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Michael Scholar, Esq.,
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Prime Minister

You may like to
glance at this note I
commissioned on the SDP proposals.
Plus 4/11

Dear Michael

SDP JOB CREATION PROGRAMME

In your letter of 29 October you requested a note for the Prime Minister on the SDP's "carefully costed package of £2-3 billion to create jobs in the short and medium term" (Hansard Col. 908 28 October).

.... The package was outlined by Mr. Roy Jenkins in a speech at Warrington on 7 July. I attach a note analysing the main points in the programme. As you will ^{see} our view is that Mr. Jenkins' costings were on the optimistic side and that many of his proposals were not described sufficiently clearly for us to be able to offer sensible comments.

Yours ever
Peter

P.S. JENKINS

MR JENKINS' PROPOSALS TO HELP UNEMPLOYMENT

Mr Jenkins outlined a six-point programme to "turn the tide of our national economic decline and start to get the jobless back to work" on 7 July in Warrington. Comments on the main points of the programme are as follows:

(i) Layard-type schemes

2. Professor Richard Layard has suggested that the Government should offer a subsidy to firms giving jobs to the "long term unemployed" (ie those who have been unemployed for more than a few months). The size of the subsidy, which is assumed to be topped ^{up} by the employer to the going wage, would be related to the resulting improvement in the PSBR - payments of unemployment benefit would be reduced and tax receipts increased - with the aim of limiting the cost to the PSBR. The scheme would apply to net additions to the workforce only, and would have limited duration; it would apply to the private sector only.

3. A marginal subsidy of this kind would encourage some firms to take on extra employees and would certainly be more cost-effective than a general subsidy on all employment. However, all schemes of this kind suffer to some degree from "deadweight", "substitution" and "displacement" effects, so that the net reduction in unemployment tends to be much smaller than the total number of subsidies paid. If allowed to run for long periods, employment subsidies can also have undesirable side effects on the efficiency of the labour market.

4. A marginal labour subsidy of the Layard-type could increase the number of jobs offered to the long term unemployed, and could probably reduce the overall level of unemployment. How cost-effective it would be is for further examination. It is understood that Mr Prior proposes that such an examination should be put in hand.

The unit cost implicit in Mr Jenkins' figure (£1,600 per person off the register) is in line with the DE estimate of the net cost of additional plans on the Community Enterprise Programme. That estimate, of course, takes credit for "first round" effects (reductions in social security benefits, higher tax receipts, etc). Both the gross cost, and the cost after taking of "second round" effects would be higher.

(ii) £1 billion expansion of public sector investment

6. How many jobs are created by such an investment programme will depend on which projects are selected: the kind of project mentioned by Mr Jenkins - investment in telecommunications, railway modernisation etc - are unlikely to be very attractive in this respect. Treasury model ready-reckoners suggest that for a £500 million expansion of average public investment, some 25,000 new jobs might be created, only half the figure quoted by Mr Jenkins.

(iii) Programme of housing renovation and environmental improvement

7. Local authorities already spend substantial sums on housing/environmental projects. Of their gross capital allocation of £2,300 million for 1981-82, it is estimated that local authorities in England and Wales will spend some £790 million to finance their own improvement schemes, some £100 million to finance housing association improvement, some £150 million for improvement grants to the public sector and £30 million for grant-aided private sector home insulation schemes (these figures are illustrative: local authorities have discretion in how they use their allocations). In addition some £500 million has been allocated to the Housing Corporation, of which about half will be used for housing association improvements in addition to that financed by local authorities.

8. There is of course always scope to spend more money on improvements as proposed by Mr Jenkins. However, the present totals (reflecting Cmnd 8175 totals) are a consequence of the degree of priority the Government has felt itself able to give to housing, faced

with the need to reduce public expenditure and borrowing.

(iv) Part-time jobs for home helps, etc

9. There is insufficient detail to provide useful comment on this. However, a high proportion of those interested in part-time work of this kind would be married women who would not usually bother to register as unemployed if they were without a job. Thus the effect on registered unemployment might be quite low.

(v) Package of measures on youth unemployment

10. Again, insufficient detail is provided to carry out a full analysis. In particular:

a. How big would the proposed educational maintenance allowances be? Would they be means-tested (as the reference to "poor families")?

b. How large would the grants to employers be?

c. What would be the content of the programme to extend and improve training? How large is the proposed expansion in Work Experience (ie YOP)?

11. The following gives some indication of the sort of numbers we might be dealing with:

a. There are about 800,000 16-18 year olds at school. So an EMA of, say, £10 a week would cost around £400 million a year. The effect on youth unemployment would be marginal since "deadweight" would be very high. Perhaps 50,000 young people?

b. The net unit cost of some current MSC proposals to subsidise apprentice training and the like is put at £4,900 per person off the register per year. If, say, 20,000 young people

a year were affected, this would give a cost of some £40 million.

c. Thus we might be talking of another 100,000 or so YOP places. The cost might be £100 million if the courses lasted six months; and about double that if the courses lasted a year.

12. In total, a programme to create 150-200,000 new jobs for young people might have a first round cost of some £550 million. This compares with Mr Jenkins' claim that a package of £300 million "should aim to bring down the dismal tally of youth unemployed by 200,000".

(vi) Measures to improve competitiveness

13. Mr Jenkins argues that action to "hold the pound at a fair rate on the foreign exchange" and other measures to improve competitiveness would "create 250,000 jobs quite quickly, and over a million if sustained for five years". Mr Jenkins does not say how large a devaluation would be necessary to achieve such increases in employment, but it would have to be very large indeed. Treasury model simulations suggest that a 20 per cent devaluation might raise employment by only 100,000 after 1 year and perhaps 400,000 after 4 years. Thus Mr Jenkins might be thinking of a devaluation of the order of 50 per cent. The impact effect on prices might be 15 per cent after one year and there would be strong upward pressure on interest rates if money supply targets were to be maintained. Mr Jenkins, however, appears to believe that interest rates could be brought down. We would agree with his view that there must be moderate wage settlements but would see this, and not devaluation, as the main instrument for achieving improvements in competitiveness.

General Comment

14. So far as it is possible to put figures on Mr Jenkins' proposals, it looks as though his costings are optimistic even if they are based on net costs. And he takes no account of "second round" effects, which we would argue are adverse. There can be no

& guarantee that Mr Jenkins' proposals would be "substantially self-financing in terms of the extra activity and tax revenue they will generate". The danger is that the extra expenditure would be dissipated in higher inflation, or that interest rates would rise and choke off the extra activity. A table summarising his proposals is attached.

Summary of Mr Jenkins' Proposals

	Jenkins' estimates		Treasury comment
	PSBR cost (£m)*	Impact on employment	
(i) Layard-type scheme	400	250,000	PSBR cost higher after allowing for "second round" effects
(ii) £½ billion public investment	500	50,000	Employment effect overstated; perhaps only 25,000
(iii) Housing/environmental improvement	200	250,000	Unit cost looks very low
(iv) Part-time jobs for women	200	60,000	Impact on <u>registered</u> unemployment might be quite low
(v) Youth employment programme	300	200,000	Costs too low: £½ billion programme might create 150-200,000 new jobs
(vi) Lower exchange rate	?	250,000	Very large devaluation needed; possibly 50%. Might add up to 15% to RPI after one year
 Total programme	 £2-3 bn	 1,060,000	

* First-round costs; take no account of adverse "second round" effects.