

010
PRIME MINISTER
6/6
cc. vgsLONG-TERM UNEMPLOYMENT

We are meeting under your chairmanship on 12 June to discuss options for action to help relieve long-term unemployment, including those set out in Tom King's ^{file with A1} minute of 5 June. As you know I have for some time been concerned about the problem of incentives to work and I recently asked my officials to work up a scheme that would highlight the dimensions of the problem and get many more of the long-term unemployed into jobs.

2. We currently face a situation in which, to take just one example, a married man with two children needs to be earning over £130 a week gross in order to end up with a net income which is just £15 a week higher than he would get on social security. At the same time, we have in the South East persistent reports of vacancies which cannot be filled - particularly at the lower end of the wages scale - despite the fact that the region has 274,000 long-term unemployed - the highest number in absolute terms of any region in the country. It seems quite clear to me that at least some of those people are not taking the available jobs because the financial incentive to do so is just too small to make it worthwhile.

3. There are two related ways in which I suggest we might tackle this problem. First, I think we need a bigger incentive for the long-term unemployed to take work. The attached note suggests a tax credit of £20 a week for 12 months for people who take employment after being on the register for more than two years. That would, in many cases, more than double the current financial incentive to get back into work, particularly at the lower levels. A scheme of this kind - while not without its difficulties - would be considerably more than another special employment measure, though it could take substantial numbers of people off the register at a cost comparable with existing measures like CP. It would also be a major contribution to recreating a culture in which getting work was seen as much more attractive than staying on benefit. The cost moreover would be almost entirely in terms of tax foregone so that additional public spending would be minimal.

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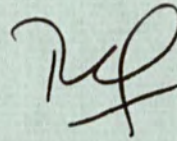
4. My second proposal - which I would see as very much linked to the first - would be to strengthen the existing measures to combat benefit fraud. Estimates of those working and signing vary considerably but few people would put the bottom end of the range below 10 per cent. Much is already being done to tackle this but I think there is scope for even more - not only because the benefit savings could be considerable but also because black economy earnings on top of benefit further reduce the incentive to take work in the white economy. What I would like to see is combined DHSS and Inland Revenue teams, built on the teams already in existence, to concentrate on those areas - primarily in the South East - and those people who we have most reason to believe are working in the black economy. I am suggesting combined teams so that it will be quite clear that we are going for those who cheat the system and not bullying the genuine claimant.

5. Of course, such measures are open to the criticism that we are simply hounding the unemployed. But that would be minimised if the measures were seen to be part of a strategy which was increasing the incentives to work and to be concentrated on areas where significant numbers of unfilled jobs exist.

6. If the idea of a scheme of the kind outlined in the attached note appealed to colleagues, we should clearly need to get more work done on it by officials, particularly on issues of practicality and costs. Meanwhile it seems sensible that, as the Prime Minister has asked, it should be looked at alongside the other options that your officials will be putting forward. It is similar in some respects to the idea of a subsidy to employers who recruit additional employees from the long-term unemployed, or a tax free allowance payable to the long-term unemployed when they find employment. A tax credit scheme would not however distort the market in the way that an employer subsidy would, but is aimed at removing distortions produced by the social security system, by acting on individual incentives. As compared with other employment measures, it has the merit that it would lever long-term unemployed people into regular employment.

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7. I am copying this minute to Nigel Lawson, George Younger, Nicholas Edwards, Patrick Jenkin, Norman Fowler, Norman Tebbit, Tom King, Peter Rees, Nicholas Ridley, Peter Morrison and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'RF' or similar initials, written in a cursive style.

DY

6 June 1985.

TAX CREDIT FOR THE LONG TERM UNEMPLOYED

Aim

1 The aim of the scheme would be to encourage the long term unemployed to leave the register by offering them a tax credit for a limited period. The tax credit would help to overcome the problem of incentives particularly in relation to low wage employment.

2 There is considerable flexibility in the design of such a scheme. The scale and cost of would vary with

i) the duration of unemployment of those covered; the "long term unemployed" are generally defined as these who have been unemployed for a year or more, but a scheme covering those unemployed more than two years has a number of advantages;

ii) the length of time over which the tax credit would operate: probably one year;

iii) the size of the credit: the credit could operate so that income was tax free up to the level of earnings attracting a tax free credit of say £20; there could be a tapering tax credit above that level. It is assumed that National Insurance contributions would continue to be paid.

The long term unemployed

3 There are about half a million people (554,000) on the unemployment register who have been unemployed for between one and two years and a further 760,000 who have been unemployed for more than two years. (The numbers of unemployed by age and duration category are shown in Table 1.)

4 These figures do not however represent static populations; Table 2 gives details of the numbers and age of people flowing off the unemployment register. This shows that in 1984 about 760,000 people who had been unemployed for more than a year left the register. They were predominantly people who had been unemployed between one and two years (550,000) with a much smaller flow off of those unemployed more than two years (208,000).

5 Many of the long term unemployed who leave the register do not obtain permanent employment. No official statistics are collected on the destination of those who leave the register but survey evidence suggests that many leave simply to return at a later stage. Table 3 summarises some evidence from the PSI Study of the stock of the long term unemployed in 1980/81 (and further evidence should be available from the present MSC Cohort Study which covers a more recent period). The broad picture was that about 27 per cent of those who left the register after being unemployed for more than one year were still in employment at the time of the second interview, whereas about 29 per cent of men and 15 per cent of women had returned to the register after a period of employment. The others had become sick, left the register, entered training schemes, or retired.

The limited available evidence on those unemployed more than two years suggests that the likelihood that those who leave the register will enter employment, and retain it, is even lower. (Table 4)

6 Such surveys also provide evidence of the characteristics of the long term unemployed. The PSI Study covered the stock of the long term unemployed in 1980 and found the long term unemployed included a complicated collection of groups with enormously

different family circumstances. Distinguishing characteristics were

- low educational attainments
- predominantly unskilled
- generally low paid in previous jobs.

The MSC Cohort Study confirms the predominance of low skill, low paid workers.

Costs of a tax holiday scheme

7 The gross costs of a scheme which offered a tax credit over a period to the long term unemployed would depend on the numbers leaving the register to enter employment and the tax foregone (which will depend on their income in work and personal tax characteristics).

8 We can identify three groups of people who would be affected

i those who would have left the register for employment anyway at the time they did leave

ii those who would have left the register for employment but whose duration of employment is lengthened by the incentive of a tax credit

iii those who leave the register as the incentive of a tax credit enables them to take a job or declare black economy income.

9 There is room for wide variation in the estimates of numbers in each group, particularly on the effect of incentives.

Possible numbers include the following

i those who would have left the register and taken a job

anyway after being unemployed more than one year might number 200,000 in a year (ie 27 per cent of 760,000). There are some difficulties in using a statistic derived from a survey of the stock of long term unemployed and applying it to a flow - and a proportion of these may well leave the register earlier due to the incentive effect of a tax holiday.

A scheme covering those unemployed more than two years might cover 31,000 who would have left the register for continuous employment (15 per cent of the flow off the register of 208,000)

- ii those whose duration of employment is lengthened by a tax credit scheme might include those who left the register for a temporary period of employment - perhaps 180,000 (ie 24 per cent of 760,000) - any estimate of how long their duration might increase is purely speculative. They might on average have spent three months in employment - say this increased by 50 per cent to four and a half months (67,500 full year equivalents).

The proportion of those who leave the register after being unemployed over two years and take a temporary job may be higher - perhaps 30 per cent. On the assumptions used above this suggests 62,000 (23,400 full year equivalents.)

- iii any estimate of the number who are "incentivised" to leave the register must be purely speculative. The pool of possible people includes those who left the register for non-employment destinations. About 380,000 of those unemployed over a year left the register but did not take a job . Many left for a period of sickness but about 200,000 left for training or "non-work". There is in addition people

who presently remain on the register but may earn a living wage from black economy earnings who could be encouraged to leave the register by a tax credit scheme. One guess might be that 125,000 leave the register and obtain employment for one year. (This is equivalent to 33 per cent of those leaving the register for non employment destinations)

These unemployed over two years who might be "incentivised" might number 25,000, This is equivalent to just over 20 per cent of the 115,000 who leave the register for non employment destinations. But again this is a purely speculative figure.

10 There is a further group who might be covered - those who presently leave unemployment with durations less than a year but who stay longer on the register to get the benefit of a tax credit. This could affect those who leave the register with relatively high durations, for example in 1984 270,000 left the register after a spell of unemployment lasting between nine months and a year. If many of them would enter employment - 50 per cent? - and a third those who would have entered employment remain on the register, this adds about 45,000 (for a full year) to the coverage of the scheme.

A similar group might be covered by a scheme covering those unemployed for more than two years. 100,000 leave the register with durations between eighteen months and two years. If 50 per cent of them enter employment and a quarter of those who would have entered employment remain on the register to take advantage of the scheme this would add 12,500 to scheme coverage. This may well be an overestimate since these people are unlikely to voluntarily extend their durations given the chance of a job.

11 So, the total number who could be covered by a full year's tax credit could amount to 435,000 in a year for a scheme covering those unemployed more than one year. A scheme covering those unemployed more than two years might cover 92,000 in a year. The cost of tax concessions will also depend on the earnings of those covered by the scheme and their average tax rate.

i Earnings are likely to be relatively low. The MSC survey of the long term unemployed gave an estimate of the wage expectations of those still on the register after twenty two months (in September 1982) as just over £60. Earnings might average around £100 for those flowing off the register.

ii Average tax rates will depend on marital status and tax deductions. Evidence from the PSI Study of the long term unemployed showed 40 per cent of the sample as married. (This may not be an appropriate estimate for the flow from unemployment.)

These two assumptions give an average value of just under £15 a week for a tax credit with a maximum of £20 a week,

12 These assumptions give an annual cost of a scheme covering those unemployed more than one year as £325 million pa. A scheme covering those unemployed more than two years would cost £69 million pa.

13 The net cost of this scheme would be less to the extent that people leave the register and fill jobs which would not otherwise have been filled - or which would have been filled by someone not registered as unemployed.

- i Some people covered by the scheme would have left the register and entered employment anyway ["deadweight"] . These are estimated at 290,000 (in full year equivalents) for a scheme covering those unemployed more one year and 60,000 for a scheme covering those unemployed more than two years. (Estimates derived from paragraphs 9 (i), 9 (ii) and 10 above.)

- ii Some people covered by the scheme will obtain employment but only at the expense of other people who either enter the register or experience longer durations of unemployment ["displacement"].

14 The beneficial effects of the scheme on the register, and the savings in benefits which result, come from

- a vacancies which would otherwise have remained unfilled, or which are filled more quickly;

- b jobs which exist in the black economy and which are brought into the white economy as a result of tax concessions;

- c jobs which may be created at lower wages because the incentives problem for this particular group of workers has been reduced. Graphs 1 and 2 show the incentive effect in relation to a single person and married couple with 2 children.

15 It is hard to quantify these effects. A scheme covering those unemployed more than one year is estimated to put about 150,000 people into vacancies. But some of these vacancies may be filled at the expense of other people on the register ie "displacement". A displacement effect of one third would give

an effect on the register of about 100,000; a displacement effect of two thirds would give an effect on the register of about 50,000.

Average benefits paid to the long term unemployed have been estimated at about £40 a week. In addition, extra National Insurance contributions are paid, amounting to £9 a week (on an average wage of £100 a week) The range of displacement assumptions would give benefit savings of between £200 million and £100 million and extra NI contributions of between £46 million and £23 million. This gives a range of net Exchequer costs per person off the register of between £770 pa and £4,080 pa,

16 For a scheme covering those unemployed more than two years, it is estimated that about 33,000 people are put into vacancies. If the same range of assumptions on the displacement effect is used, this implies net Exchequer costs per person off the register of between £620 pa. and £3,800 pa. A central estimate would be a net cost of about £2,000 pa.

17 The more significant are the effects identified in paragraph 14, the less is the scale of displacement. The concentration of the tax credit scheme on those unemployed over two years, and the emphasis on lower paid jobs is likely to keep displacement low.

Estimates of costs have concentrated on net Exchequer costs i.e. the effect on the PSBR. Public spending would be reduced by the scheme which involves a loss of tax revenue but a reduction in spending on social security benefits.

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TABLE 1
 NUMBER OF UNEMPLOYED BY AGE AND DURATION
 OF UNEMPLOYMENT : JANUARY 1985

Duration						thousands	
	16-24	25-34	35-44	45-54	55+	TOTAL	
MALES							
0 - 1 year	547	291	182	138	148	1306	
1 - 2 years	129	93	64	56	56	398	
2 - 3 years	63	59	44	39	32	236	
more than 3 years	54	97	82	82	62	376	
FEMALES							
0 - 1 year	375	183	77	59	26	720	
1 - 2 years	71	31	18	23	14	156	
2 - 3 years	29	10	8	14	10	71	
more than 3 years	20	12	9	19	18	78	

Source : DE Gazette

Note : These statistics show the stock of unemployed at a point in time

TABLE 2

(i) FLOW OF UNEMPLOYED OFF THE REGISTER BETWEEN
JANUARY 1984 AND JANUARY 1985 BY LENGTH OF UNEMPLOYMENT

Duration	Males	Females	thousands
1 - 2 years	350	202	
2 - 3 years	99	31	
more than 3 years	<u>65</u>	<u>13</u>	
	515	246	

(ii) FLOW OF UNEMPLOYED OFF THE REGISTER BETWEEN
OCTOBER 1984 AND JANUARY 1985 AGE ANALYSIS

Percentage of the flow off the register
unemployed more than a year in each age
group

Age	Males	Females	Percentage
16-24	31.7	45.8	
25-34	23.2	30.5	
35-44	13.4	10.3	
45-54	9.0	7.3	
55+	22.5	6.2	
TOTAL	100	100	

Source : DE Gazette

Note : These statistics show the flow of long term unemployed off the register between two the period.

TABLE 3
 MOVEMENTS OFF THE REGISTER FROM THE PSI
 STUDY OF LONG TERM UNEMPLOYMENT 1980-81

Status during 1980-81	Percentage of sample	
	Male	Female
obtained employment but unemployed (by second interview)	6.7	6.3
in work	6.5	11.0
left register not in work	2.5	13.6
registered sick	7.2	6.5
training/special scheme	3.2	2.6
state pension	0.4	7.1
all leaving register	23.5	40.8

Source : M White "Long term unemployment and labour Markets" PSI
 (figures derived from Table III.2)

Note : 1. These statistics show the proportion of the (sample) stock of long term unemployed who flowed off the register between 1980 and 1981.

2 Sum of categories listed above is greater than the total percentage shown as leaving the register as some categories will be overlapping. The sum of categories is 26.5 per cent for men and 47.1 per cent for women.

3. The percentage of those leaving the register who were in employment at the time of the second interview was 28 per cent of males and 27 per cent of females. A further 29 per cent of males and 15 per cent of females left the register for employment but had rejoined the register by the time of the second interview.

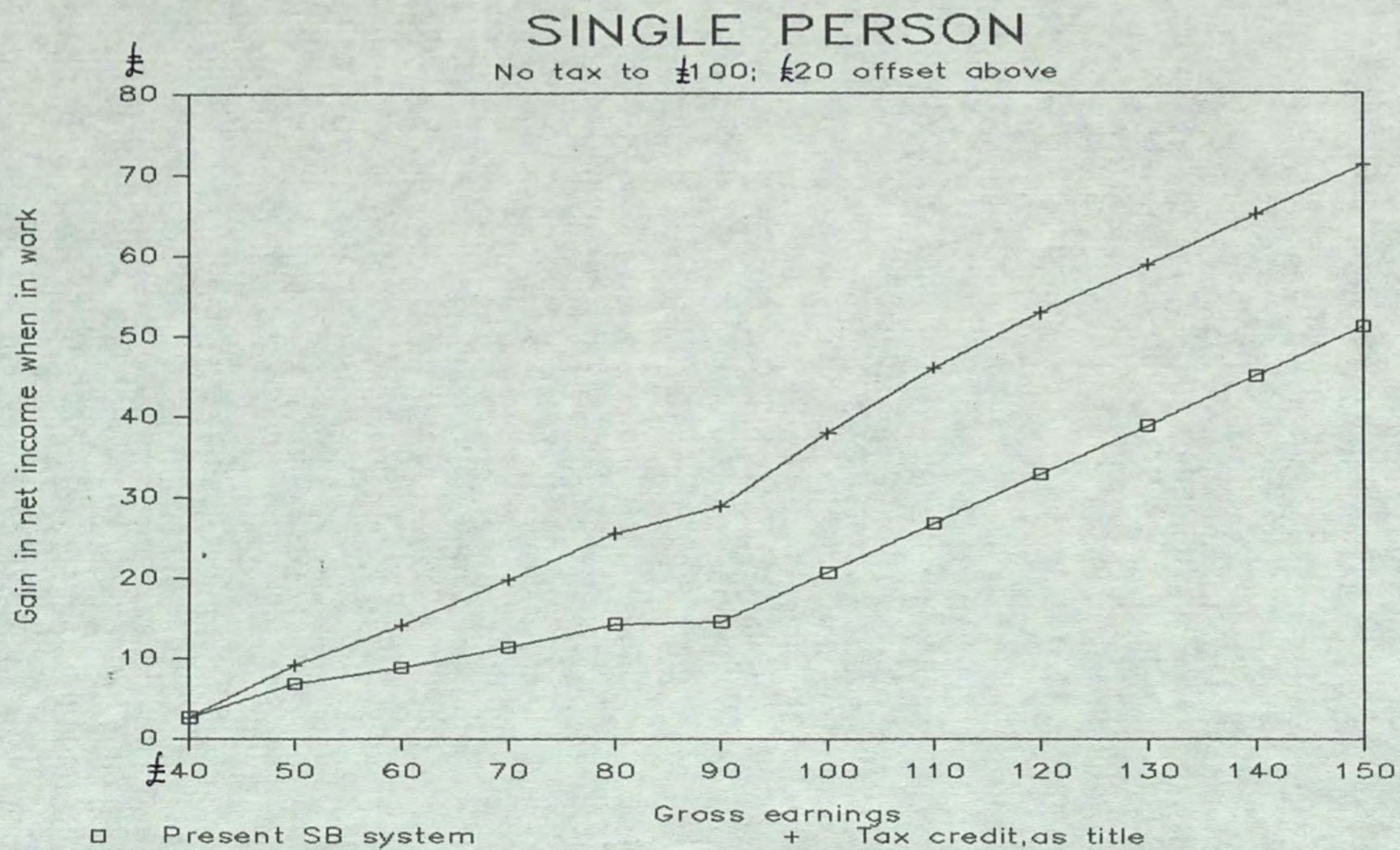
TABLE 4
EMPLOYMENT STATUS DURING 1980-81

	unem- ployed 1-2 years	unem- ployed more than 2 years	unem- ployed 1-2 years	unem- ployed more than 2 years
Employment status at time of second interview in 1981				
In work continuously 1980-81	4.7	1.2	6.9	3.3
In work at time of second interview but not throughout 1980-81	7.8	2.4	9.6	4.3
Unemployed at time of interview but in work during 1980-81	9.7	5.3	10.1	3.9
Always out of work 1980-81	77.7	91.1	73.4	88.5

Source : M White "Long Term Unemployment and Labour Markets
" PSI (Figures as for Table VII.) but separate data
distinguishing the two groups provided by PSI)

Note : Length of unemployment is defined as at the time of
first interview in 1980.

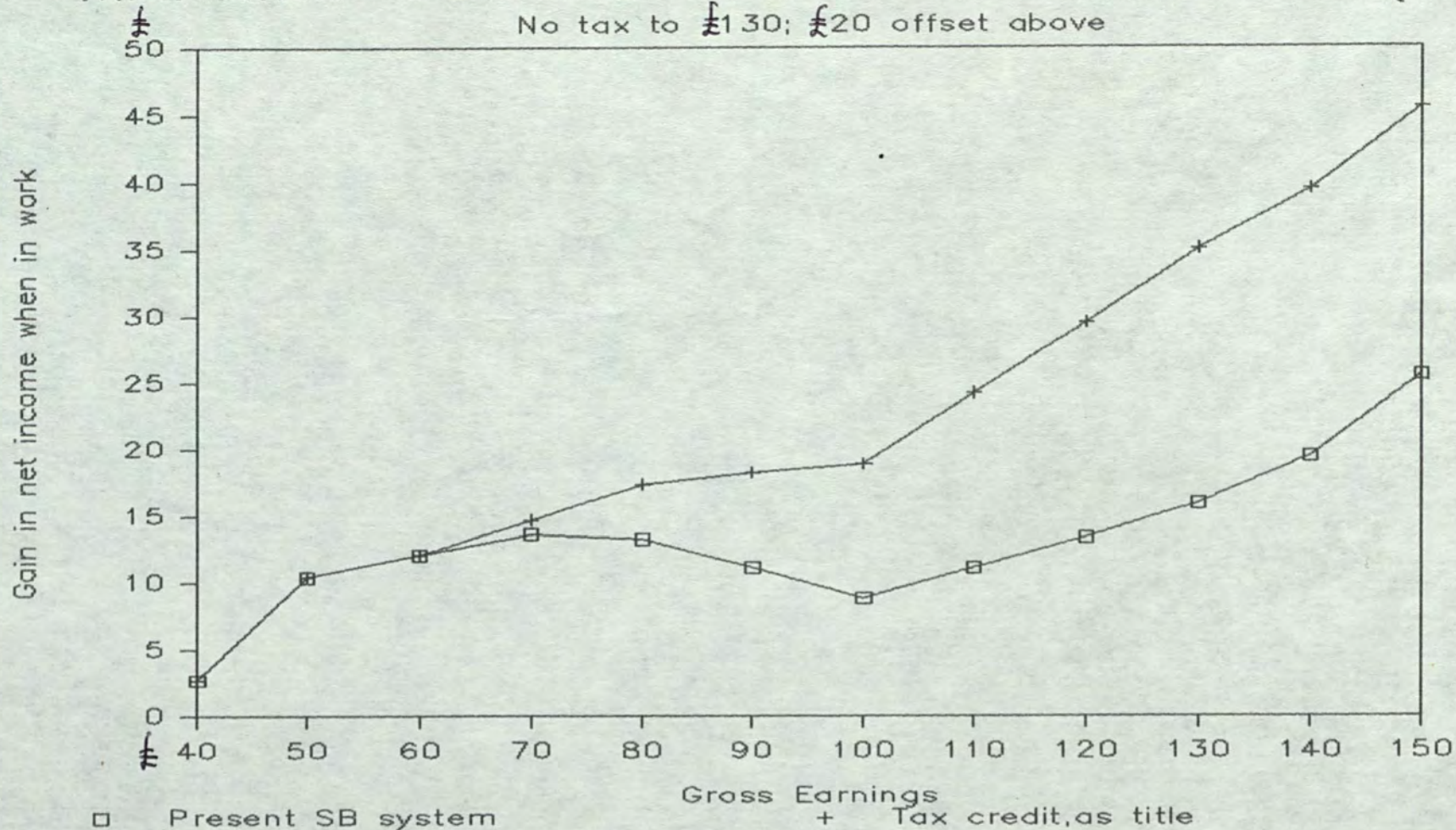
GRAPH 1.



GRAPH 2.

MARRIED COUPLE PLUS TWO CHILDREN(4,6)

No tax to £130; £20 offset above



Manpower: SEM. PT12.

1975

MEMORANDUM FOR THE DIRECTOR, FBI (100-443887)

DATE: 10/15/75

TO: SAC, NEW YORK (100-100000)

FROM: SA [Name], NEW YORK (100-100000)

SUBJECT: [Subject Name]

RE: [Subject Name]

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