Prime Minister

SECRET

cc Mr. Hoskyns
Mr. Ingham
Mr. Scholar
Mr. Duguid

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MR. VEREKER

ECONOMIC ASSUMPTIONS FOR THE INDUSTRY ACT
AND THE GOVERNMENT ACTUARY

I find it difficult to disagree with the figures which the Chancellor has used in his minute of 27 October.

If anything, I suspect the price assumption of 10% between November 1981 and November 1982 is likely to be interpreted as a little veering towards wishful thinking. But I, for one, would not regard it as very unlikely. I doubt very much whether we would have any effect at all on pay bargaining if we said that the price increase was going to be 9% for that period. Negotiators would simply take it with a larger pinch of salt and put their own estimates in to their game of bluff.

I think that the aspect to stress on the earnings assumption of 7½% is that it is predicated on a very considerable increase in productivity. This is not merely due to additional hours, through overtime working as the Chancellor says, but due to genuine increases in output per man hour worked. The increased value of the product should at least in part go towards rewarding the labour involved. Again, however, I wouldn't want to dispute his basic figure of 5% on basic rates and a drift of 2½%.

Your problem is to make this consistent with the public sector 4% cash limits on pay. I suppose part of this can be rationalised by saying that there is "wage drift" in the public sector due to the quasi automatic promotion up the pay scale. Public servants ascend the pay scale more or less automatically, while in private industry the ascension is associated with increased productivity and is usually dubbed "wage drift". But I guess there are a lot of other excuses, such as catching up, etc which you have in your locker.

The other point that concerns me about the Chancellor's memo, is that he discusses the distribution of the national insurance contribution burden between employees and employers. He in fact talks about sparing employers as far as possible from increases in

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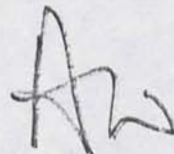
their burden leaving the weight of the increase (NIC) to rest on employees. This proposition seems to me to violate one of the fundamental propositions of price theory. Under competitive conditions, it does not matter whether you put a tax on the buyer or on the seller. The same tax will give exactly the same results. The burden of a given tax is determined by the extent to which the purchasers, in this case the employer, can escape it (our old friend the elasticity of demand for labour) and the degree to which labour (the suppliers) will respond. But the whole point is that, under competitive conditions, the issue of who pays a subsidy, whether employer or employee, is trivial and of no consequence. To give you the flavour of this argument, consider the tax on beer. At the moment the brewers pay this. But supposing we said the brewers could supply the beer tax free and we'd simply collect the tax in the pub. Administrative difficulties aside, this would have no effect on the distribution of burdens.

There are, of course, more problems when we consider markedly non-competitive markets. The issue becomes very complex. (I examined these problems in my book, with Esra Bennathan, on Port Pricing.) But there is certainly no presumption that the burden of a tax is borne by the group who actually pays it. Broadly speaking, my research suggested that the results of the competitive model were not dramatically reversed by any of the "non competitive" aspects of a more general model.

What a boring memo this is! But there is a point of substance in it.



28 October 1981

ALAN WALTERS