



DEPARTMENT OF ECONOMICS

DISCUSSION PAPER SERIES

NEW LABOUR'S ECONOMIC POLICY

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Number 49

December 2000

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New Labour's Economic Policy

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1. Introduction

Social democratic parties have returned to power across western Europe in the 1990s. However, as the contributions to this volume show, the rediscovery of electoral success has been accompanied by a marked ideological and policy shift away from the traditional terrain of social democracy. Nowhere has this shift been espoused with more enthusiasm, or coincided with a more spectacular victory at the polls, than in the case of the British Labour Party under the leadership of Tony Blair, cloaked in the embryonic ideology of the 'Third Way'. Since taking over from John Smith in 1994, Blair has continually stressed the need to 'modernize' traditional social democratic policy platforms, advocating an 'adherence to our values but also a willingness to change our old approaches and traditional policy instruments' (Blair and Schröder, 1999). To many, the rapid policy movement that Blair has initiated seems more like an ideological retreat than modernization. For example Labour's 1992 election manifesto contained commitments to raise the top rate of income tax from 40 per cent to 50 per cent, to restore the link between the state pension and average earnings, and to increase welfare spending significantly. By the time Labour returned to power in a landslide electoral victory in May 1997, 'New Labour' (as the leadership renamed the party) had abandoned these commitments, pledging instead to retain the existing top rate of income tax and to abide by Tory spending plans for the first 2 years of government.

But to what extent has the New Labour government abandoned social democratic ambitions and policies? Two-thirds through one term

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in office the contours of Labour's economic policy seem clear enough. This chapter examines the main economic policies of the Blair government, and provides an assessment of their content and likely consequences. It covers macroeconomic and spending policies, where 'prudence' rules and where control over interest rates has been delegated to the Bank of England, before proceeding to aspects of welfare policy and implications for income distribution. The focus then shifts to education and training, which Blair has stressed as central to economic policy, and finally to broader issues of industrial and industrial relations policy. Preoccupation with the supply side is the most distinctive aspect of Labour policy, combining a wholesale reorientation of the welfare state towards encouraging work with abandonment of both the interventionist policies towards industry and the collaboration with trade unions so characteristic of social democracy in the 1960s and 1970s.

2. Macroeconomic Policy

Labour's macroeconomic policy places overriding importance on devising a framework for economic stability. This has both political and economic origins. Economic mismanagement was widely blamed for Labour's loss of power in 1979 in the aftermath of the collapse of its pay policy in the 'winter of discontent'. Thirteen years later the Tory government suffered an irretrievable collapse of support after sterling's ignominious exit from the European Exchange Rate Mechanism (see King, 1998). Avoidance of such macroeconomic debacles has accordingly been a political priority. In narrower economic terms the UK suffered extremely severe recessions in both the early 1980s and early 1990s, punctuated by the unsustainable Lawson boom. The government's 1999 budget statement noted: 'Over the past three decades, the UK economy has exhibited high volatility in output and inflation. . . . The Government has reformed the framework for macroeconomic policy to promote economic stability. . . . Stability is essential for high levels of growth and employment' (HM Treasury, 1999, Economic and Fiscal Strategy Report, paras 2.1, 2.3, 2.4). Securing steady growth at the long-term sustainable rate is hardly controversial as an objective. The question is how to achieve it?

Monetary policy has been placed in the hands of the Monetary Policy Committee (MPC), with Bank of England officials in the majority and the remainder economists appointed by the government. The MPC is charged with hitting the government's inflation target of 2.5 per cent per year. The idea is that interest rates would be changed in a timely

manner to offset inflationary or deflationary pressures. Removing monetary policy from short-term political manipulation is supposed to enhance its 'credibility' in the eyes of the financial markets and the government claims the reduction in the differential between German and UK bond yields (from more than 1 per cent in the months before the election to around 0.25 per cent in the autumn of 1999) as a significant achievement. The MPC is charged with hitting the inflation target, not staying beneath it, and this is supposed to prevent over-zealous central bankers focusing solely on minimizing inflation without regard to the consequences for employment.

Labour's pursuit of longer-term goals has extended to fiscal policy as well. The government has 'set two strict fiscal rules to deliver sound public finances'; first, the *golden rule* decrees that on average over the economic cycle, the government will borrow only to invest and not to fund current spending; second the government pledges that its (net) debt 'will be held over the economic cycle at a stable and prudent level' (HM Treasury, 1999, para 2.16). With government (net) investment forecast to average only 1 per cent of GDP per year up to 2003–4, the public sector's net debt should gently decline to less than 40 per cent of GDP. Reaching this trajectory has involved a severe fiscal squeeze. Between 1996–7 and 1998–9 the government estimates that the cyclically adjusted deficit will have fallen by almost 4 per cent of GDP.

This policy framework does not necessarily constrain macroeconomic policy from acting to support demand and employment. If unemployment was rising and inflation was below the target, the Bank of England would be expected to cut interest rates and the government could allow the automatic fiscal stabilizers to work and even engage in some discretionary fiscal expansion as well. The real test of the policy will come if unemployment was rising and inflation was above the target; only then would the claim that the Bank of England can 'respond where necessary with discretion' and 'without paying a high price in terms of lost output' (Balls, 1998) be put to the test. Under such circumstances it would obviously be convenient for the government to deflect criticism by blaming the Bank of England for high or rising interest rates.

Unemployment declined steadily over the government's first two and a half years, but before attributing this to successful macroeconomic policy it is important to remember that no previous Labour government had inherited such a favourable economic conjuncture. When Labour took office, unemployment had been falling for 4 years as the sharp depreciation in 1992 set in train a strong export recovery; inflation was about 2 per cent per year and the world economy was delivering steadily growing export markets and stable commodity

prices. Even the government deficit, which had reached an alarming 7.9 per cent of GDP in 1993/4, had been halved. This favourable pattern has been maintained under Labour and by the middle of 1999 unemployment had fallen to 5.8 per cent (not much more than one half the level in France, Germany, and Italy) without serious signs of resurgent inflation. Thus the government's macroeconomic framework consolidated the expansion which was launched by the monetary policy implemented by the Tory Chancellor, Kenneth Clarke, after 1992. However, this expansion was more fragile than appeared at first sight.

The weak point has been the chronic overvaluation of sterling, to which higher interest rates than elsewhere in Europe have contributed. Sterling's effective rate rose 24 per cent between the middle of 1996 and 1998. Worse still, this appreciation has occurred while unit wage costs grew faster in the UK than elsewhere. This has led to terrific pressure on UK industry, with relative unit labour costs rising by 41 per cent between 1993 and 1998. As a consequence, cost competitiveness has been dragged down to the level reached in 1981 in the depths of Thatcher's monetary squeeze. The result of the high exchange rate is that the expansion has been severely biased away from manufacturing. Manufacturing output in the middle of 1999 was only 3 per cent higher than a decade before. This has contributed to the maintenance of large regional differentials in joblessness (discussed below). However the high exchange rate contributed to holding down inflation; a fall in sterling to more competitive levels would have pushed up import prices and reduced the competitive pressure on UK firms selling in the domestic market. It is probable that it was the overvalued pound which allowed unemployment to fall so low without compromising the inflation target. If sterling were to fall sharply to a more realistic long-run level, then the MPC would feel obliged to slam on the brakes, and the implication for jobs of privileging the inflation target would become clear.

Further falls in unemployment, while staying within the inflation target, depend on policies to reduce the unemployment rate at which inflation would begin to rise (the non-accelerating inflation rate of unemployment—NAIRU). The more optimistic of the government's longer-term projections assume that 'improved labour market performance leads to a ½ percentage point decline in the sustainable rate of unemployment (or NAIRU) in both 1999 and 2000 and a further ¼ percentage point reduction in 2001' (HM Treasury, 1999, p. 128). Policies to achieve this 'supply-side' improvement are the core of Labour's economic programme.

3. Employment, Welfare to Work, and The New Deal

Keynesians regard unemployment as being largely 'involuntary', in that the unemployed would work for the going level of wages if jobs were available. Expanding aggregate demand allows them to find work. However, it is the involuntarily unemployed who constitute the reserve army of labour and thus hold in check wage bargaining (see Carlin and Soskice, 1990, ch. 6). So the possibilities of reducing unemployment by a durable macroeconomic expansion are limited to situations where the economy has 'surplus' unemployment (that is, more than the NAIRU). But is it really the case that all types of unemployed worker are equally 'effective' as members of the reserve army? Richard Layard, now economic adviser at the Department for Education and Employment (DfEE,) has argued forcefully that the long-term unemployed in particular exert little downward pressure on wage bargaining as they are semi-detached from the labour market (e.g. Layard, 1997). They are too demoralized or stigmatized by employers to be actively or realistically seeking work. If they can be enticed or cajoled back into searching for work (or if employers can be persuaded that they are in fact employable) then the extra competition they inject into the labour market will bring downward pressure on wages. This would allow a more expansionary demand-management policy to generate extra jobs, without the inflationary pressure which would otherwise result. The NAIRU would be reduced and the sustainable level of employment increased.

If successful, such a policy leads not only to lower unemployment but also to higher tax receipts (from the incomes of the additional people at work) and reduced social security benefits (to those previously unemployed). Even quite expensive policies (in terms of employment subsidies or in-work benefits) could pay for themselves if they brought many more earners and thus tax-payers. Moreover, this approach can be extended from the long-term unemployed to other groups who are not working. Lone parents with small children, people claiming disability benefits, those in early retirement because of lack of work, and partners of unemployed people caught in the benefit system's 'unemployment trap' may all be targets for persuasion, by an appropriate mixture of incentives and sanctions, to re-enter the labour force. The downward pressure on wages which these additional recruits to the reserve army would bring would allow faster growth. Sustainable employment would rise and non-employment would fall.¹

¹ Labour-force participation by people not previously counted as unemployed would not reduce the NAIRU, but would raise the sustainable level of employment. The principles behind the New Deal are summarized in paras 4.9 and 4.10 of the Economic and Fiscal Strategy Report (HM Treasury, 1999).

The standard bearer for the New Deal programmes is that relating to the young long-term unemployed (18–24-year-olds unemployed for more than 6 months). They enter a ‘gateway’ period of intensive career counselling; if they do not move into education or a job they choose one of four ‘options’: a 6-month job, with the employer subsidized by £60 per week (or help with becoming self-employed); work with a voluntary organization; work with an environmental task-force (where they receive a little more than benefit); or, if their educational level is considered a serious hindrance to their finding work, a period of formal education of up to 12 months (Undy, 1999). There is no ‘fifth option’ of simply remaining on unemployment benefit. Similar schemes, either on a pilot or economy-wide basis, but so far usually voluntary, have been introduced for other age groups of the long-term unemployed, lone parents, the partners of unemployed people, and the disabled.

In addition to making people on benefits more ‘employable’ the government has reformed the system of in-work benefits for families with children and disabled people, to help ‘make work pay’. The biggest change has been the Working Families Tax Credit (WFTC), aimed at guaranteeing any family with a full-time worker £214 per week (by spring 2001). It was set at a considerably more generous level than the Family Credit programme which it replaced, and was boosted by an additional subsidy to cover child-care expenses for the low paid. Those on low earnings will also benefit from adjustments to the bottom end of the tax and national insurance schedules. The 1999 Budget (HM Treasury, 1999, table 4.2) claimed that the number of those at work who face effective marginal tax (and withdrawal of benefit) rates of more than 70 per cent has fallen from 715,000 to 230,000.² Single-earner families with two children will be £30–40 per week better off over quite a range of weekly earnings (£120–280 per week).³

The *Financial Times* (23 March 1999) reported, under the headline ‘Brown plans tax credit for all in employment’, that:

The government wants to give a guaranteed minimum income to all people in work as part of a comprehensive plan to integrate the tax and benefit

² However, the inevitable effect of greater generosity and slower withdrawal of benefits is that many more people receive (and lose) them so that numbers on marginal rates of more than 60 per cent *rise* from 730,000 to 915,000.

³ By transforming a range of benefits into tax credits the government also contrived to reduce measures of the social security bill (with tax credits not included) and the average burden of taxation (tax credits counting as negative taxation). By 2001–2 tax credits will be cutting the tax bill by 0.6 per cent of GDP—shades of Mrs Thatcher’s massaging of the public-sector deficit by subtracting receipts from privatization!

systems. . . . The absorption of benefits in the new employment tax credit, as the Treasury has christened it, would be the culmination of Gordon Brown's ambition to provide subsidized jobs for those fit for work. Only the chronically disabled and lone parents with very young children would be expected to live on benefits.

The implication is that the element of compulsion in the New Deal, so far most apparent in the 'no fifth option' for the young long-term unemployed, will be applied much more generally. This represents a radical redefinition of the functions of the welfare state, and raises a number of questions about the tension between compulsion and individual rights in social democratic thinking (King, 1999; White, 2000). Although welfare rights in Britain since 1945 have been predominantly 'unconditional', the widely praised 'welfare to work' model in Sweden has always relied upon pressures from withdrawal of unemployment benefits after a fixed period (Esping-Andersen, 1990). Of course, such compulsion to take up an employment or training alternative to benefits depends very much on what these alternatives really offer.

In assessing the economic impact of the British version of 'welfare to work', three issues are particularly important.

- How big will the effect be on labour supply, i.e. on the number actively seeking work?
- Will jobs be available?
- What will be the effect on the pattern of wages?

If the New Deal for the young long-term unemployed really increases their 'employability', then substantially more of those who enter the 'gateway' should be employed after leaving the New Deal than would otherwise be the case. This would then cumulate, into a substantial impact on the stock of people in or actively seeking work. Even if a subsidized job had no longer-term effects on the job prospect of the person concerned, and was simply used by employers as a substitute for another worker, there would be some effect on wage pressure if those 'displaced' by the New Dealers were more 'effective' in job search.

Numbers who have passed through the New Deal into unsubsidized jobs can provide impressive sound bites for politicians, but convey little information about the true impact of the programme since many would have found work anyway. Analysis by the National Institute (reported in the *Financial Times*, 12 July 2000) suggests that the New Deal may have increased employment of young people by a very modest 13,000 by the spring of 2000. Youth unemployment was estimated to be reduced by

41,000, with the difference accounted for by some of those who would have been unemployed moving into education or one of the other options.

Blundell and Reed (1999) report a number of studies which modelled the effects of WFTC and which agree that those actively seeking work may increase by some 30,000 (with increased participation by lone mothers and people with non-working partners offsetting reduced participation by people whose partner was already working and who would receive more benefits under the proposals). Somewhat similar effects result from the reductions in national insurance and from the introduction of the new 10p income tax rate (Gregg *et al.*, 1999) and the minimum wage would further tend to increase labour-force participation (especially of women). Combined with the impact of other measures to increase job search, it is quite possible that the whole New Deal/Making Work Pay programme could increase the effective labour supply by around 100,000. If these estimates are roughly accurate, they suggest a distinctly modest effect (perhaps $\frac{1}{2}$ per cent rise in the labour force or $\frac{3}{4}$ on the Treasury's more optimistic forecast).

In simulations, the impacts on the labour supply are often reported as 'employment effects'. This begs the very important question of whether Say's Law (supply creates its own demand) really applies in the labour market. It is important to reiterate that the mechanism proposed is fundamentally macroeconomic, with the extra competition in the labour market reducing inflationary pressure. As a result, the MPC can take a more relaxed attitude to interest rates and allow demand to expand. While not all those joining the labour supply would necessarily get jobs themselves, additional jobs would be created by the macro-economy until the unemployment rate as a whole falls to the new lower NAIRU. The most problematic part of this story is whether the posited additions to the labour supply would really bring the expected easing of wage pressure.

The emphasis in the economic analysis underlying the strategy is on the impact of employment status on wage pressure—the short-term unemployed look actively for work and constitute effective labour-market competition; the long-term unemployed search less effectively and on average bring much less downward pressure on wages; those out of the labour force (e.g. lone parents) have no effect whatsoever. Transforming the position of the long-term unemployed, or lone parents, so that they are both involuntarily unemployed and employable in the eyes of employers, will swell the reserve army and ease wage pressure. But if the long-term unemployed, lone parents, people taking early retirement, and those on sickness benefit disproportionately have low qualifications and live in areas of mass unemployment, then will

their moving into active job search have much effect on the overall degree of wage pressure in the economy generally?

There is a huge jobs deficit in the old industrial areas, especially for jobs for the less qualified. In Merseyside, for example, a minority of men of working age without qualifications are working (though many fewer are categorized as unemployed). If the least qualified one-quarter of the population were to have as many jobs in the rest of the country as they do in the prosperous south-east, then there would have to be an additional 850,000 extra jobs for them (calculated from Labour Force Survey for 1998—see Erdem and Glyn, 2000, for fuller discussion). Many of those brought into the labour force by the Welfare to Work measures will have relatively poor qualifications and will live in an area where labour demand is already weak, especially for the unskilled. Increasing the reserve army of labour in these areas is unlikely significantly to hold down wages in the economy as a whole and thus allow macroeconomic expansion. Conversely, macroeconomic expansion, to the extent that it really was facilitated, will definitely not create jobs *disproportionately* in the areas where Welfare to Work has most clients.

For the policy to work, either the less qualified would have to be encouraged to move to the high-employment southern parts of the UK or jobs would have to be created deliberately in the areas where labour supply is most expanded, reversing the process of job destruction which caused their unemployment and labour-force non-participation rates to be so high in the first place (see Turok and Webster (1998) for trenchant criticism along these lines). However, the government has fought hard against the idea of a 'North-South divide' in employment, emphasizing instead the problem of localized employment blackspots (see Webster, 2000). Thus there is a New Deal for Communities aimed at the 'intensive regeneration of some of our poorest neighbourhoods' and Employment Zones have been set up. But again most of the focus is on quality of life in the area and on special measures to make individuals there more employable, rather than on deliberate creation of work through public spending, introducing incentives for employers to locate in these areas, and so forth.

If substantial numbers of less-qualified people seeking work were to find jobs, what would be the implication for their wages? 'Making work pay' applies to employers as well as employees and they would only offer less-qualified people more jobs if the relative cost of less-qualified labour declined. There is a real danger that getting a large number of less-qualified people into the labour force by one means or another will drive down wages at the bottom of the pay scale. This could bring conflict with the minimum-wage regulations and would raise the cost of in-work benefits for those who have low-paid jobs already. To the

extent that the New Deal really does improve skill levels, this problem would be reduced, but it is notoriously difficult substantially to raise the skill levels of many of those targeted by these schemes.

To summarize, the government's macroeconomic strategy puts great weight on increasing labour supply, though existing estimates suggest relatively modest effects. Moreover, the belief that raising labour supply will allow sustainable higher employment without inflationary pressure ignores the regional concentration of the workless. Ensuring that work is available for such people, without further substantial increases in pay dispersion, requires much more deliberate action to target increases in demand for labour on the areas and skill-groups most affected by joblessness.

One glaring absence in this whole approach concerns wage bargaining. Blair has repeatedly made it clear that New Labour's return to power after 18 years of Conservative government will not usher in the return of 'beer and sandwiches' at 10 Downing Street. Addressing the TUC Annual Congress in September 1999, Blair asserted that 'in many ways we have a better, clearer relationship than ever before between trade unions and Labour. . . . You run the unions. We run the government. We will never confuse the two again.' This renunciation by New Labour of Old Labour's corporatism has left the government without any means to encourage the kind of coordination of wage bargaining which appears to have played a significant part in a number of recent 'employment miracles', the Netherlands and Ireland, for example (Visser and Hemerijck, 1997).

Whenever wage increases appeared to be moving up, Gordon Brown has been reduced to urging employers and unions to show restraint in their wage bargaining. However, such appeals from the sidelines will fall on deaf ears unless there is a serious attempt to solve the coordination problem—why should any union in a strong bargaining position or employer with a shortage of skilled labour show restraint while there is no mechanism for ensuring that others will follow suit? Given the weakness of unions in wide sections of the private sector (Brown, 1994) and the employers' hostility towards constraints on their freedom of manoeuvre, attempting to steer them towards coordinated bargaining would be very difficult. But it seems that political considerations—fear of appearing to favour union power and corporatism—have dictated a prohibition even on discussion of the issue. In the event that the UK joins the Euro, with no possibility of depreciation to offset faster cost increases, the issue of wage coordination will become, if anything, more important.

4. Income Distribution

Labour inherited a Britain with rapidly growing inequality. Between 1978 and 1990 household income inequality in the UK rose much more than in any other OECD country for which data are available (Gottschalk and Smeeding, 1997), more or less overturning all the reduction in household income inequality in the UK achieved since 1938. Tony Blair said in 1996, 'I believe in greater equality. If the next Labour Government has not raised the living standards of the poorest by the end of its time in office it will have failed' (*Guardian*, 16 December 1998). Blair has also committed himself to the very bold target of eliminating child poverty over 20 years (currently 30 per cent of UK children live in households with less than half average income, which appears to be the criterion of poverty he is using). Nevertheless his government clearly prefers to talk of social inclusion and equality of opportunity than to espouse the goal of equality of outcome.

The fundamental constraint which New Labour has set for itself is its commitment not to raise the tax burden.⁴ It should be emphasized that the UK has a very low share of government expenditure by EU standards (in 1999 general government spending was some 40.8 per cent of UK GDP, compared with the EU average of 47.6 per cent, 47.1 per cent in Germany, 54.1 per cent in France, and 60.2 per cent in Sweden, for example). A major contribution to the rise in inequality was Mrs Thatcher's decision to index benefits to prices rather than earnings. Since the poorest households receive most of their incomes from benefits, this inevitably drags down the share of the poorest groups whenever real incomes rise. New Labour steadfastly refused to reverse this general policy, arguing that benefits compensate for poverty rather than eliminate its causes.⁵ The main thrust has been to concentrate support on 'work as the best way out of poverty' (HM Treasury, 1999, p. 65), as discussed in the previous section; quite consistent with this approach is to refuse to reinstate the link between benefits, especially for the unemployed. Aside from the increases in in-work benefits, the introduction of a minimum wage in April 1999, albeit at a level well below the proposal of trade unions, represents an

⁴ Controversy abounds over precisely what measure is relevant here. The 1999 Budget shows the share of taxes in GDP (the broadest and most sensible measure) rising from 35.4 per cent in 1996/7 to 36.7 per cent in 2000/1, which will give plenty of scope for arguments about how much of the tax increases in New Labour's first year were 'Tory taxes' that Labour inherited.

⁵ The 1999 Budget represented some retreat on this with its commitment to up-rate the Minimum Income Guarantee for pensioners (in effect a renamed and slightly more generous version of Income Support) by *earnings* in April 2000.

important policy initiative. Although its impact on the very bottom of the income distribution is limited because most of the poorest households have nobody working, it is still the case that the bottom decile gains most from the minimum wage; moreover, 70 per cent of those who benefit from the minimum wage live in the poorest 40 per cent of working households (Dickens, 1999).

The most comprehensive estimates of the impact of Labour's changes to the tax and benefit system up to the spring of 2000 show the worst-off 20 per cent of households gaining by around 8.5 per cent on average whereas the best-off 20 per cent lost around 0.5 per cent.⁶ The worst-off 20 per cent of households with children, are estimated by the Treasury to be going to benefit by 30 per cent, which must be made some inroads into the child poverty which Blair promised to reduce by 700,000 by the next election.

In one respect these figures underestimate the effect of Labour's measures for they are based on the present pattern of behaviour of households. If large numbers respond to the incentives provided by the WFTC, for example, and take a job, then the extra income they receive will constitute an additional gain for low-income groups over and above the extra benefits received by people already working. However, the analyses discussed earlier suggest that these effects will be relatively small and so the main effect on inequality of these measures comes via the boost to incomes of existing low-income workers.

Moreover, the estimates quoted earlier of the redistributive impact of Labour's measures give an over-optimistic impression of what is happening to inequality. The benchmark against which budget changes are measured is the up-rating of benefits in line with prices. With earnings tending to grow faster than prices, the incomes of those mainly dependent on benefits tend to fall systematically behind average incomes as a whole (the bottom 20 per cent are dependent on benefits for more than 80 per cent of their incomes). If the government does nothing (beyond increasing benefits in line with the cost of living) then the benefit system itself implies rising inequality.

In the first 2 years of the Labour government the measures implemented were not large enough to offset this 'benefit drag' and household income inequality increased. Institute for Fiscal Studies (IFS) calculations suggest incomes rose by less than 2 per cent for the typical household in the bottom 20 per cent, while the increase was 7 per cent for a typical household in the top 20 per cent. In real terms income per head rose about £2 per week at the bottom and £47 a week at the top.⁷ Numbers in poverty (less than half average incomes) rose.

⁶ IFS calculations available at www.ifs.org/budget. The figures would be a little larger if the impact of the minimum wage were included (see Immervoll *et al.*, 1999).

⁷ Information kindly supplied by Jayne Taylor of IFS.

Table 1
Government Spending
(average per cent per year increases of real spending)

	Blair government 1997–2002	Major government 1992–7	Thatcher and Major 1979–97
Health	4.7	2.6	3.1
Education	3.8	1.6	1.5
Defence	–0.6	–3.1	–0.2
Social security	1.5	3.8	3.5
Total spending	1.8	2.0	1.6

Note: Social security includes tax credits as spending (for comparability); when excluded (as they are in the Total figure), the growth rate for social security spending is projected at 0.4 per cent per year.

Source: Chennells *et al.* (2000) plus updating and detail kindly supplied by Carl Emmerson (IFS) to include impact of the Comprehensive Spending Review of July 2000.

Now it is true that important measures, such as the WFTC and the minimum wage, had not come into effect in the period covered by these calculations. Overall the measures announced for Labour's first 4 years should bring some reduction in household income inequality if nothing else changes.⁸ However, other factors may be pushing in the opposite direction. Over Labour's first 2 years the pay distribution widened only marginally, and interest payments, which benefit mainly the better off, stagnated. However, if shortages of skilled labour push up wages faster at the top end of the pay distribution, and if interest rates were to rise, then all Labour's measures would be absorbed simply in preventing inequality rising further. So it is quite possible that inequality will be only slightly, if at all, lower at the end of the government's first term in office than at the beginning. Of course this is better than the previous upward trend, but there is no chance of a substantial reversal of the unprecedented rise in inequality since 1979. This would require a major increase in the general level of benefits.

Although not included in the conventional figures on income distribution, spending programmes on the welfare state have an important egalitarian effect because the benefits are spread relatively evenly. The combination of reducing the budget deficit and holding the share of taxation (roughly) constant have inevitably constrained spending programmes. IFS calculations (Table 1) provide comparisons of real spend-

⁸ Calculations carried out by Holly Sutherland with the Cambridge microsimulation model suggest that about one half of the 'redistribution' from Labour's measures would be absorbed in preventing inequality from rising as a result of benefit drag.

ing increases planned by Labour, compared to both the preceding Major government and the whole 18 years of Tory rule.

The government is delivering distinctly faster increases in health and education spending than its conservative predecessors, and, especially in the case of health, a definite rise in the share of GDP. Overall, however, government expenditure as a percentage of GDP is expected to fall from 41.2 per cent in 1996/7 to 39.7 per cent in 2001/2, essentially stabilizing after the cut inherited from the Tories during the first year of government.⁹ Over a 5-year period the Blair government would raise total public spending at a slower rate than the Major government and only slightly faster than Conservative governments over the previous 18 years—an extraordinary outcome. The big increases in health and education are to be achieved by squeezing some other parts of public spending, notably defence spending and interest payments.¹⁰ However, the most important diversion is to come from social security spending which Labour plans to raise by 2 per cent per year less than under the Tories (even excluding the reduction in spending resulting from the switch from benefits, which do count as spending, to tax credits, which do not). Even if substantial numbers come off benefits, such a target could never be met if benefits were generally and consistently indexed to wages rather than prices, let alone if their relative value was pushed back towards 1979 levels. Given the government's reluctance to raise taxation the only way that substantial increases in spending on government services can be financed is by squeezing social security.

The pressures emerging from the tight rein on spending of the first 2 years of the Blair government were dramatically revealed by a crisis in the health service at the end of 1999. This pushed Tony Blair into appearing to promise to raise UK health spending to the EU average. Increases of 6.2 per cent per year in real terms are now planned between 1999 and 2004. The extent to which these welcome increases are being financed by the squeeze on social security is not widely appreciated.

⁹ These data refer to the fairly comprehensive definition of total managed expenditure as a percentage of GDP

¹⁰ The figures for the increases in 'real spending' have to be handled with care. They overstate the real volume of inputs because low productivity growth in the sectors providing these labour-intensive services pushes up their costs faster than in the economy as a whole (around 0.5 per cent per year between 1990 and 1996, for example). See also footnote 3 above.

5. Education and Training Policy

Under Blair education policy has assumed primary importance as a tool of economic policy. In part this is the result of Labour's self-imposed constraints on conventional macroeconomic policy levers discussed earlier. Yet it also arises from a belief in the centrality of educational attainment to improving individuals' labour-market prospects. Education, in other words, is regarded primarily from an economic point of view. The government's first policy proposal on educational policy began, 'Learning is the key to prosperity' (DfEE, 1998).

Labour's main initiative in adult education has been to spread the gospel of 'lifelong learning'. The government's aim is to break the exclusive association of learning with schooling by emphasizing the variety of formats in which learning can take place, and by stressing that education continues *throughout* working lives rather than exclusively prior to them. Though this campaign has so far been largely a rhetorical one, there have been some innovations. In 1998 the University for Industry (Ufi) scheme was launched—in essence, an internet-based brokering service which will offer information on a range of education and training courses in different regions. The Ufi was accompanied by 'Learning Direct', a new freephone national advice and information service about learning and career options. The main financial instrument for boosting lifelong learning has been the introduction of Individual Learning Accounts (ILAs). ILAs are intended to enable individuals to invest in up-skilling and re-skilling throughout their careers. The Chancellor announced in his March 1999 Budget that a million ILAs will be created this year, with an initial government contribution of £150 per person. Both employers and employees will be able to contribute tax-free to these accounts. In addition any adult with an Individual Learning Account will be able to claim a discount of 20 per cent, or an additional grant of up to £100, on the cost of the training they choose. Adults signing up to improve their basic education—including computer literacy—will receive a discount of 80 per cent on course fees.

In other respects, New Labour's approach to learning in the workplace is a mixture of exhortations to train more, calls for partnership between government and business, and a continuation of structures and schemes developed under the previous government. Government training programmes, for example, continue to be administered by regional employer-led Training and Enterprise Councils (TECs). In the summer of 1999 an umbrella body—the Learning and Skills Council—was created to coordinate the various educational programmes tar-

geted at those over 16 who do not stay in formal education, including in-firm training offered through the New Deal employment programme. Nevertheless, although the emphasis on training has become more prominent under New Labour, the structures responsible for delivering it have not been reformed in any significant way. This contrasts strongly with the proposals developed by the party in the late 1980s. By 1990 Labour had committed itself to a National Training Fund financed by a levy of 0.5 per cent on companies' payrolls, and involving the participation of trade union representatives. Prompted by the opposition of business, and under the influence of Blair—first as employment spokesman, later as leader—the party gradually abandoned this corporatist approach in favour of one stressing the responsibility of individuals and employers for training, and seeking to involve business in the delivery of training rather than relying on tripartite consultation (King and Wickham-Jones, 1999). In training as in other policy areas, trade unions remain firmly outside the decision-making process.

There remains considerable doubt about the impact these educational policies will make on the distribution of opportunities in the UK. The British educational system, like those of other Anglo Saxon countries, delivers a very inegalitarian pattern of educational outcomes. Standardized tests reveal a distance between the literacy skills of the least able 5 per cent of the labour force and the average that is more than half as big again as in Germany, for example (OECD, 1997, Table 1.1). A major attempt to raise educational standards targeted especially at the bottom end of the distribution would help to reduce earnings inequality. It would also represent an unambiguous increase in economic efficiency as there is ample evidence of appalling wastage of talent in a system where educational achievement is so closely tied to the social and economic background of pupils (see Edwards and Whitty, 1994). Some of New Labour's flagship educational policies could, indeed, be interpreted as part of a radical agenda to improve the opportunities available to those at the 'bottom end'. Currently in a pilot phase, educational maintenance allowances have been introduced as means-tested financial incentives for 16-year olds to stay in full-time education. Meanwhile the DfEE has demonstrated its willingness to intervene directly in the management of schools—over the heads of local education authorities—in order to improve standards and eliminate poor teaching. This interventionist approach is being combined with an effort to involve business more directly in education activities in their localities, mainly through the newly created Education Action Zones in areas of poor educational performance. In one case a private-sector company took over direct responsibility for the management of

a school. These and other policies testify to Labour's commitment to use the arm of central government to redress failure of local governments to carry out their educational responsibilities.

However, leaving aside the question of whether the educational reforms are well-conceived in themselves, a further question concerns the economic context in which they are introduced. Educational achievements are lowest precisely in the areas where poverty and joblessness is most prevalent (Bradley and Taylor, 1996). There are a number of reasons for this. Children (and parents) are less likely to take hard work at school seriously when there is a widespread perception that effort and job prospects are only weakly related. And learning will be difficult in schools which have high concentrations of children from low-literacy and low-numeracy backgrounds. Sustained improvements in educational outcomes in such areas probably depend on bringing employment to these areas, thereby increasing the 'point' of gaining qualifications and reducing household poverty. The weakness of the welfare-to-work policies in the face of joblessness in these areas noted earlier is likely to jeopardize the government's hopes for a radical extension of equality of opportunity through educational reform.

6. Labour and the Trade Unions

Between his accession to the Labour Party leadership in 1994 and the general election 3 years later, Tony Blair spent considerable energy undermining the party's links to the trade union movement. The somewhat surprising electoral defeat in 1992 was attributed in part to the continuing identification of Labour as a party representing the special interests of organized labour. In April 1995 the Labour leadership succeeded in ditching Labour's symbolic commitment to nationalization after party members voted 9:1 to delete the famous Clause 4 from the party's constitution. Union influence within the party was further diminished when the unions' block vote at the annual conference was lowered from 70 per cent to 50 per cent. A month later Blair told the TUC Conference that the unions would have no more influence than employers over a Labour government's policy agenda, promising to 'govern for the whole nation, not any vested interest within it'.

In two areas, however, Labour did bow to union pressure before coming to power in 1997. First, it maintained its pledge to introduce a minimum wage; second, it promised that firms would be compelled to recognize and negotiate with unions where they are supported by a majority of the work-force. In both cases, however, the government insisted on important caveats that continued to generate tense relations

with the unions after the 1997 election. Despite continued pressure the Labour leadership refused to commit itself to a stated minimum wage, arguing instead that a specially convened independent Low Pay Commission would set the figure. The Commission's recommendations, adopted by the government in late 1998, disappointed the union movement hugely. First, the government set a minimum wage of £3.60 per hour, whereas the TUC had called for £4, and some unions (such as the public-sector workers' union, Unison, and the Trade and General Workers Union) for £5. Second, it added a lower minimum of £3 per hour for workers aged 18–21, a figure which will remain unchanged until 2001 (as does the adult rate). Once in power, the Labour government also infuriated unions by demanding extra conditions on the procedure for union recognition in the work-place. After a year of heated tripartite negotiations, the TUC conceded to government demands that a majority of those voting *and* at least 40 per cent of those eligible to vote would be required before a union would be recognized. In addition, firms with fewer than 21 employees are exempted from recognition procedures, and a derecognition provision has been included 'if employee support for recognition arrangements reduces significantly'.

These bitter rows between Labour and the unions have been tempered somewhat by the package of measures concerning employee rights contained within the *Fairness at Work* proposals (now the Employment Relations Act). The mandatory recognition procedures are accompanied by a range of increases in statutory minima that the TUC has hailed as the 'biggest advance in workers' rights for a generation'. First, the proposals include a raft of family-friendly regulations for employed parents. Maternity leave will be increased for all employees from 14 to 18 weeks, notice arrangements for leave will be simplified, and leave entitlement will apply after less than a year of employment. A statutory right of 3 months' parental leave for all employees is to be introduced. Contracts of employment will continue to be in force during parental leave and additional maternity leave unless expressly terminated by dismissal or resignation. Second, the individual employee's rights in the event of dismissal have been strengthened. The period of employment before an employee can qualify for protection against unfair dismissal is to be reduced from 2 years to one, and maximum amounts of compensation awards will be raised from £12,000 to £50,000. Employees will also be given a right to be accompanied by a trade union representative in disciplinary or grievance procedures. Third, trade unions have secured moderate but important gains from the bill. Blacklisting and work-place discrimination against workers because of union membership will no longer be

allowed, and public funds are to be provided for training union representatives.

These measures may well constitute 'the most comprehensive package of legislative proposals to extend employee and trade union rights . . . for more than a quarter of a century' (Taylor, 1998). That this is the case, however, is more a testament to the neo-liberal revolution in industrial relations law under the Conservatives than to the radical content of these proposals. The Employment Relations Act is fundamentally concerned with individual employment rights rather than those of trade unions. Though the bill expands union powers and protection, it is far from clear that their bargaining strength in the workplace will be any greater than before. Even when union recognition has been secured, for example, there is nothing in the bill that forces the employer to bargain in good faith. Nor will the law prevent individual employees from agreeing different terms with their employer to those agreed between the company and the recognized trade union. Second, the significance of the catalogue of employment protections proposed should not be overstated. Workers' rights in Britain continue to lag far behind those of their EU counterparts in Germany, France, and elsewhere. Finally, but most importantly of all, Labour's most significant decision remains that of not reversing the most important inroads into statutory protection for unions and employees that the Conservatives introduced in the 1980s, such as restrictions on strike activity and enforced liabilities for the economic consequences of strikes at firm level.

Despite this reluctance to restore union rights, individual workers' prospects may improve considerably as a result of Labour's decision to sign the Social Chapter of the Maastricht Treaty. In itself, the Social Chapter constitutes little more than broad areas of priority for social policy, such as affirming equal treatment for men and women, the protection of the rights of workers who move within the EU, and the improvement of conditions of employment. Signing up to the Chapter, however, binds Britain to implementation of European Commission directives regulating specific aspects of working life. In December 1997 Britain became subject to the terms of the Parental Leave Directive, later incorporated into the Employment Relations Act. At the same time the European Works Council Directive came into force in the UK, requiring companies with at least 1,000 employees in total, and at least 150 workers in each of two EU member states, to establish consultative structures with the work-force on issues affecting them.

Most controversial has been the adoption of the Working Time Directive, which stipulates that EU workers must not be required to work over 48 hours per week. The politics surrounding the implemen-

tation of this Directive capture many of the dilemmas confronting New Labour. Britain's average working hours are considerably longer than those of other nations (in 1997 average annual hours worked were 1,731 in the UK compared to 1,656 in France, 1,574 in Germany, and 1,552 in Sweden).¹¹ The relative effect of the Directive in the UK's highly deregulated labour market would thus be sizeable. Yet the restriction of working hours by legislative fiat is something that the Blair government would almost certainly not have chosen to introduce, anxious as it is to reassure business of its commitment to the neo-liberal conditions for competitiveness. New Labour's response to the inescapability of implementing the undesirable has been to introduce amendments to the legislative version of the Directive which would exempt millions of workers from coverage by the 48-hour rule. The government proposes to exempt voluntary work hours above the contractual maximum from the 48-hour limit, as well as exempting employers from maintaining detailed records on employees' overtime. Blanket restrictions apply to a number of categories of employment, particularly in the public sector.

In other areas of social and industrial relations policy the Labour government is fighting within the European Commission and the Council of Ministers to amend and/or veto additional directives—for example, requiring employee consultation within companies solely operating at the national level. The government's opposition to creeping regulation from Brussels has predictably earned it strong support from employers' organizations and hostility from the TUC. Labour is therefore able to claim credit for the social welfare improvements forced upon it by EU membership, while simultaneously fighting to dilute their impact.

7. Competitiveness

Labour's competitiveness strategy is classic Third Way politics: 'Old-fashioned state intervention did not and cannot work. But neither does naïve reliance on markets' (Tony Blair, Foreword to *Our Competitive Future* (DTI, 1998)). The government's Competitiveness White Paper conceives of a division of labour between companies and government—the state's job is to establish and police competitive markets to allow entrepreneurs to innovate, but also to invest in companies' 'capabilities' when they cannot do so alone (for example, investment in a work-force with good basic skills). The government stresses repeatedly the need for companies to adapt their competitive strategies to the realities of the

¹¹ *OECD Employment Outlook* (1998, Table F, p. 207).

new 'knowledge-driven economy', and to that end has introduced measures designed to promote links between educational and research institutions and industry (Education Action Zones, and an extra investment of £2 billion in science and engineering research, for example).

Primarily, however, New Labour endorses the view that the best approach to improving competitiveness is for governments to keep intervention and regulatory burdens to a minimum. This approach to state-industry relations reflects one of the most significant policy continuities with the Conservative governments under Thatcher and Major that preceded it. New Labour has not only rejected calls for the re-nationalization of industries privatized under the Tories, most spectacularly after the Paddington rail disaster when opinion polls suggested huge public support for renationalizing Railtrack. It is also actively pursuing *further* privatizations, most notably of the air traffic control system. Labour is also initiating a restructuring of the ownership structure of the Post Office, proposing its conversion into a public limited company with all shares owned by the government. In a similar vein, New Labour has taken up the Tory policy of introducing private-sector capital into the public sector through private finance initiatives (PFIs). By 2004 the UK government will be paying out £3.5 billion per year under PFI contracts, much of which will involve purchase of current services (such as hospital maintenance) as well as interest payments which, as Chennells *et al.* (2000) note, 'will always costs more under the PFI than under conventional finance, since the government is able to borrow more cheaply than the private sector' (p. 37). British business is now heavily involved not only in investment in infrastructure in education, health, and other areas of the public sector, but is also extending beachheads into public-sector management—for example, in the management of educational authorities, schools, and urban regeneration zones.

8. Conclusion

Although New Labour's policies share little with those classically identified with social democracy, it would be wrong to characterize them as devoid of any overall objective or coherence. Clearly Labour has prioritized macroeconomic stability—partly in response to the anxieties about a return to the economic tribulations of the 1970s. From this perspective, joining the ERM, thereby ensuring much greater stability for the exchange rate, seems an entirely logical next step (provided it occurred at a reasonable exchange rate for sterling). Gordon Brown's five economic tests for judging whether the time is

right for entry are pitched at an extraordinary level of generality (for example, 'If problems emerge, is there sufficient flexibility to deal with them?') and give ample latitude for justifying whatever decision on entry is felt to be politically expedient.

In its quest for economic stability and the political centre ground, Labour has imposed upon itself stringent constraints on its tax and spending capacities, and this rules out many of the redistributive policies that left parties have traditionally pursued. Yet this is not a source of regret for Blair's New Labour, as the pursuit of greater equality by active redistribution of income is rejected *in principle*, for a mixture of political, economic, and moral reasons. Redistribution implies a zero-sum trade-off between the interests of rich and poor that New Labour considers misguided. New Labour's egalitarianism lies in its various attempts to construct incentive structures for individuals on low incomes to increase their earnings potential through their own efforts. These and other policies reflect an approach to poverty which focuses solely on the absolute position of the least advantaged, one which would accept greater inequality if this was a necessary by-product of raising standards at the bottom end via supposed 'trickle-down' effects resulting from improved incentives for entrepreneurs at the top end. So this concern for improving the position of the most disadvantaged coexists with policies that reflect a tolerance for (and even actively encourage) the further acquisition of wealth by the most advantaged. The result of this combination is one which may well be *more* inequalitarian, though arguably more meritocratic and with a higher floor than before. In this respect New Labour has disentangled the traditional social democratic aims of promoting equality and eliminating poverty in ways that many on the left find both unacceptable (in respect of greater inequality in the top half of the distribution) and unconvincing (in respect of the near exclusive emphasis on the labour market).

The central feature in New Labour's strategy for addressing poverty, disadvantage and social exclusion is the reliance on *work*, and government policies are being tailored to encourage, and in some cases compel, individuals to enter and remain in employment. These have had positive effects on the distribution of income but fall far short of a comprehensive assault on the trend towards greater inequality and increased poverty. A radical improvement in educational performance, especially in areas of low educational achievement, would be an important component of a more thorough strategy to tackle these problems. But it needs to be complemented by:

- deliberate policies for job creation in the areas of highest joblessness, currently missing from New Labour's supply-side approach;
- a comprehensive attempt to improve conditions of employment at the bottom of the labour market (where the minimum wage stands in contrast to the government's stress on flexibility);
- acceptance of greater redistribution towards those at the lower end of the income distribution for whom education and the labour market does not provide an escape route.

The broader point for comparative social democracy is that the policies introduced by Blair's government so far imply a significant redrawing of the boundaries of state activity. Rather than provide a generous safety net for the unemployed, for example, New Labour sees the state's role as stimulating their re-entry into the labour market. As the welfare state evolves from a generous and comprehensive safety net for multiple categories of individuals into a series of employment programs with lower levels of long-term 'dependency', the rationale for increasing the state's share of GNP will diminish further. In macroeconomic policy the fiscal ambition of social democracy is rejected, and control of interest-rate policy is seen as better exercised by an (almost) independent central bank (whether in London or Frankfurt), than by the government.

Responsibility for training and re-training, meanwhile, must rest with individuals and employers, not with the state. Neither should the state involve itself in private-sector industrial relations or wage bargaining. And with regard to ownership and investment in industry and services—even those in the public sector—the private solution is instinctively preferred to one relying on the state. The difficulties with a strategy of combining an improvement in the position of the worst-off with a diminishing role for the state has been the theme of this chapter. If New Labour could square this particular circle it would be the envy of many a social democrat abroad.

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