Alan Walters

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Prime Minister

I suggest you discuss with the Chancellor at your meeting tomorrow.

* Alan Walters agrees with the Chancellor's proposal, but does not accept the assumption at X that it hurts employment more if the increase is loaded on to the employers rather than the employees.

Shall I suggest he discusses with the Treasury?

MCS 18/11

PRIME MINISTER

* see attached minute.

NATIONAL INSURANCE CONTRIBUTIONS

The Secretary of State for Social Services and I have been considering the rates and earnings levels of National Insurance Contributions payable from April 1982. This minute has been agreed with Norman Fowler although as you will see we have not agreed a proposal. We have also had discussions with the Secretaries of State for Industry and for Employment.

2. The questions at issue have to be seen against the background of our current discussions on public expenditure. These are not yet completed, but it is apparent that the public expenditure totals will be well above those which I proposed in my paper (C(81)50) which we discussed on 20 October.

3. I have already minuted you about my fears that we shall be forced into tax increases in the next Budget, and I have decided that I cannot now announce a reduction in the National Insurance Surcharge to take effect from next April. I shall look at this again at Budget time but any change could then take effect only in the summer at the earliest. In my judgement we cannot allow National Insurance Contributions to increase less than we had assumed, and ideally should look for more. Combining these features we need to look for the maximum tolerable increase in contribution income over and above what we had assumed, with such increase coming as far as possible from employees, so as to spare employers unnecessary extra burdens.

X

.... 3. I attach a note by officials which gives the necessary facts and figures. There are three elements:

- We need an increase in contributions in order first to balance the NI Fund, and a further increase if we are to retain for the PSBR the savings that flow from the 1 per cent abatement in benefit savings, for which we have already legislated. The effective range is between 0.35 and 0.70 percentage points depending on whether we go for balance or something more and on the upper earnings limit chosen.

- We need an increase in the allocation to the Redundancy Fund of at least 0.35 percentage points if it is not to exceed its statutory borrowing powers.

- The Secretary of State for Social Services wishes to increase the Health element of the contribution by 0.1 percentage points.

4. An important conclusion is that if we made no changes, the resulting deficit on the NI Fund for 1982-83 would be some £700 million more than has been assumed in our forecasts so far, even before any decisions are taken on public expenditure. The minimum necessary increase is above the level which can be achieved within the existing statutory framework. In my view we could only avoid legislation at the expense of either worsening our PSBR objective or imposing a disproportionate burden on employers. I regard neither as acceptable.

5. That means that we must legislate to increase NI contributions, and in my judgement on much the same pattern as last year's Social Security Contributions Bill, putting the main share of the burden on the employee.

6. I recognise that this will be difficult in relation to our desire to limit the growth of earnings. The Secretary of State

for Employment has drawn particular attention to the effects on wage bargaining of this measure and of rising real local authority rents. I am therefore prepared to accept an increase in the upper earnings limit to £220, despite the additional burden it involves for employers (an extra £120 million in NIC and NIS for private sector employers in addition to the £550 million they can expect to pay solely as a result of the increase in earnings). This means that the additional contribution for the employee will be 0.85 per cent - an extra £1.38 a week for the man on average earnings - though the effect on take-home pay would be eased if I were able in the Budget to raise income tax personal allowance in line with inflation.

7. This will enable us to balance the NI Fund and contain the deficit on the Redundancy Fund. I am willing to allow the 0.1 per cent increase in the Health element of the contribution as an alternative to at least part of the surplus on the NI Fund that would otherwise be required to obtain the savings in benefit expenditure. It will also involve the employee paying for the Redundancy Fund Allocation. But I think so long as we are clear about the reasons for this I see no presentational difficulty. The Secretary of State for Social Services will also be making proposals for the self-employed.

8. The Secretary of State has expressed grave reservations about making sharp increases in NI Contributions at the same time as he is being asked, in the public expenditure context, to consider abating next year's uprating of social security benefits. He thinks this combination of factors will make it difficult to carry through the necessary social security legislation.

9. You may want to see this discussed further among the Ministers most directly concerned, and it may be right to bring in the business managers at that stage. Timetable pressures mean that the legislation must be introduced in the week beginning 30 November,

to be through the Commons by the Christmas Recess and receive Royal Assent by the end of January. We need also to keep an eye on the relationship to an announcement about public expenditure. Subject to your views, I suggest that we should put the options to Cabinet, and if necessary dispense with the normal discussion in Legislation Committee.

10. I am sending copies of this minute to the Secretaries of State for Social Services, Employment and Industry, and to Sir Robert Armstrong.

Peter Jenkins

for (G.H.)

17th November 1981

(Approved by the Chancellor of the Exchequer and signed in his absence).

(7)

POSSIBLE INCREASES IN NATIONAL INSURANCE CONTRIBUTIONS

Note by officials in the Treasury, Department of Health and Social Security and Department of Employment

Introduction

1 The Government has to review the National Insurance contributions (NIC) payable from 1 April 1982. Four questions are involved:

(i) the increase in rates and/or earnings limits necessary to provide income to the National Insurance Fund either to balance exactly expected expenditure or to provide to the PSBR the expenditure savings which flow from the 1% abatement in benefits in November 1981 (estimated at £170 million).

(ii) the increase in allocation from the employers contribution (within the overall rate) necessary to prevent the Rundndancy Fund from exceeding its statutory borrowing powers (£300 million). If the allocation were to be increased without an effect on the NIF this would involve an increase in rates, whether of employer or employee.

(iii) the Secretary of State for Social Services has proposed an increase in the allocation to the NHS of 0.1 per cent.

(iv) the distribution of the increases between employers and employees and between the rate and the earnings limits. There will be subordinate decisions to take on the rates for the self-employed and non-employed.

The present position on rates and earnings limits

2 The standard rate contributions are at present as follows:

	National Insurance Fund	National Health Service	Employment Protection allocation	Total
Employer	9.4%	0.6%	0.2%	10.2%
Employee	7.1%	0.65%	-	7.75%
TOTAL				17.95%

In addition the rate of NI Surcharge paid to the Consolidated Fund is 3.5% on employers.

3 The lower earnings limit is £27 a week, and the upper earnings limit £200 a week. The LEL will rise to about £29.50 next year, and all calculations in this note assume that this happens. The UEL could stay at £200; the maximum possible increase under current legislation would in practice be £220.

National Insurance Fund

4 The Government Actuary has provided the following calculation of the increase required in the contribution to the NI Fund on assumptions given to him with Ministers' approval of earnings, prices and unemployment. (The figures are for increases in the employees' rate, assuming no change in the employers' rate, but if the increases were to be shared between employers and employees the total for the two together would be approximately the same.)

	Required increases for 1982-83	
	To provide a Surplus of £170m in Fund	To maintain balance in Fund
UEL £200	0.69	0.54
UEL £210	0.57	0.41
UEL £220	0.49	0.33

5 Even if the employers' rate did not change, extra costs would fall on private sector employers from raising the UEL, as follows:

	NIC	NIS	Total £m
£210	48	22	70
£220	80	40	120

These figures are additional to increases in private sector employers' costs next year, resulting mainly from the rise in earnings, of £400 million on the NIC and £170 million on the NIS.

6 The expenditure savings that result from the 1% abatement in benefits at November 1981 can be secured for the Consolidated Fund by a reduction of one percentage point in the Treasury Supplement to the National Insurance Fund.

Redundancy Fund

7 An Order is now before Parliament to increase the Fund's borrowing power to £300 million. Any further increase would require primary legislation. The deficit is expected to be some £265 million by March 1982 and without special action might well rise to £519 million by March 1983. Increases in the EPA of the following order would produce extra revenue as shown below, resulting in deficits in March 1983 also as shown.

	Extra revenue during 1982-83	Deficit in March 1983 £m
0.3%	306	198
0.35%	360	142
0.4%	412	86

In the DE view 0.3% is the minimum increase in allocation needed and carries some risk of borrowing limits being exceeded. An increase of 0.35 reduces that risk and makes a start on reducing the deficit in Fund from the beginning of the financial year. These figures are for increases in the employers' contribution. Increases in the employees' contribution would have to be 0.03 percentage points higher in each case to yield the same extra revenue.

8 These figures assume no special measures to adjust expenditure by the Fund. The following measures could be considered:

(a) Reduction of the statutory scale of redundancy payments. Primary legislation would be required. A cut of 10% would save £34 million in 1982-83.

(b) Reduction of the Fund's contribution to employers' redundancy payments from the current 41%. A reduction to 35% would be the maximum possible under the current legislation; it would require an affirmative Order. The saving would be some £43 million in 1982-83.

9 An alternative would be to increase the Fund's borrowing limit. A rise to £600 million would be necessary to avoid any change in contributions. Primary legislation would be required.

10 Under current legislation, contributions to the Redundancy Fund are paid only by the employer. If the objective was to avoid any increase in employers' costs, it would be possible to raise their contribution to the Redundancy Fund and make an offsetting reduction in their contribution to the National Insurance Fund. An alternative would be to legislate to provide for employees to contribute to the Redundancy Fund.

National Health Service

11 The Secretary of State for Social Services has proposed an increase of 0.1 per cent in the NHS allocation. This is the most that can be done without primary legislation.

Legislative Position

12 Under existing legislation there is a limit to the increase that may be made in either employee or employer contributions of 0.25 per cent each. The effects of such a maximum increase in the rate combined with the maximum UEL are shown as Option 1 of the attached table. Thus, to achieve a balance on the NI Fund even without a surplus, to prevent the Redundancy Fund from exceeding statutory borrowing powers and to increase the NHS allocation, would require legislation.

Alternative Options

15 The other options in the attached table show the effects of

- Option 2: the increase necessary in the employees rate alone sufficient to put the NI Fund in surplus of £70 million, to prevent the Redundancy Fund from exceeding borrowing powers and to increase the NHS allocation by 0.1 per cent keeping the UEL at £200.
- Option 3: the increase necessary to provide the same result as Option 2 but with the UEL increased to £220.
- Option 4: as Option 3 but with the increase in contribution rates split equally between employer and employee.

Effects of different options for changes in NI contribution rates and earnings limits

Option		Increase in rates: employer base 10.2%	Increase in rates: employee 7.75%	UEL	Additional burden: employer(1) NIC	Additional burden: employer(1) NIS	Additional burden: employee NIC	Effects on NI Fund in 1982-83 deficit(-) or surplus(+)	Direct effects on PSBR in 82-83 (compared with forecast)(2)
		%	%	£ pw	£m	£m	£m		£m
1	Effects of changes in rates and earnings limits to maximum within permissible legislation assuming 0.35% from employers to RF and 0.1% from employees to NHS	0.25	0.25	220	280	40	330	-310	- 50
2	Increase in rates necessary to keep RF within statutory borrowing limits, to provide 0.1% to NHS and retain for Consolidated Fund savings in benefit expenditure using only change in employee rate	Nil	1.05	200	Nil	Nil	1010	+70	-450
3	As 2 but with UEL increased to £220	Nil	0.85	220	80	40	920	+80	-500
4	As 3, but with increase in contribution rates split equally between employer and employee	0.40	0.40	220	400	40	480	+60	-300

(1) Central and local government employers excluded

(2) Direct effect on PSBR before second round effects on tax receipts and benefit payments etc are taken into account. The total effect on the PSBR for Option 2 for example would be roughly £420m (compared with forecasts).

For comparison, a 1 per cent reduction in NIS would have a direct cost to the PSBR in 1982-83 of £800m if reduced from April, £550m if reduced from July, £300 million if reduced from October.