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By

T Burns
Second Permanent Secretary
Chief Economic Adviser

12th November, 1980.

Dear Tim,

SPECIAL EMPLOYMENT MEASURES

You wrote to me on 15th October asking why if it is right to spend some extra money on employment measures why not spend more? This discussion has moved on since you wrote but I agree there is both an intellectual and a presentational problem.

2. In macro-economic terms we begin from the point where we think we have the appropriate PSBR for the monetary target. In a full "crowding-out" world any attempt to increase the PSBR will set in motion offsetting forces that will damage activity elsewhere. In practice we are unlikely to get full crowding-out in the short-term but we consider it unwise to rely upon this for large changes as the cumulative effect upon interest rates and activity can become large. The implication for high interest rates can increase more than in proportion. This might be because of the effect on the confidence of investors in the gilts market as they observe the extent of overrun of the PSBR relative to the MTFs. The risk of having to raise interest rates sharply is increased more than proportionately.

3. Therefore whilst we are prepared to spend some money on unemployment measures the scope is limited if we are to avoid running into the PSBR problem and the consequences for interest rates outlined above. In addition:

- (a) Their effectiveness relies upon how well they can be targetted to special groups so that they create jobs without displacing other workers on a one to one basis. Targetting is always tricky and gets progressively more difficult as the programmes get larger. Another reason why targetted programmes can run into diminishing returns is that the scope for sensible jobs gets exhausted and expansion of the programme leads to relatively silly jobs being created.

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- (b) It may be that the Phillips curve is non-linear in the relevant range; particularly if there are major imbalances within regions or age groups and those groups can be specifically reached. In the early stages it may be possible to employ such groups without adding to labour market pressures but the higher the rate of expenditure the more it becomes equivalent to general reflation.
- (c) It is not clear that the regional distribution of employment is affected but age unemployment may be. Apart from STEP, SEMs do not have a useful regional effect but they are likely to shift unemployment from the young to the main mass of the labour market. There are many political benefits to redressing the balance here even if the macro-economic arguments are limited.

John

Terry

(TERRY BURNS)

P.S. I am copying this letter to John Patterson and John Wiggins here and to Andrew Duguid at No.10.