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Author       David Chan and Dr Martin Rich,
              City University London

Title        Addressing the Problem of Economic Growth and
              Youth Unemployment - YPSUS
Introduction

Here are some stark facts:

- The UK Economy is once again in recession in the first quarter of 2012 (BBC News, 25th April 2012).
- There is also a growing youth unemployment problem; 2.15m unemployed between the ages of 16-24 in the UK (ONS Labour Market Statistics March 2012).
- A third of graduates were in non-graduate jobs and a fifth of graduates were unemployed (53%), BBC News Online 7th March 2012.

There seems to be few initiatives that imaginatively tackle the problem of growth and youth unemployment. What is required is an innovative policy that can address these two problems that does not require Government to find any new money. We at the Centre for Information Leadership (CIL) believe that we have found such a policy.

This paper sets out this policy and challenges the UK Government to implement our proposals. For ease of reference this paper is structured under the following main headings:-

- The Policy
- Rationale for the Policy
- Fiscal and Political Impact
- Implementation
- Conclusion

The Policy

There are two important issues for Government whilst the UK executes its strategy of Deficit Reduction. The need for to generate economic growth and the need to address the growing problem of youth unemployment. We believe significant contributions to both these policy objectives can be achieved by adopting the following policy recommendation.

We propose that Government create a scheme that radically alters the risks and difficulties for Start Up companies whilst providing an incentive for Start Ups to employ young people. We call this scheme the Young Peoples Start Up Scheme (YPSUS).

YPSUS companies must be genuine new business Start Ups with the following characteristics:-

- They employ 10 people or less
- At least 51% of the employees are less than 26 years old (Young Employees)
• Where the Young Employees are awarded or have the prospect of being awarded at least 25% of the equity stake in the company
• Where no employee has income greater than three times the lowest paid employee
• Where the average income per employee is less than the National UK average
• Where annual net profits do not exceed £500K

YPSUS companies are granted the following facilities:-
• The companies do not pay income tax or national insurance for any of their employees for three years while the company qualifies under YPSUS
• The companies are not liable to corporation tax for 3 years while the company qualifies under YPSUS
• Any investors in a YPSUS company have capital gains tax holiday for three years or for the period while the company qualifies for YPSUS

A detailed discussion of why the specific rules have been included is attached at Appendix A.

Rationale for YPSUS

The policy dramatically changes the incentives for people to start up new businesses using young people and therefore promotes economic growth. By adopting this policy, Government provides incentives for educated graduates to explore the entrepreneurial option rather than hoping for employment.

If we look at the third of graduates taking non-graduate jobs, those people who would have taken these jobs, school leavers with GCSEs and A Levels are displaced into even lower quality jobs. Those who have no qualifications are then competing with these more qualified non-graduates and therefore their prospects are dramatically decreased. By addressing the graduate problem, it is likely that we create more opportunities for the least qualified in our society.

Recent graduates are better placed to take risks and become more entrepreneurial. For a mid-career professional with perhaps a family, mortgage or other personal commitments, the risk of giving up the security of employment is too high to become entrepreneurs. However, for recent graduates, the risk is less if we can provide sufficient incentives for them to start or participate in Start Ups.

We also know that smaller medium sized companies (SMEs) are the largest employers of people. Jan de Kok et al, EIM Business Policy Research (2011) show that SMEs employ 67% of the workforce in the EU. SMEs begin as Start Ups. Therefore if we launch YPSUS, the businesses created will address the key policy issue of addressing Youth Unemployment.

YPSUS provides incentives for older and more experienced people to collaborate with young people in creating new businesses. The scheme incentivises the more experienced people to recruit and develop young people’s skills. We can envisage experienced business practitioners and entrepreneurs taking non-executive roles in Start Up companies staffed by Young People where they can participate with an equity stake. This would accelerate the spread of skills and learning amongst the younger population.
By creating a powerful incentive for graduates to take the entrepreneurial path rather than the employment option, we create a pool of talent with the experience that would be beneficial to the economy as a whole. Even if some of the Start Up fails, those employed under YPSUS will have skills and experience that larger organisations may well value once the economy grows again.

The YPSUS directly addresses the need for growth in the UK economy. The circumstances are ripe for innovation and by supporting new Start Ups, we may be better placed to exploit the opportunities available in the Digital and Mobile revolution. This is particularly relevant now as we appear to be at the cusp of a major expansion of the mobile applications marketplace. Encouraging new start ups would help the UK to gain a proportion of this growing market.

Whilst larger companies will require direct government grants for a new factory or additional incentives to maintain employment levels, by investing in YPSUS, no additional government investment or incentive is required!

The proposed policy will not require additional investment from the Treasury. All that is required is some promotional spending to announce the scheme and to promote its uptake to the public. Indeed, the granting of tax holidays is probably fiscally neutral as YPSUS companies will be additional to what would have happened without the scheme.

Fiscal and Political Impact

The YPSUS policy may well be cash generative for the UK economy as a whole. For each young person unemployed, the public sector spends at a minimum £10k per person. This will be made up of direct benefits payments (JSA, IS etc) and also social subsidies borne by Local Authorities (Housing Benefits, Training Schemes, etc). This does not include the indirect costs of frustration, lack of prospects and lack of hope that could translate into higher costs in Policing, Social Services, and Health Service etc.

The Summer Riots in 2011 is a salutary lesson for us all. If Young People feel that they have nothing to gain from society, then they are more likely to join in such disturbances. By adopting the YPSUS, Government signals that they wish to address the problem of Youth Unemployment through a radical policy targeted at young people and to provide opportunities for young people to build a stake in society.

If we could address the issue of 33% graduates taking non-graduate jobs through YPSUS, then we begin to open out opportunities for the most disadvantaged in our society. This should free up employment opportunities that better match non-graduate capabilities and provide hope for those who some have called the Underclass. Although YPSUS has been designed and targeted at highly educated graduates, there is no reason why non-graduates may not take advantage of the scheme. All it needs is a business idea and some capital and anyone could start a YPSUS company.

We could also appeal to young people’s energy and creativity through the YPSUS. Government is providing them with the incentives, the framework and the opportunity
to harness their energy and creativity in building businesses. This begins the break the mentality of being clients of the state that has evolved in the last few decades.

This policy may also give greater weight to the Big Society idea from the Prime Minister. Although YPSUS applies to creating business start ups, there is no reason why some of these businesses may not have a social enterprise objective. The initial advantages created by the YPSUS may well enable many social enterprises staffed by Young Employees to ‘bootstrap’ themselves. The key is that they create a sustainable business model that lasts beyond the initial three years.

Unlike the USA where Business Angels willing to invest in new start up, the UK market is lacking in sources of funding for new start up companies. Whilst the EIS scheme provides some incentive to invest in SMEs there is nothing to encourage investors to take on start ups. Indeed, the UK Capital Markets are characterised by venture capitalists who only want to invest in relatively low risk business expansion.

By adopting YPSUS, we transform the investment landscape and the risk rewards particularly for those who would invest in start ups. By providing a powerful incentive in the form of a capital gains tax holiday, Government can encourage those who would take a bigger risk to invest in start ups. YPSUS would not conflict with EIS as they would likely be drawn from different groups with different risk profiles.

Although we would like to see YPSUS create a new type of Angel investor, the more likely scenario is that investments will be drawn from friends and family of the participants in YPSUS. However, from a policy objective, this would be a positive result as we would thus expand the base of investors in businesses.

Potential Issues with YPSUS

The above proposals are radical and for the sake of clarity, we have presented the scheme in its simplest and starkest form. In producing this paper, we have shared the ideas with a number of people who raised issues about the scheme. Some of the more challenging issues are documented below together with the authors’ answers.

Q: How would you prevent companies, large or small, from shifting their existing staff from employment to these new entities? It would not be too difficult to create a service provider with no meaningful capital and turn the young people, or a group of them, into an independent company to enjoy the tax holiday?

A: We should not try to prevent existing companies doing this at all as we believe the criteria of having the Young Persons owning 25% of the equity and capping the size to 10 employees will pose some difficulties for the tax avoider. Furthermore, we could consider reducing the cap on net profits from £500k to say £150k to minimise such risks.

As for a company enjoying a tax holiday, when the legislation is drafted it could contain provisions to prevent a large class of avoidance strategies and tactics. We will leave this to the tax specialists to define.
Q: How would you prevent these same companies from routing their profits through these companies as well? Keep in mind that this can be done with a bit of clever book-keeping even if there is no meaningful equity in the firms the young people supposedly own. For example, suppose the new company is a marketing firm that retails the item produced by the original firm. The parent company sells the item at a loss to the new firm that then sells the item on at a large profit. The profits accumulate as a capital gain that the parent firm and the young part owners share tax free (the latter get these capital gains in lieu of wages).

A: Again, we believe this is a matter of detail in drafting. The Treasury tax specialists could probably draft clauses preventing transfer pricing within a group of companies. Where the YPSUS Company is set up as an independent company and not a subsidiary, there may well need to be provisions to look at the share-ownership structures to discover whether the YPSUS is a ‘shadow’ subsidiary. Furthermore, more complex tax avoidance schemes like this may well rebound on the avoider particularly if it becomes public and the avoider suffers reputational damage.

Q: What if I have an existing company that meets the criteria? Do I qualify? Do I need to break-up the existing company to reincorporate? What if I do not qualify and I am competing with this new firm and go under because they have been given an advantage?

A: Our answer would be if you already qualify, then reconstitute yourself as a YPSUS company. From a competition perspective, there may well be some companies who are also start ups that may feel pressure from YPSUS companies. If they exist already, then they might wish to reconstitute as YPSUS. If they do not, then they may well have compensating advantages such as an established market presence, brand, experienced staff etc.

From a policy perspective, there is a precedent for creating differential advantages. We subsidise the banks, transport, TV Licenses for the elderly etc. There are Regional Development grants. There are tax breaks for investing in SMEs, and other significant distortions of a ‘free market’ in place. The key issue is whether there is sufficient political will to take the breaks off growth and at the same time impact on Youth Unemployment.

Q: How would you prevent people using this scheme to start low-value businesses like window-cleaning, car washing etc?

A: The fact that YPSUS only applies to Limited companies will tend to exclude small one-man band businesses as they would not want the overheads of administrations like filing accounts. Again, legislation experts can examine whether we could effectively draft clauses that exclude these types of businesses.

Q: How would you prevent companies starting up an operation as a tax saving vehicle? For example, a company that employs 10 caterers may establish an YPSUS and outsource this to the start up for 3 years then take that back in-house after this period having obtained the tax advantages.

A: Using companies as tax saving vehicles is already in place even within the public sector (cf: Guardian Online, Civil servants’ union chief says tax schemes must stop).
These schemes apply mostly to senior higher paid staff. YPSUS is focused on young people who are likely to be paid less and therefore the tax savings would be less. There are also some disincentives for a larger organisation to set up YPSUS as a tax vehicle. They must employ 51% young people and the salary of the highest employee is only three times the lowest paid. This will provide a powerful disincentive for good managers to join the YPSUS. If we look at the total tax savings available, it would be hardly worth the larger company’s while to set up the vehicle when balanced with the risks. Furthermore, if this did occur and they can take on unemployed young people, this would save the public purse £8k to £10k per person. Therefore, the gains would outweigh the losses in introducing the scheme.

Implementation

It is not clear whether launching YPSUS requires an Act of Parliament. It may be possible to create the scheme using Ministerial Powers under statutory instruments. Therefore, Policy and Legislation specialists in DWP, HMRC, DBIS should asked to explore this possibility.

There may be anomalies created in the termination of a company from the YPSUS schemes and therefore taxation specialists should be asked to look at how this would work. We may also want DWP Legislation specialist to look at the impact of transitioning someone to and from social security benefits when they participate in a YPSUS company. Since the YPSUS companies allow older people to participate as long as they are in the minority, there is unlikely to be any age discrimination impact but it would be useful to check this out prior to implementation. In a similar vein, we need to check out that YPSUS does not contravene EU legislation.

As for the implementation on YPSUS, this should be relatively straight forward. We need to appoint a Department to take the lead, say DBIS, and if the legislation has been completed, then a modest promotional budget is all that would be needed. The rest of the likely issues can be looked after as Business As Usual for all Departments of Central Government impacted by the scheme.

Conclusion

The YPSUS policy is an imaginative and creative solution to two of the UK’s main policy issues: Economic Growth and Youth Unemployment. We hope to have demonstrated in this paper the benefits of adopting such a scheme. We also hope to have shown how relatively easy it would be for Government to adopt this policy recommendation.

We believe the UK will benefit. We also believe the IT industry will benefit as many of the YPSUS companies will be based on digital technology. By implementing this policy, the UK Government could enable the UK economy to be in the forefront of the Digital Economy and a source of innovation and growth. We therefore commend this policy to Government. The question is does Government have the political will to implement it?
References


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Appendix A – YPSUS Scheme Rules

The following is a discussion of why specific scheme conditions have been formulated.

The employee income multiplier of 3 times is also a measure against unfair exploitation of young people. Of course, this multiplier could be set higher but we must balance this against the possibility of an experienced person taking the majority of the income. Another option could be to restrict the tax holiday and NI free provisions just to the young people employed.

The requirement for not more than 10 staff is to encourage the formation of start-up companies rather than re-labeling existing organisations as YPSUS companies. We believe that the requirement for having 51% young people as employees will make it difficult for existing operations to be relabeled. We also considered having a minimum employee count of 3 but decided that it would be clearer to present it without the minimum. Introducing a minimum employee condition may be possible if legislation specialist feel that this is required to stop one man businesses using YPSUS as a tax avoidance vehicle.

One of our experts suggested that the maximum number should be 6. We are relaxed about the precise number and that would depend on consideration by policy specialists. However, the number should be not greater than 10 to minimize the risk of exploitation and tax avoidance.

The condition of having 51% of the employees being under 26 directly targets the policy at addressing the youth unemployment problem. Note, once the percentage falls below 51%, the company no longer qualifies so to benefit the full 3 years, the company must take on people of 21 years old or less. Alternatively, it must take on more young people to the maximum of 10 to ensure compliance with the scheme rules. This incentivises the employment of young people.

The awarding of 25% of the equity stake or at least the prospect of 25% of the equity stake subject to performance within the 3 years provides some protection against tax avoidance and exploitation. The dilution of equity will decrease the incentives for tax avoidance as the young employees will also benefit from the sale of the company. Again, careful drafting of the scheme may be needed to cover ‘pathological’ tax avoidance schemes based on YPSUS.

Setting the average salary levels to be less than the national average is also another measure to prevent exploitation and tax avoidance. If this is seen as too low, this could be set as not exceeding x% of the national average wage.

There must be an upper limit set for the annual net profit. The authors have suggested £0.5m but it could be set lower after consultation with tax and social security experts. The authors believe a ‘reasonable’ upper limit must be set to forestall exploitation and tax avoidance.
We envisage that the scheme would be a ‘one-off’ to last for three years. If it is successful in reducing youth unemployment and increasing growth, Government may well consider extending the scheme.