

CCRB

PRIME MINISTER

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1 August 1986

A lot of this is in the way of already
dismiss this paper with Lord Young's note in August

REVIEW OF UNEMPLOYMENT POLICIES

The Government's record and policies on unemployment will be one of the crucial battlegrounds for the next Election. The purpose of this memorandum is to take stock of the current position and set out a range of policy options that can be examined and developed as appropriate - either for immediate implementation or for incorporation in the next Manifesto.

Our conclusion is that the current high levels of unemployment primarily reflect the substantial restructuring of the UK economy over the last 7 years combined with a welfare environment that has removed the financial imperative to work. With UK productivity still well below world standards, the restructuring still has a long way to go and there is consequently little prospect of getting unemployment down to much lower levels in the near term.

Despite this prognosis, it is clearly important politically to show some downward movement over the next year or so, and Lord Young's campaign to shift 2-300,000 ineligible claimants off the register through Restart interviews and tougher claim tests offers the best (and cheapest) hope for achieving this. To address the remaining longer term problem the Government also needs to consider what further action it might take to assist economic adjustment and improve work incentives while ensuring that temporary measures to provide short term relief provide maximum value for money.

To allow time for any new approaches to be developed, you may wish to arrange an early autumn discussion with both the Policy Unit and Lord Young on priorities for further work.

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1. How Real is the Problem?

While opinions differ widely on both the origins and importance of the current high unemployment levels, in our view the primary cause of the major rise in the 1980's has been a major and long overdue restructuring of the UK economy forced by the need to catch up with the productivity levels of our major competitors. After several decades of avoiding the problem, the initial shock provided by the oil price rise and world recession of 1980 combined with this Government's favourable industrial relations climate have triggered a major shake-out of non-productive labour in both private and public sectors.

Total employment consequently fell by 1.9m between 1979 and 1983, and - despite the recent rise - is still 1.0m less than 7 years ago. At the same time, there has been an unprecedented rise in the UK labour force - with the 'working population' up 1.2m from 1979 as a result of both the baby boom and increased female participation. Reflecting the increasing gap between the labour force and employment, the number of registered unemployed rose by 2.2m during this period (see Annex 1).

At the macroeconomic level, a significant reduction in the current levels of unemployment arithmetically requires a sustained period of fast economic growth. However, the barriers in the UK labour market combined with our poor international competitiveness render any purely macroeconomic approach ineffective. A sustained reduction in unemployment can only be achieved by continuing to improve competitiveness while tackling the microeconomic problems that have prevented the labour market from adjusting to absorb the unemployed:

- a. The welfare cushion has clearly been an important contributor - removing the downward pressure on wages and encouraging many unemployed to opt out of the labour market. Almost one

quarter of the unemployed are estimated to have been getting benefit levels within 20% of their expected work income, and unemployment benefits are often topped up with occasional black economy earnings. In the south east, in particular, the growing welfare culture has led to a whole generation of youth drop-outs supporting their lifestyle on benefits, grants and petty crime. However, given the drop in total employment noted above and the remaining low level of vacancies, it is difficult to blame the benefit system as the primary cause of recent unemployment growth in the way claimed by Ralph Howell and others.

- b. The failure of real wages to adjust has been a second major barrier. Recently in Gwent, for example, an engineering company's workforce opted for redundancy rather than accept the proposed cut in earnings. In the US, by contrast, wage reductions have been a well-publicised feature of several corporate rescue plans - for example, Chrysler and United Airlines. In 1983, approximately 15% of workers covered by major contracts in the US agreed a wage reduction; in the UK, no such examples can be found. At the bottom end of the wage structure (where it matters), this wage rigidity has been compounded by the continued enforcement of statutory minimum wages in specific industries.
- c. A third and very considerable barrier has been the low educational and work qualifications of many unemployed workers, which makes them unattractive recruits to fill the new vacancies being created. While US employment grew from 82m to 110m between 1973 and 1985, blue collar manufacturing employment actually dropped by 5m over this period, despite a continuing rise in manufacturing output. The entire growth in employment has been in non-manufacturing, and especially in non-blue collar jobs. Yet in the UK, Restart interviews suggest that a significant proportion of the long-term unemployed have difficulty in the basic skills of reading and writing. Thus, one has the anomaly of record unemployment

co-existing with increasing reports of skilled labour shortages.

- d. A further major factor has been the basic lack of entrepreneurialism in the UK relative to the US, with much less new employment generation coming from the small and medium business sector which has been the engine for growth in the US economy.
- e. High redundancy costs have also had some impact in discouraging firms from expanding their labour force and may partially account for the steady increase in overtime working.
- f. Finally, economic adjustment has been inhibited by the historic lack of mobility in the UK labour market, for all the reasons associated with our highly regulated housing market and the severe differentials in house prices between London and the North (which have been exacerbated by planning restrictions).

Given this analysis, the prospects for a major reduction in unemployment in the near term are not encouraging. However there is some prospect of achieving a small short term decline as a result of Lord Young's measures and the Government can also point to specific areas where it has achieved a major impact.

- With the expansion of special measures now coming to an end, the prospect of achieving some decline in total unemployment now depends heavily on whether the anticipated 2-300,000 claimants removed from the register by Restart and eligibility tests, together with the expected slower growth in the labour force, will be sufficient to reverse the recent trend rise of 15,000 per month. Given the considerable opportunities for a further shakeout of non-productive labour, the uncertain prospects

for economic growth and the possibility of disruption in South African trade, a positive outcome cannot be assured. Furthermore, any short term decline could prove to be only a temporary effect. The prospects will obviously need to be kept under close review.

- The 1.4m long-term unemployed (up from 32% to 42% over 7 years) are an important secondary target. Over 4m people join the unemployment register each year, but a quarter of these readily find new employment within one month and two thirds within six months. The number of short term unemployed has actually remained almost constant since 1981 while total unemployment has risen. Those who fail to get a job within a year, apart from the "malingerers", are generally those with the lowest education and skill levels who find it difficult to compete for jobs (Annex 2) - and this group therefore becomes increasingly isolated from the labour market. Many of the Government's existing programmes are specifically aimed at tackling this problem.

- Youth unemployment has been another area of particular concern, but all those under 18 who wish to work should now be catered for through YTS, CP and other tailored programmes. The task here is now to publicise the Government's achievements and deal with the remaining 'drop-out' group. Attention also needs to be given to the 18+ group where unemployment rates are still over 23%.

- A more difficult problem - and one highlighted by the media - is the concentration of unemployment in particular regional blackspots. Travel to work areas (TTWAs) with a very high unemployment rate (20% or above) contain only 20% of the unemployed population, but are nevertheless highly visible. The proportion of long-term unemployed is also much higher in these locations - 45% as against 31% in the TTWAs with unemployment below 10%. This is an area

where cost-effective action is particularly hard, but more needs to be achieved.

In tackling these problems, the Government's response can be divided into those policies aimed primarily at assisting the long-run economic adjustment, and those aimed at providing cost-effective short-term relief. These are considered in turn.

2. Encouraging long-term structural adjustment

Both already done

Within the essential framework of the Government's macroeconomic strategy, the two crucial areas where the Government can assist the long term adjustment of the economy are in (i) encouraging the growth of new, job-creating enterprises; and (ii) providing work training for the long-term unemployed to enable them to be reabsorbed in the new growth areas. In addition the Government can help to speed the adjustment and reduce the voluntary unemployed by tackling barriers that result from the lack of work incentives, difficulties in mobility and inflexibility in wages. In all these areas the Government has a good record, but more can be done.

Further encouragement for new enterprises

The Government has considerably improved the environment for new enterprise development, and further measures on general deregulation remain a priority. In addition there are a number of possible measures for increasing direct support to new enterprise development, although the balance must be carefully weighed to ensure that the Government is not just subsidising start-ups at the expense of existing businesses.

- An easy but powerful step could be to provide a simple administrative package to help the self-employed through the process of taking on their first employee. The 2.7m

who are already self-employed provide a tremendous base on which to generate new employment. To reduce the perceived complexities of administering PAYE, National Insurance etc, the Government could provide a simple "stamp" system that covered NI and tax deductions, with under/overpayment adjusted by the Revenue at the end of the year.

- Xpensive*
- The successful Enterprise Allowance Scheme could be modified to encourage more mature workers into self employment. At the moment the fixed allowance - £40 per week - is primarily attractive to the young unemployed whose benefit level would otherwise be lower (70% of EAS scheme participants are reported to gain an increase in benefit!). Scaling the EAS allowance could attract a higher proportion of 25-40 year old entrants who are more likely to have the experience required to succeed. Although the gross cost of the scheme would rise, the net Exchequer cost should fall if the proportion of people gaining a rise in income from the EAS declines.

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In addition, it may be worthwhile removing the limitation on EAS to those currently unemployed - attracting high potential candidates to leave existing safe jobs and start up on their own. If a high proportion of the vacated places are subsequently filled the short term impact on unemployment levels could still be maintained.

- The loan guarantee scheme could also be changed to remove the need for the entrepreneur's house to be given as the primary security on a loan. The risk of losing the family residence is a significant deterrent to would-be entrepreneurs, and the lower value of housing outside the South East makes it more difficult to raise money from bank loans in the less prosperous regions. Those in rented accommodation are automatically excluded. If a minimum level of personal capital was invested (perhaps by

allowing borrowing against pension investments), the limited liability principle could be used to exclude the family home.

- Distinction*
- Xpensive*
- Further incentives for the larger scale entrepreneur might be provided by adaptations to the BES. Although BES has been very effective in attracting investment funds, many projects have relatively low employment effects. An alternative scheme could link tax reliefs to success in reaching and maintaining specified employment levels over a period of years rather than the capital sum invested - giving support to employment intensive areas like hotels which are now excluded from BES. Another option would be to allow individuals to invest their own funds in businesses of which they are the owner/manager: this might be particularly attractive in attracting mid-career executives to start up on their own.

 - A new and potentially powerful policy initiative to stimulate the rapid creation of entrepreneurial businesses would be the use of tax incentives to encourage large companies to spin-off existing small, management units. It is now increasingly recognised that large companies - while providing significant support for some subsidiaries - can severely constrain management entrepreneurialism in peripheral businesses through controls and bureaucracy. Recognition of this factor has already stimulated many "break-ups" and "spin-offs" in recent years - many through management buy-outs. Encouraging this could have positive wealth and employment effects; analysis in the US has shown that mid-size companies generally have much faster growth than the Fortune 500 and achieve higher rates of return.

On a smaller scale, similar tax incentives could also be applied to the release of individual managers to set up

and run small business units, exploiting ideas that could not be developed within the main corporate structure.

Expanded Training Measures for Unemployed Workers

Given the low employment qualifications of the long term unemployed, work focussed training to meet the requirements of new job opportunities is likely to be an essential part of moving those that can adapt back into employment. The training required may be both basic literacy and numeracy and, at a higher level, rudimentary training in a new work area.

The MSC's Wider Opportunities Programme has recently been added to the existing Job Training Scheme to provide a wider range of training for the long term unemployed. However, the Department of Employment is critical of their narrow focus on specific 'skills' and is cautious about the possibility of any larger scale initiatives because of the high cost per trainee without guarantee of subsequent employment. The solution may be an alternative approach based on extending the YTS principal to cover suitable adults as well as school leavers.

Placing the long term unemployed in what would effectively be "adult apprenticeships" with private sector employers could be much more valuable than the questionable work experience of a place on the Community Programme, while having a similar short run impact on the unemployment count. If such schemes were effective, it could also be worthwhile to divert funds from the costly Job Training Schemes, shifting the focus to 'training for work' rather than 'learning skills'.

To provide the classroom content of these schemes cost effectively - and also to provide remedial primary education for those requiring it - mechanisms should also be found to utilise the current spare teaching capacity in schools and

polytechnics identified by the Audit Commission. It is becoming increasingly apparent that basic education is a significant problem in the UK. I was recently told about a Midlands employer who wanted to move a group of employees from the production line to the warehouse - but found that 50% failed the simple literary/numeracy test he had devised as a safety check! With school and college rolls falling in the years ahead, there may be a golden opportunity to upgrade the basic educational level of the workforce at low marginal cost.

The current Restart interviews confirm that low employment qualifications are a serious problem amongst the long term unemployed. We are right to expect employers to take the initiative in training their own employees, but we cannot expect them to rectify deficiencies in our elementary education and training systems. Ensuring that this is dealt with as effectively as possible within available budgets should be a major priority. There may be room here for a major new initiative.

Greater Work Incentives

The growth of the welfare economy has obviously been a long term development. In recent years the ratio of benefit to earnings has started to reduce and the current Fowler reforms should make a significant contribution towards correcting the worst anomalies of the current system - improving the gain from employment for those with family responsibilities and reducing benefit levels for the young, single unemployed. However, the impact of these changes will take some time to work through and assess. In the meantime it may be possible to provide special arrangements to ease the transition to work - eg a one year "tax holiday" after a minimum period of unemployment. This is an area worth examining.

Encouragement to Mobility

Deregulation of the rented accommodation market is still the most important step the Government could take to encourage mobility, but is clearly not on the agenda before the next election. In the meantime the Department of Environment might consider more limited relaxation to open up the market for lodgings in private houses or hostels. Special "relocation tenancies" could be offered on terms that provide added protection to the houseowner, with places offered nationally through Job Centre interviews to individuals needing a base to establish themselves in a new location.

Greater Wage flexibility

In due course, further steps towards a more flexible labour market should be made through the abolition of Wages Councils and minimum wages to cover all workers, not just the under 21 age group. Another initiative that should be pursued, however, is the introduction of greater regional variations in public sector wages. Current national agreements tend to be set by reference to pay levels in the South East and are often far above the level needed to recruit staff in other regions with higher unemployment. Since Government and local authority pay levels tend to be used as benchmarks for other wage negotiations, the national settlement inhibits a market adjustment that might otherwise help to make regions more attractive for new business investment.

3. Providing Short-Term Relief

Alongside the policies aimed at assisting long-run economic adjustment, it is estimated that the special employment measures have had a direct impact in removing 275,000 from the register (primarily through the Community Programme), with YTS removing a further 220,000 school leavers. Consideration should now be given to refocusing the existing

programmes to improve their output value and focus. In addition the Government should develop further options to strengthen the availability for work test while developing the "work for benefit" concept as a possible fallback option.

Refocussing Existing Programmes

CP will be providing a total of 255,000 places by November 1986, with an estimated register effect of 238,000. Although some expansion of the scheme is available as a last resort to bring the count down, most of those involved believe the programme is already at the scale where it is hitting marginal returns. In particular:

- The low wage levels offered mean that the scheme is primarily attractive to the young unemployed on low benefits (62% of participants are under 25 and only 21% are married).
- The average earnings ceiling of £67 per week, while paying the going hourly rate, means that 85% of participants are now only employed part-time (up from 60% when the scheme began).
- The condition that projects must not substitute for "real work" means that the value of the output is often quite low and can appear to be a "make work" activity.

Despite these problems, the Community Programme obviously has an extremely valuable role to play. With its recent growth completed, attention should now switch to ensuring maximum value for the resources committed (£1bn gross expenditure). Possible adjustments include:

- Attracting more mature participants by enabling them to get top-up benefits while on CP which bring their total

income closer to their benefit level while unemployed. (Since many individuals could already get a top-up from the Family Income Supplement, the first step may simply be to ensure that applicants have an easy way to find out their full entitlement when they consider the Community Programme).

- Improving the social and political value of Community Programme employment by linking schemes more closely to national objectives set by Government Departments which cannot be funded through their normal budget. Rather than leaving it to local MSC offices to identify worthy causes, the CP labour army would be marshalled behind a limited number of national programmes - like the current Branson clean-up - which serve clear national priorities.

In addition the Department of Employment should review the possibility of redistributing resources on the Community Programme and other measures to create a greater regional focus - extending the notion of a 'package' approach to areas of greatest need. This could also include a new look at DTI-funded regional grants to see whether this expenditure could be more closely linked to job creation (which is the ultimate objective) rather than investment. Outside of specific high need areas, however, any general development of a straight subsidy for new employment would have extremely high costs.

Other special measures have relatively little impact in comparison with the Community Programme. The only significant option for having any fast impact on unemployment is an expansion of the Job Release Scheme for early retirement, but this has no positive economic value.

Strengthening Availability for Work: Workfare

The most effective measure for reducing unemployment in the short term and encouraging the 'voluntary' unemployed back to work is Lord Young's current Restart programme combined with tougher claim tests. If these continue to prove successful, the Department of Employment should be ready with options to bring forward the programme (if necessary) to have a larger and more rapid impact. Further options could also be devised (at some cost) to strengthen the availability of work criteria - for example, more regular reporting at the Job Centre or Benefit Office. These may well be worth pursuing as the next step.

The final step in this process would be the development of the Workfare, or work for benefit approach. This has all the disadvantages of compulsion and Government employment which have recently been well aired. However, if unemployment stays permanently high, or rises further, the political pressures for getting the long-term unemployed to "do something useful" will grow. Given the problems of extending the voluntary CP programme, instituting some limited form of enforced "work for benefit" could be the only low-cost route to achieve this. An easy first step might be to apply this principle to youth unemployment - where the electorate might readily accept that school leavers should either work or train rather than sit back on the dole.

Further work on understanding the legal and administrative problems would therefore be well worthwhile, although it is doubtful whether even a limited trial could be put in place before the next Election.

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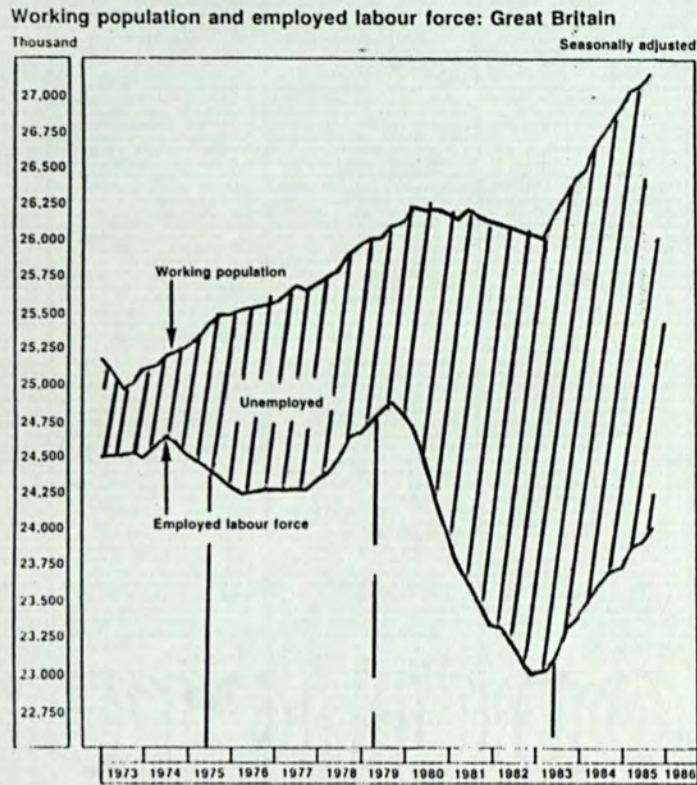
Conclusion

Unemployment remains a serious concern. The Government can do more without simply opting for further cosmetic spending. You may therefore wish to arrange an early autumn discussion on priorities and next steps.

Norman Blackwell

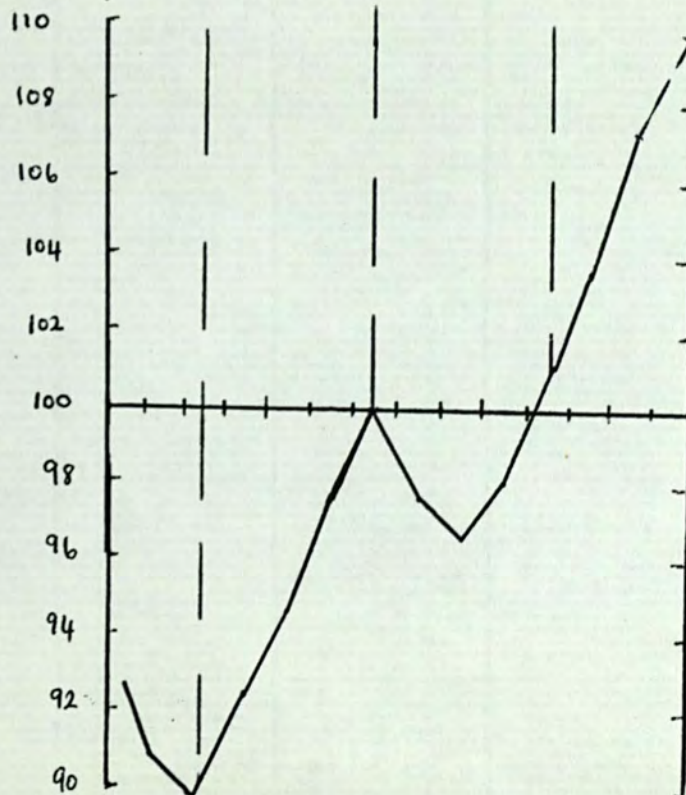
NORMAN BLACKWELL

(1) CURRENT UNEMPLOYMENT REFLECTS BOTH A FALL IN EMPLOYMENT AND A RISE IN THE WORKING POPULATION ...

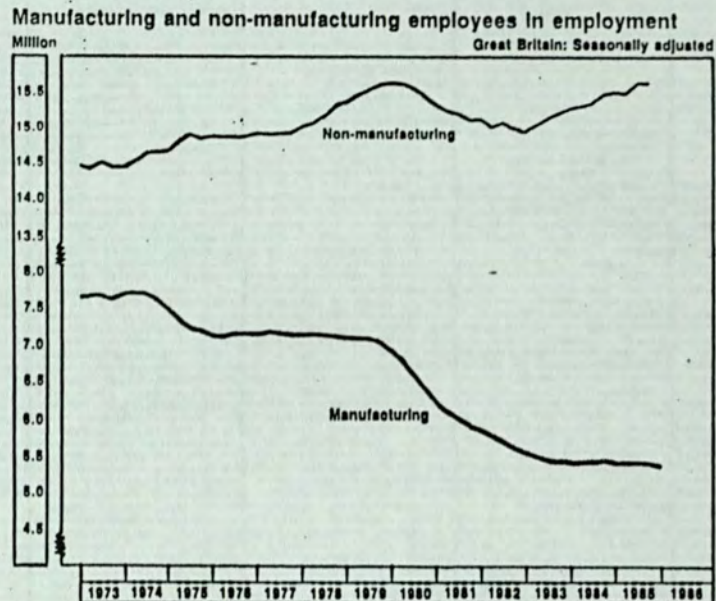


EMPLOYMENT
AND
UNEMPLOYMENT

GDP
GROWTH
(1979 = 100)



(2) MANUFACTURING EMPLOYMENT HAS FALLEN BY 2 MILLION SINCE 1979

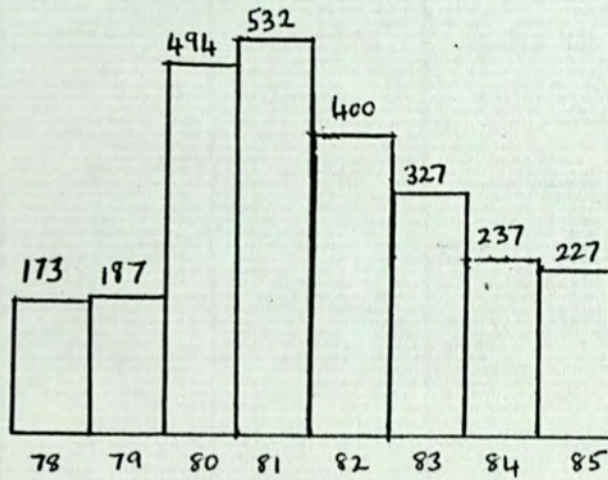


(3) PUBLIC SECTOR MANPOWER HAS REDUCED ...

PUB. SECTOR EMPLOYMENT EXCLUDING NIs	CHANGE 1979-85 (000)	EMPLOYMENT BY MAJOR NIs	CHANGE 1979-85 (000)
Civil Service	-113	B.Steel	-120
Local Authorities	-32	BL	-100
NHS	+72	B.Rail	-97
Other	<u>-34</u>	NCB	-75
TOTAL	<u>-107</u>	B.Shipbuilders	-36
		CEGB	-26
		B.Airways	-19
		R.Royce	-15
		B.Gas	-6
		Post Office	<u>+4</u>
		TOTAL	<u>-490</u>

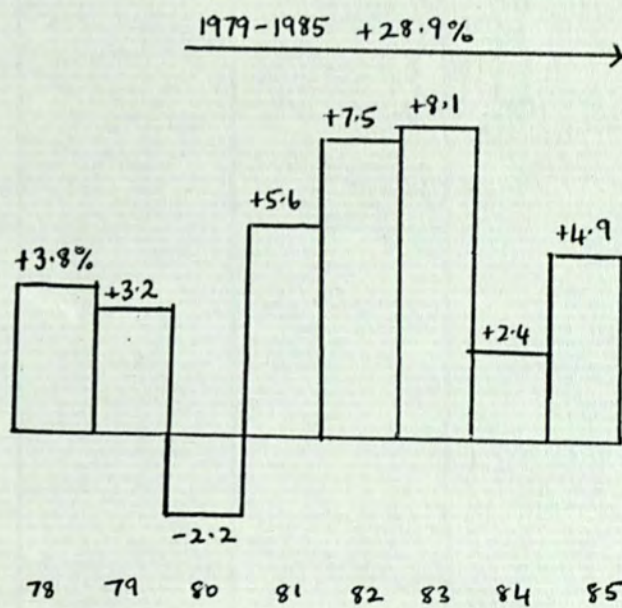
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(4) REDUNDANCIES ROSE TO OVER ½ MILLION A YEAR ...

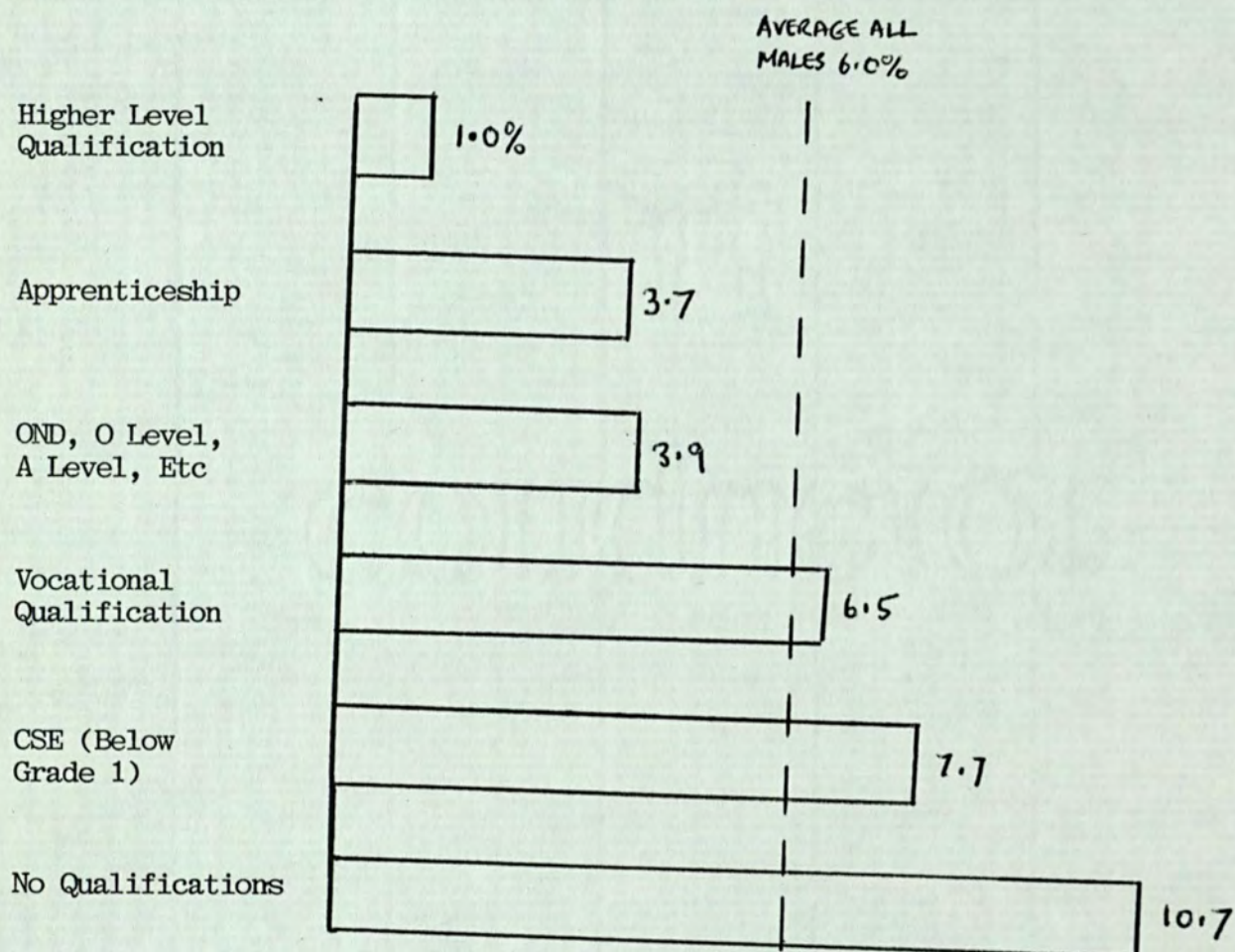
NOTIFIED REDUNDANCIES - GREAT BRITAIN
(000)

(5) BUT PRODUCTIVITY HAS GROWN RAPIDLY ...

% CHANGE IN OUTPUT/EMPLOYEE - PRODUCTION INDUSTRIES



UNQUALIFIED MALES ARE PARTICULARLY LIKELY TO BECOME LONG TERM UNEMPLOYED ...

PERCENTAGE OF MALES WHO HAVE BEEN UNEMPLOYED FOR OVER 1 YEAR -
BY QUALIFICATION LEVEL

Source: 1985 Labour Force Survey