PM WM 4/10

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Dear Michael

You asked for notes for the Prime Minister's Question Time today on the four main proposals now being put forward by the CBI to revise the economy. These were reported in today's Financial Times as being "substantially lower interest rates, lower national insurance surcharges, lower rates for industry and a £1bn package of capital spending by 1984".

The note on an NIS reduction is more detailed than the others to meet your earlier request for a note for use with the 1922 Committee this evening.

Yours ever
Peter

P S JENKINS

NATIONAL INSURANCE SURCHARGE

CBI PROPOSAL

CBI propose "lower National Insurance Surcharge".

Facts

National Insurance Surcharge introduced by Labour Government (Mr Healey). Time of last Budget stood at $3\frac{1}{2}$ per cent (levied on earnings liable to employers National Insurance Contributions).

2. Chancellor in Budget announced effective reduction over the whole year of 1 per cent, to $2\frac{1}{2}$ per cent. This to be brought about by reducing the rate itself to $2\frac{1}{2}$ per cent with effect from 2 August 1982 (earliest practicable date) plus a further temporary reduction of $\frac{1}{2}$ per cent between August 1982 and April 1983. This gives a rate of approximately $2\frac{1}{2}$ per cent over the whole year, as promised.

3. Applies to private sector employers only. Cost in 1982-83 put at £640 million.

4. Because of way reduction effected, running rate of NIS, which will be 2 per cent from 2 August, will go back to $2\frac{1}{2}$ per cent in April 1983 if nothing is done. Decision time for enabling the running 2 per cent rate to continue through 1983-84 comes in November (though to do nothing in November does not mean that the 1983-84 overall rate could not be reduced, because this year's device could be repeated).

5. Employers see NIS as "tax on jobs". Reduction directly reduces costs in employing labour. Matter of debate how far it leaks into wages claims - CBI assert that this does not happen. Of the total cost of the reduction this year about half went to benefit manufacturing and construction; the rest to other sectors (financial, distributory, etc).

6. NIS payable on top of employers NIC (current rate 10.2 per cent). Employers have been shielded from increases in employers NIC rates for two successive years, probably worth about 1 percentage point in full.

Line to take

7. Acknowledge desirability if possible of reducing this tax on jobs invented and imposed by previous Labour Government. Note 1 percentage point effective reduction given in the last Budget, starting to come through in 10 days time, costing £640 million in 1982-83. Note also way employers have been shielded from increases in National Insurance Contribution rates for two successive years. Aware that going rate of NIS will go back to $2\frac{1}{2}$ per cent next April if further action is not taken. Right time to consider this in the autumn. But likely to be many other claims on available resources if borrowing is to be kept in check and interest rates (another CBI priority) restrained. However desirable, NIS reduction is expensive. A better and more direct way for industry to cut its labour costs is to restrain pay increases.

Lower interest rates?

Interest rates have been falling - down 4 points since last autumn. Since the clearing banks reduced their base rates to 12 per cent on 13 July, short-term rates have come down further. Cannot ignore developments in other countries, particularly US. But some success in uncoupling our interest rates from US rates; at beginning of year our rates some 2 points higher than in the US, now some 1-2 points lower. Progress made in reducing interest rates reflects satisfactory developments on main monetary indicators and government borrowing under control. How would CBI proposals be able to sustain lower interest rates when there are reports that they would add £1.8 billion to PSBR in first year.

Lower rates for industry?

[A 10 per cent derating for all non-domestic ratepayers would cost approximately £600 million per annum; if applied to industry alone about £140 million.]

Derating, whether for all non-domestic ratepayers or for industry alone, would require legislation. It would also be expensive, though less so if it were to apply to industry alone (10 per cent derating for industry approximately £140 million per annum). One of a number of possible ways of assisting industry and business, but in last Budget preference was given to other forms of relief, notably reduction in NIS.

£1 billion Capital Spending Package by 1984?

[Capital expenditure has fallen from about 17 per cent of total public expenditure in 1976-77 to about 11 per cent in 1981-82. Cmnd 8494 plans show a further fall to just over 10 per cent in 1982-83.]

Why has fixed investment fallen?

- sales of council houses score as negative capital expenditure
- also a fall in council house new construction
- finally (much smaller) fall in roads programme

Government has therefore not been cutting "productive investment".

What is really happening to cause fall

- "needs" have declined since 1970s
- increasing proportion of nationalised industries investment financed out of own resources
- defence procurement counts as current expenditure and increasing defence capital expenditure worsens apparent capital/current balance.

How much is capital expenditure planned to increase, does it meet "needs"

[Plans for 1982/83 provide for cash spending in new construction to increase by 14 per cent to £10.3 billion; for nationalised industry investment to rise by 26 per cent to over £7½ billion.]

No reason to assume future standards and public amenities and services will be jeopardised.

Line to take

Government prepared to give priority to worthwhile capital projects whenever possible within overall spending totals. Public expenditure plans have not cut "productive investment" and there is no reason to assume present plans will jeopardise future standards and public amenities and services. Nationalised industries' investment in 1982/83 planned to be about a quarter higher than previous year. The real answer is to continue with policies to lower interest rates, increase incentives and provide for the prospect of a higher rate of return on investment in the private sector.