10 DOWNING STREET

Prime Minister

(i) The Chancellor would like the Chief Secretary to come.* Content?
Yes mt
(That would make 8 in total.)

(ii) I suggest you raise the question of Local Enterprise Agencies at your next bilateral rather than tomorrow. Tomorrow's meeting has a big agenda.

DRN
6/11

* Both Employment Ministers are coming.

PRIME MINISTER 6 November 1985

MEETING ON JOBS

GENERAL STRATEGY

David Young has come up with a characteristically enterprising set of proposals to bring unemployment gradually down over the next two years.

The combined effects of his proposals are meant be:

	Direct Reduction in Unemployment	Gross Cost	Net Cost [Gross Cost less Benefits Saved & Extra Tax Recouped]
By April 1987	160,000	£340m pa	£115m pa
By April 1988	230,000	£800m pa	£295m pa

The Department of Employment's predictions of the direct effects on the unemployment count and the gross costs are fairly robust, because they are based on reasonable assumptions derived from previous experience of similar schemes.

But we cannot be confident about the net costs or the indirect effects on employment, because:

i. it is not certain how many businesses are damaged by the economic distortions caused by such schemes;

ii. it is never possible to be sure, in advance, how far the schemes will subsidise people to do jobs that they would have done anyway.

Our guess is that - to play safe - you should double the net cost figures, and then round them upwards. On that basis, you could be talking about a package costing the Exchequer about £250 million in 1986/7 and about £600 million in 1987/8.

The main question is whether you think it worth foregoing that amount of tax cuts for the sake of knocking roughly a quarter of a million people off the unemployment count between now and the next election.

We believe that, on political grounds, the game is worth the candle. Somewhat smaller tax cuts with falling unemployment will be welcomed; whereas bigger tax cuts with stable or rising unemployment may well be regarded in many quarters as heartless. A significant and sustained decline in unemployment would probably do more than anything else to deprive your opponents of ammunition and to help you win the election.

We therefore recommend that you should back David Young's general strategy.

TIMING

It would cause extreme resentment if you allowed David Young to announce these expensive measures directly after the hard-fought public spending round. And there are many details yet to be sorted out.

We therefore recommend that you ask David to work up the proposals with the Treasury and other Departments so that he has fully developed schemes to announce in next year's budget. This should leave enough time for the measures to produce the desired effects by 1987/8.

THE PROPOSALS IN DETAIL

1. Extension of Existing Schemes

	Effect on Count by April 1988	Annual Gross Cost from 1987/8	Likely Annual Net Cost from 1987/8
Enterprise Allowance	16,000	£85m	£40m-£80m
New Workers Scheme (ie Young Workers Scheme for 18-21 year olds)	23,000	£48m	£30m-£60m
Additional Anti-Fraud Teams	10,000	£3m	-£5m-0
Community Programme	65,000	£334m	£150m-£300m
	114,000	£470m	£215m-£440m

As you can see, these extensions would, fairly predictably, remove over 100,000 people from the register by April 1988; and they might have a net cost near to David Young's figures of only £215m, since they have all been amended over the years to minimise both displacement of other economic activity and the subsidy of job creation that would have occurred anyway.

If you want an employment package at all, it is clearly sensible to begin by expanding the schemes that have already been tested. Both the costs and the direct effects on unemployment are more secure than for new schemes.

We therefore recommend that you should ask for these extensions to be planned as part of next year's Budget.

2. Cost-Free Legislative and Administrative Changes

You will clearly want to welcome David Young's initiatives on **tourism, deregulation and more effective targetting of the Adult Training Strategy.**

We recommend that David Young should emphasise these items in the presentation of any jobs package, so that the long-term economic aims of the government are not submerged beneath short-term employment projects.

We also recommend that you should ask David Young for an assurance that the next Paper on deregulation will contain proposals for action, not just vague promises like the last document.

3. 'Guarantee' for the Long-Term Unemployed

For years, you have been asking D/Emp and DHSS to produce a tough mechanism for driving fraudsters off the register. The problem has always been to make this presentationally acceptable in the North of England, where real unemployment exists in large quantities.

David Young has come up with an extremely ingenious wheeze. His so-called 'guarantee' for the long-term unemployed (an interview followed by either a job or a place on a scheme or a brief training course) is actually a method for introducing mass detection of fraud by the back-door. All the evidence suggests that, when all the long-term 'unemployed' are called for interview, a significant proportion will sign off the register immediately. The Department of Employment's estimate that 10% will act in this way may even be an understimate: the existing fraud squads reckon on 20% or 25% 'defections'.

We recommend that you support this 'guarantee' in principle, and ask David Young to run a pilot scheme immediately to see whether it works in practice. A few weeks' trial will reveal its success rate.

4. 'Enterprise' Scheme for the Long-Term Unemployed

David Young is also proposing to introduce an 'enterprise' scheme for the long-term unemployed. People unemployed for more than a year would be given a six month non-taxable allowance of £20 per week if they took a job at £80 per week or less. When a similar scheme was discussed a few months ago, Tom King decided against it because:

- it might involve a lot of 'deadweight' (subsidising people who would have taken jobs anyway); this could drive the net cost way up;

- it might cause resentment amongst people who were already employed at low wages, and who would complain that no-one was giving them a £20 bonus each week;

- it might conflict with Norman Fowler's new 'family credit'.

These are real dangers. But they may be outweighed by two advantages:

- the scheme could dramatically reduce the 'why work?' problem at much lower cost than rises in tax thresholds;

- it could put considerable downwards pressure on wages.

The Japanese, who run the same sort of scheme, seem to be persuaded that it is effective - though they, of course, make it more attractive by allying it to a complete absence of long-term unemployment benefit!

On balance, we recommend that this proposal is worth further consideration. You could ask David Young to:

i. consult Norman Fowler about the relation between the scheme and family credit;

ii. consider amendments to limit deadweight and other dangerous effects; such amendments could include:

- gradual tapering away of the £20 so workers don't suddenly lose income and go back on the dole;

- preventing people benefitting from the scheme more than once in any five year period;

- restricting the scheme to people who become unemployed due to being sacked or made compulsorily redundant.

5. Loan Guarantee Scheme

David Young proposes to give the a loan guarantee scheme a new lease of life.

This would be extremely risky. In the past, when such loans were offered on attractive terms, the failure rates were high; and when a tougher regime was installed to reduce losses, the scheme failed to attract borrowers.

In addition:

- The Government would guarantee a total of £400m, without any way of knowing what proportion of this would be called in: a recipe for sleepless nights.

- Given present interest rates, a new loan guarantee scheme with a 2% premium could be a route to speedy bankruptcy for all but the most successful small businesses .

These dangers probably outweigh the political advantages of the proposal.

However, there are two options that might capture the political benefits without exposing the Government, banks and small businesses to so much risk. You could:

either make it a condition of the guarantee that the bank also provides an equity investment of a fixed proportion of the loaned sum; (this would both reduce the interest charges for the small businessman and give the bank more of an incentive to take a real interest in the development of the business);

or abandon the loan scheme and instead loosen the terms of the Business Expansion Scheme, to bring more venture capital to small businesses.

We recommend that you ask David Young to consider these and other less risky forms of aid for small business.

6. Expansion of TVEI

David Young wants to expand the Technical and Vocational Education Initiative. This initiative is the darling of the DES; but we doubt whether it is, in practice, much more than a method of providing extra money and a fancy title for already existent 'vocational' training in schools. £40m per annum sounds like a lot of money to spend on that.

We recommend that you drop this option, too. If you want to spend another £40 million on training, it would be better given to the YTS, which does not share the anti-vocational ethos of the schools.

7. <u>Reserve Measures</u>

You do not need to take any decisions about the proposed reserve measures at this stage. It is comforting that David Young has things up his sleeve; but there is no point in arguing about the details unless and until the need for yet more reductions in the unemployment count becomes apparent.

CONCLUSION

<u>We suggest</u> that you should:

- back David Young's general strategy;

- agree that the proposed extensions of existing schemes be worked up in time for next year's budget;

- emphasise deregulation, tourism and the re-targetting of the adult training strategy;

- extract an assurance that the next Paper on deregulation will contain firm proposals for action;

- support the so-called 'guarantee' for the long-term unemployed (ie the interview that scares fraudsters off the register), and ask David Young to set up a pilot scheme immediately;

- ask for more work to be done on the 'enterprise' scheme for the long-term unemployed (ie the allowance that might crack the 'why work?' problem);

- press for a less risky version of the proposed loan guarantee scheme, and a re-examination of the rules of the Business Expansion Scheme;

- refuse to extend the 'Technical and Vocational Education Initiative'.

Janet Ewison.

pp. OLIVER LETWIN