10 DOWNING STREET

Prime Minister ②

It can be argued that the projections of net new jobs are pessimistic. 300,000 a year has been the rate over the past ~~year~~ two years. If, as many expect, the rate of redundancies in manufacturing eases off and if the new NIC rates have a significant impact, the position could be better. But this is an area where the pessimists have more often proved right so it makes sense to continue developing new ideas.

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PRIME MINISTER ② AT 17/5

16 May 1985

UNEMPLOYMENT

We are all agreed that unemployment ought to fall before the next election. On present policies, there is little likelihood of it doing so.

Unofficial projections made by Treasury officials are extremely tentative; none of them are sufficiently robust to be quoted in public. But they give an indication of the problem:

	1985/6	1986/7	1987/8
Growth in Employment allowing for recent changes in National Insurance	300,000	300,000	250,000
Less:			
Growth in Labour Force	(120,000)	(120,000)	(70,000)
New jobs taken by people not presently registered as unemployed	(180,000)	(180,000)	(150,000)
Net effect on register	0	0	(30,000)
Additional effect of Special Employment Measures announced in 1985	(60,000)	0	(80,000)
Total Rise/(Fall) in Unemployment	(60,000)	0	(80,000)

SECRET

No weight should be placed on the tiny projected 'decline' in unemployment for 1985/6 or 1987/8: the figures are well within the forecast's margin of error. Indeed, the forecasters admit that there could well be a slight increase in unemployment in any or all of the three years - nobody yet understands why the register has been growing over the past few months.

The distribution of unemployment is also increasingly unfavourable. The number of people unemployed for over a year almost tripled between January 1981 (455,000) and January 1985 (1,300,000), and is forecast to go on rising for another year. The unemployment rate in the North (17.8%) is almost twice that in the South-East (9.7%), and this contrast may well intensify rather than diminish, since traditional manufacturing industries are still shedding labour whilst services and high-technology companies are expanding.

These gloomy predictions allow for all the changes in taxation, national insurance, and special employment measures announced this year. And the Government's next steps are not likely to alter the picture. The Benefit Reviews, the freeing of Sunday training, the abolition of Wages Councils, the Privatisation programme, and other deregulatory measures should help in the long term; but they are not likely to have much effect in the lifetime of the Parliament.

How can the picture be altered before 1987?

There will be increasing pressure for large-scale construction projects. This cannot solve the job problem. Each new job would cost £25,000 - £50,000. On that basis, removing half the 1.3 million long-term unemployed people from the register would cost at least £16 billion - tripling the Public Sector Borrowing requirement. And, according to

Treasury estimates, the offsetting effects of higher interest rates and inflation would mean that, after 3 or 4 years, unemployment would rise again to its original level.

One possibility is to avoid all new tactical moves, sticking resolutely to the overall strategy, in the hope that it will reduce unemployment more quickly than we at present expect. This seems to be the Treasury's favoured option. It has the advantage of being cheap; and, as Norman Tebbit would argue, it enables the Government to re-iterate the assertion that Parliament cannot legislate jobs into existence. But can we hold this line a second time after 8 or 9 years?

Various other tactics are available:

1. Further steps could be taken to improve, rapidly, the prospects for small businesses and self-employment. (We are minuting you separately on this).

2. The Enterprise Allowance Scheme could be expanded by a further 30,000 places, with a net effect on unemployment of about 8,000 in March 1987, at a net cost of £30 million p.a. or less.

3. A new version of the Young Workers' Scheme for 18-24 years olds could be devised, removing about 25,000 people from the register at a net cost of about £40 million p.a.

4. Present development of the Voluntary Projects Programme could be continued, so that all participants received a training allowance and were removed from the register; this might reduce the unemployment count by up to 50,000, at a net cost of about £100 million p.a.

5. More stringent measures could be taken to reduce the number of fraudulent benefit claimants. The 'Rabbit' teams are highly unpopular; but they appear to be cost-effective, and they can be supported by other tactics such as the issuing of warning cards. This has the advantage both of saving money and of casting doubt on the validity of the current unemployment figures.

If the Government were lucky, steps of this sort might together reduce unemployment, at least temporarily, by as much as 100,000, at a net cost of under £250 million p.a.: this compares with a cost of £2.5 billion p.a. or more for an equivalent register effect through construction projects.

But such low-profile moves are not likely to win many political battles; the measures announced this Spring - though somewhat larger and more expensive - were not seen as solving the problem.

A New Programme for the Long-Term Unemployed

Tom King is working on a big new scheme which might recapture the political initiative, without engaging in ruinously expensive construction programmes.

Two possibilities are:

1. A benefit-plus programme, in which large numbers of the long-term unemployed are given jobs doing community work at near-benefit rates. This could achieve a low net cost - perhaps near to, or even below, the Community Programme's £2,000 per person off the register - enabling the Government to provide places for 500,000 people at roughly £1 billion. That might be sufficient to back a guarantee of a place for all people unemployed for

more than one year who wishes to take one. But the unions would fight it tooth and nail, both because of the low wage rates, and because people would be paid different amounts for the same work. And there would be huge administrative problems: the scheme would have to be run by D/Employment directly, because of TUC opposition with MSC; and there would be conflicts with the Community Programme.

2. A subsidy for employers who take on long-term unemployed people. This idea has been floated by several different bodies, including the CBI and Professor Layard. It could be much simpler to administer than a benefit-plus scheme, and the job would seem less 'fake'. The main difficulty is that employers - once offered a subsidy - tend to substitute long-term unemployed people for those whom they could otherwise have taken on. (The YWS, which was similar in many ways, had a substitution and deadweight rate of about 80%). As a result, such schemes can become ~~extremely~~ more expensive; one might expect net costs of £3,000 or £4,000 per person off the register - bringing a reduction of only 250,000 - 350,000 in unemployment for your £1 billion.

If a scheme with a sufficiently low net cost can be developed, it would be worth thinking about. The money - £1 billion or less - could be found either from increasing public expenditure or from cuts announced simultaneously with the announcement of the new scheme. The simultaneous cut would be better, since it would enable you to avoid any accusation of a U-turn.

The Real Problem

Unfortunately, none of these schemes tackles the real problem: as Layard and everyone else agrees, large numbers of the long-term unemployed have effectively withdrawn from the labour-market because, with benefits at their present rates, they have little incentive to seek low-paid jobs. As a result, these people do not exert any real downward presure on wages, and the labour market does not clear.

One way to cure this problem would be slash benefits and accept the social consequences; but the social security reviews have demonstrated that Ministers do not consider this an acceptable option. Another method would be to cut taxes and raise benefits significantly for those in low-paid jobs: but the reviews have shown that this is also unacceptable, because of its cost.

We therefore suggest that you should consider a system which would counteract the unemployment trap by providing the long-term unemployed with an incentive to take up low-paid jobs. The idea is to give each long-term unemployed person who takes a low-paid job an allowance of, say £20 per week for one year. The allowance would be tax free, and would not reduce the holder's entitlement to any in-work benefits to which he was otherwise entitled.

A similar scheme is run in Japan, where it seems to be regarded as a natural way of inducing people to rejoin the labour market. People are allowed to keep a proportion of their year's unemployment benefit as a tax-free lump sum if they re-enter work during the course of the year.

The effect of the allowance would be considerable. A man with a wife and two children, unemployed for over a year, currently receives a total of about £85 per week. In order to get the same amount in work, he would need to earn about £110 per week gross; whereas if the first year working allowance were introduced, he could keep his net income of £85 by taking a job at only about £60 per week gross.

Once a person had worked for a year, his allowance would cease. This might, of course, drive some people back into unemployment. But, with the annual pay rise and renewed work habits, many would undoubtedly think it worthwhile to remain in work.

The scheme has the advantage that you pay only if recipient finds a job.

True, some people presently unemployed for, say, 9 months would stay unemployed for a further 3 months, so as to qualify for the allowance thereafter. But this problem would not be immense because the total number of people unemployed for between 6 months and 1 year is only about 500,000; and the number leaving the register between 6 months and 1 year is very small. On the whole, people either find a job within 6 months, or drift into long-term unemployment. The Allowance could hardly make matters much worse than they are already.

In principle, the scheme could be very cheap, or even a money-saver, since many people would receive an in-work allowance and in-work benefits lower than the benefit to which they were entitled out of work. The question is whether large-scale substitution would occur, driving other people into the dole queues. This would need to be investigated by D/Employment economists.

Conclusion

We believe that the introduction of a first year working allowance for all long-term unemployed people might quickly and significantly reduce the scale of long-term unemployment.

Are you content for us to pursue this with D/Employment officials, so that the details of the proposal, and possible difficulties can be worked out?

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