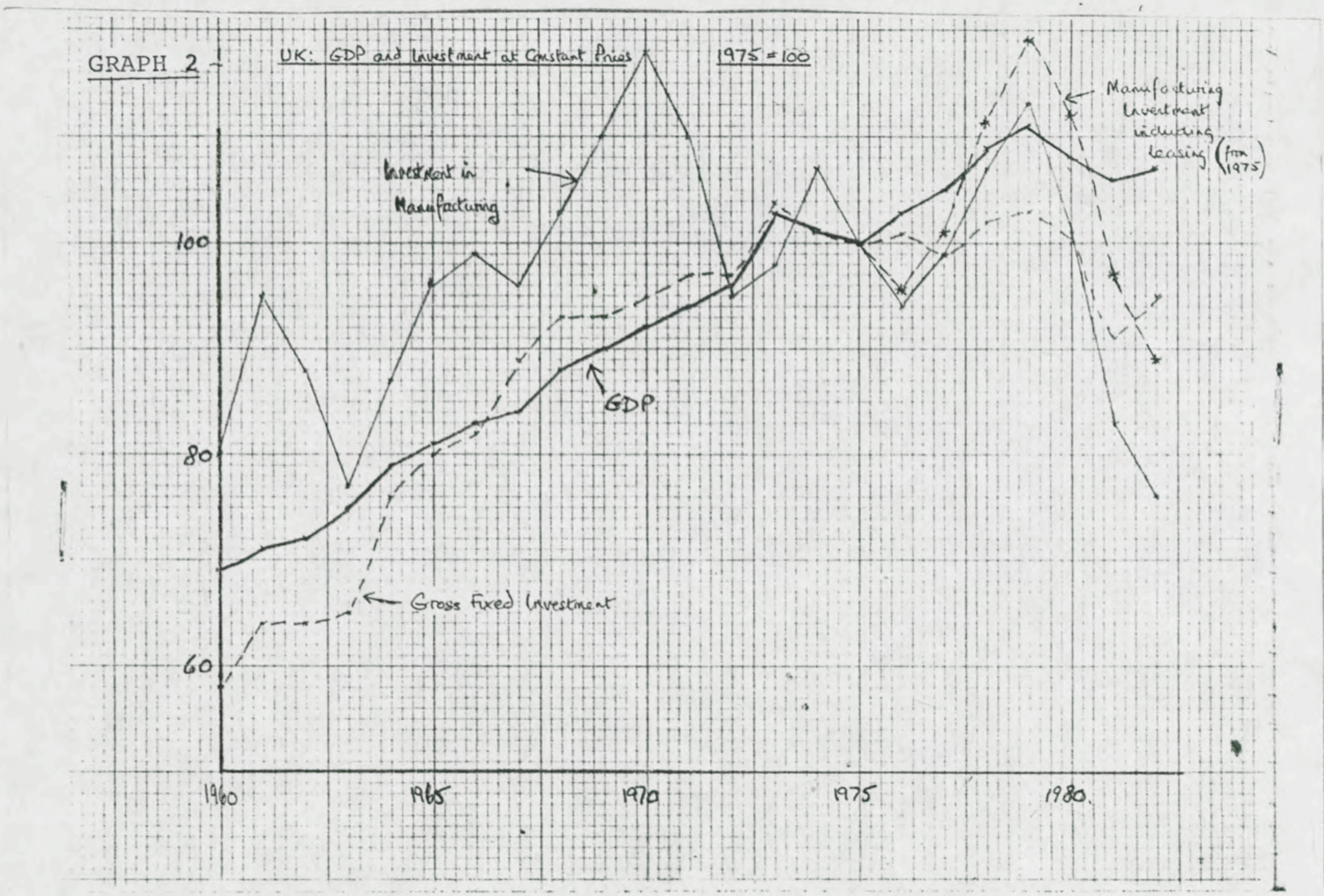
We need to examine the manner in which electronics would enable more people to work at home. We should look into potential new patterns of shift working and the potentiality of retraining educational and sabbatical years.

It would be disastrous to move to an economy where 75% were employed and 25% unemployed as opposed to an economy where the majority were employed but in a different way to the pattern of employment in the past.

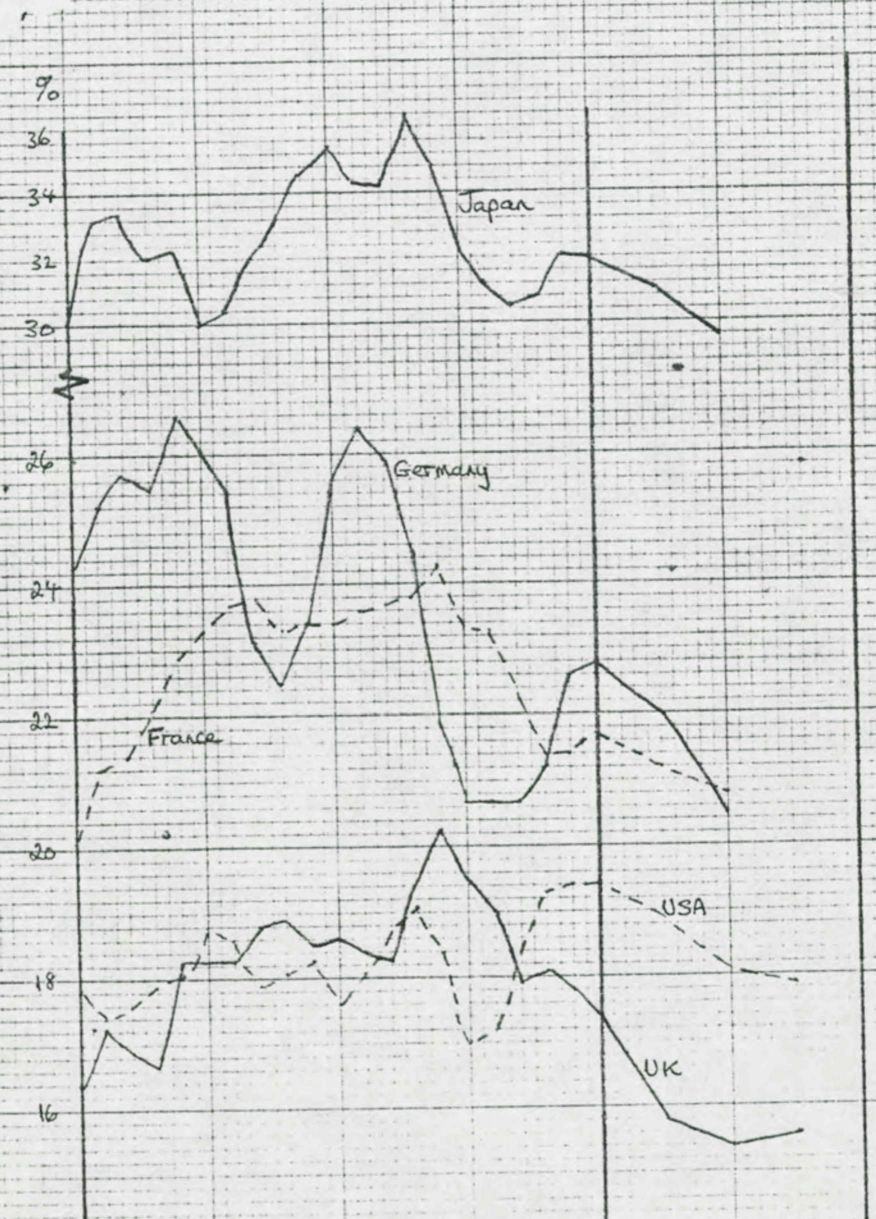
PEW/SPC

Chart 1 : LABOUR PRODUCTIVITY : WHOLE ECONOMY, EXCLUDING OIL + GAS, 1962-'82

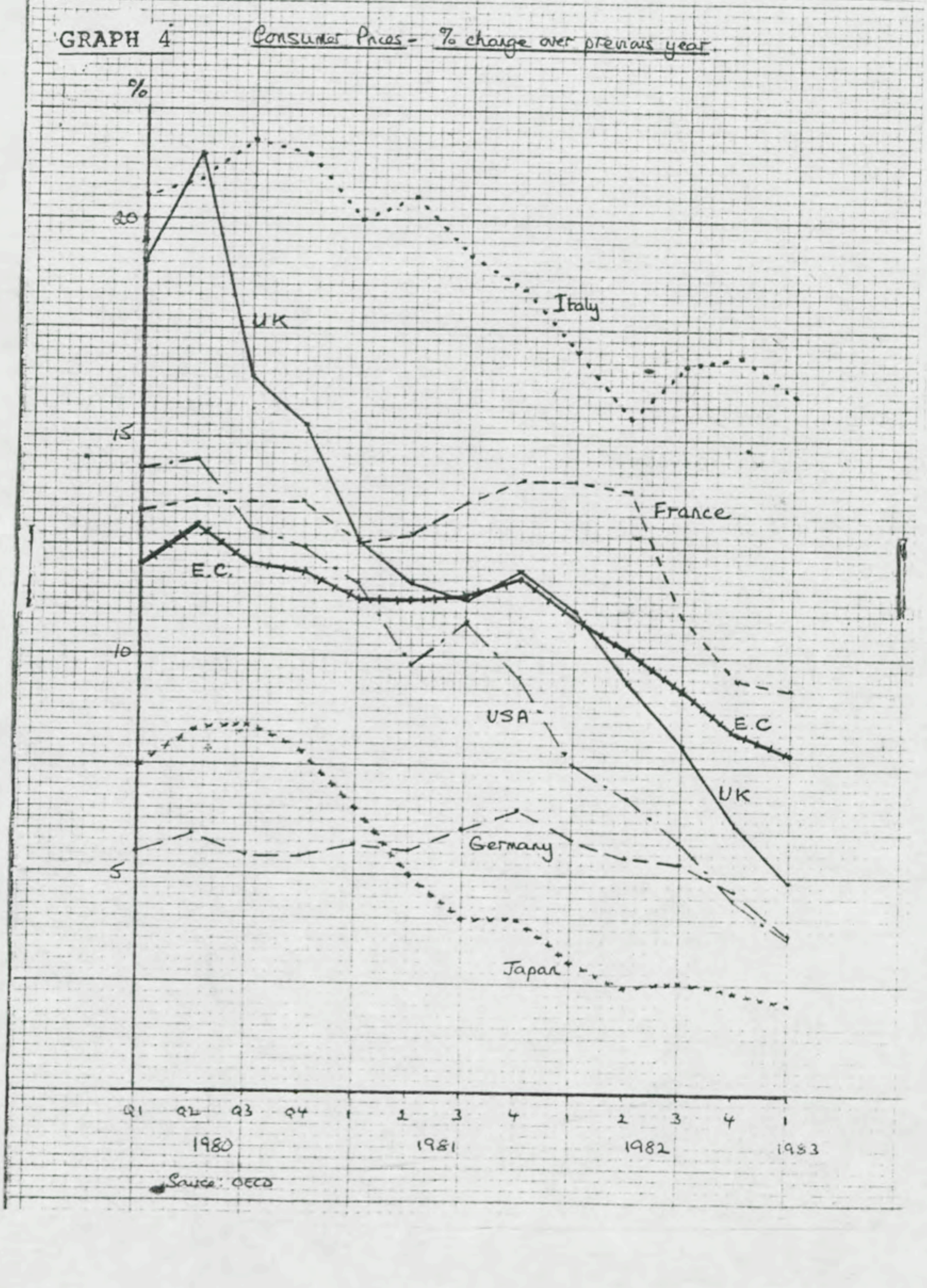



GRAPH 2
UK: GDP and Investment at Constant Prices
1975 = 100
Investment in Manufacturing
Manufacturing Investment including leasing (from 1975)
GDP
Gross Fixed Investment
100
80
60
1960
1965
1970
1975
1980

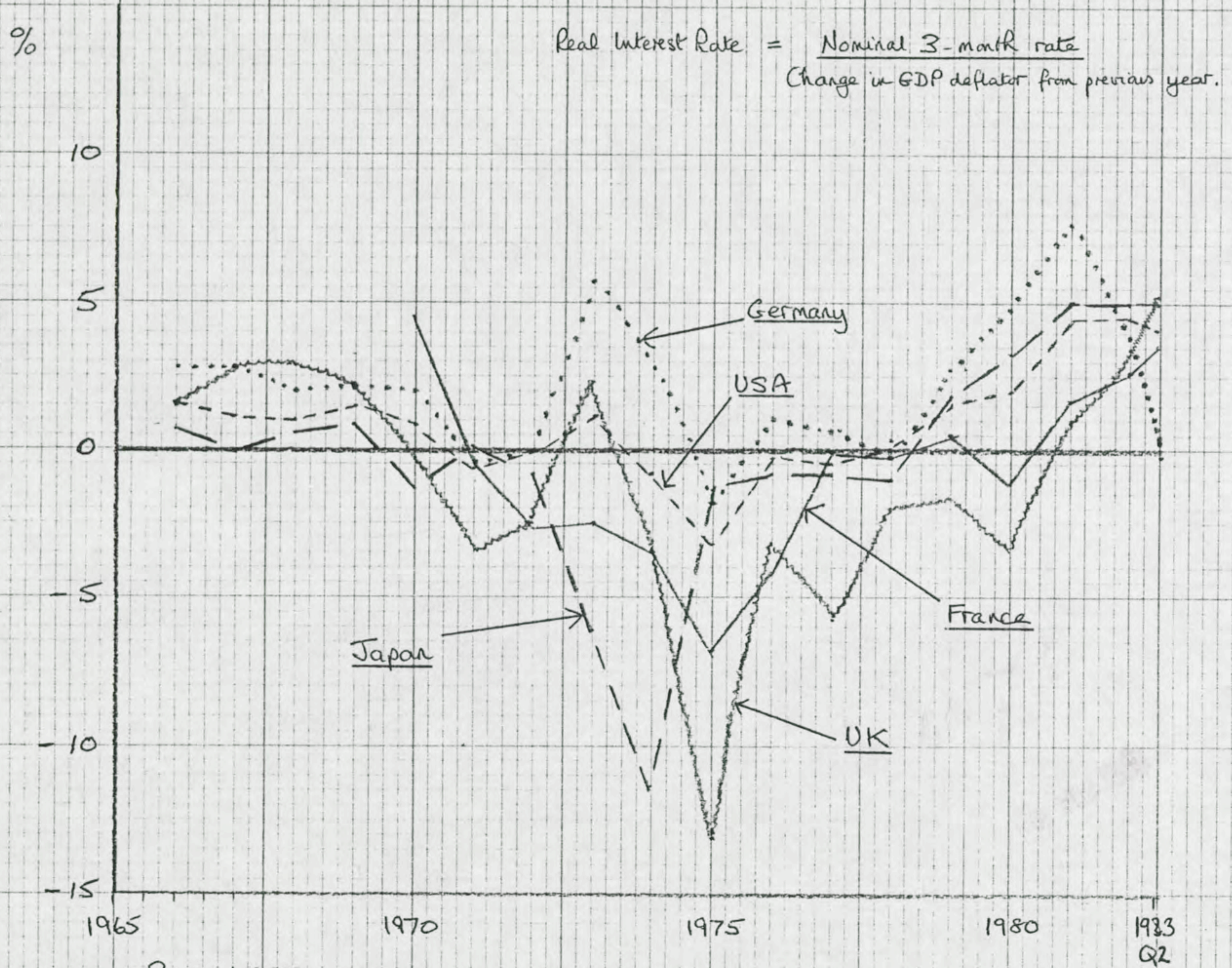
GRAPH 3 *Gross fixed capital formation as % of GDP*



Source: OECD.


GRAPH 4
Consumer Prices - % change over previous year
%
20
15
10
5
UK
Italy
France
E.C.
USA
Germany
Japan
Q1
Q2
Q3
Q4
1980
1981
1982
1983
Source: OECD

GRAPH 5 Real Interest Rates (Short-term) 1966-82



Source: OECD

Note: 1983 Q2 based on estimates of GDP deflators.