8

Ref: A06097

PRIME MINISTER

National Insurance Contributions

BACKGROUND

The Chancellor of the Exchequer proposes:

(a) an increase in the employee's national insurance contribution (NIC) rate by one percentage point, to 8.75 per cent;

(b) an increase from £200 to £220 in the upper earnings limit, the maximum amount of weekly pay on which the NIC and national insurance surcharge (NIS) are levied.

2. These changes would take effect in April 1982; would yield, gross, rather more than £1,100 million next year, and would:

(i) permit the Redundancy Fund to stay within its statutory borrowing limit;

(ii) allow an increase of 0.1 per cent in the contribution to the Health Service, which the Secretary of State for Social Services proposed as an alternative to cuts in Health Service expenditure;

(iii) prevent the National Insurance Fund from going into deficit next year;

(iv) provide a surplus of £250 million for the National Insurance Fund in 1982-83 - the net gain to the PSBR from these changes after allowing for outgoings from the Fund next year. The Chancellor proposes an equivalent reduction in the Treasury supplement to the Fund - an accounting device to reduce the PSBR without a surplus accruing in the Fund.

3. Primary legislation is needed to increase the NIC by more than 0.25 per cent. The Chancellor proposes that the Government should introduce a bill next week for enactment before the end of January.

4. The Chancellor has decided that he cannot now announce a reduction in the NIS. If he does so in the Budget the NIS could probably be reduced in July 1982.

MAIN ISSUES

5. Two points are likely to concern some Ministers. First, there is the impact on employers. Though the Chancellor proposes no increase in the employers' contributions rate, raising the upper earnings limit means that employers must pay more (NIC and NIS) in respect of any employee earning more than £200 a week. The cost to employers will be about £120 million next year - in addition to the £550 million extra they will have to pay as a result of probable increases in earnings. The Secretary of State for Industry may argue (as he has in a letter of 24 November to the Chancellor of the Exchequer) that this increase should be offset by a reduction in the NIS, which the Chancellor should announce now. Secondly, there is the impact on pay bargaining, to which the Secretary of State for Employment referred in his minute to you of 18 November.

Flag B

6. The Chancellor of the Exchequer may argue in reply on the following lines:

a. There is little room for manoeuvre. Most of the increase in contributions is necessary to ensure that the National Insurance Fund stays in broad balance, as the law requires; and to avoid legislation to increase the Redundancy Fund's borrowing limit. The net gain to the PSBR is small: £250 million. A smaller increase in employee contributions means either more from employers or a larger PSBR.

b. It is not clear how much wage settlements will be affected by changes in employee's contributions or the upper earnings limit; but the alternatives (higher PSBR or taxation) might well have effects which were even less desirable.

Flag C

7. The Secretary of State for Industry may suggest (as in his letter of 24 November) that the National Insurance Bill should provide that the NIS can be reduced by secondary legislation: primary legislation is necessary at the moment. If he does, he could be invited to pursue the matter with the Chancellor of the Exchequer in correspondence. (The answer may be that the NIS is a tax: a provision of the sort Mr Jenkin proposes would have to be included in a Finance Bill).

HANDLING

8. After the Chancellor has introduced his proposals you will want to invite comments from the Secretary of State for Social Services (who agreed to these proposals at your meeting on 23 November); the Secretary of State for Employment; the Secretary of State for Industry; the Lord President (on the legislative timetable); and other colleagues.

CONCLUSIONS

9. You will want to record the Cabinet's decision on the Chancellor's proposals and any points of detail which the Ministers concerned must sort out.

10. On the assumption that the Chancellor's proposals are endorsed it will be for the Chancellor and the Secretary of State for Social Services, in consultation with other colleagues as necessary, to agree on the terms and timing of an announcement; and the Secretary of State for Social Services, who will have to introduce the National Insurance Bill that will be necessary, to discuss its handling with the business managers.

RtA

25 November 1981