

Budget - secret



8.(A-E.)

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From the Private Secretary

PRIME MINISTER

BUDGET PACKAGE

1. You saw the Chancellor's aide-memoire over the weekend, and noted a number of queries on it.
2. I am now able to alert you to what the Chancellor is likely to propose for a future package on basic rate / allowances / NICs. As before please do not reveal that you have been briefed.
3. The key points are:
 - the Chancellor still thinks he should publish PSDR figures of £14b. in 1988-89 and £12b. in 1989-90. Net of privatisation proceeds this implies an uncharged figure of some £7b. in the 2 years.
 - a PSDR of this size in 89-90 allows room for about 1 billion extra £1b. tax reductions over and above the table at the back of the aide memoire.
 - in the light of your and Crichton's views he has now decided against a 1p. tax cut.

- he wants to stick with normal indexation of tax allowances and, in line with Cabinet comments, now proposes a NICs package.

NICs Package

4. Following the normal annual review the 1988 Autumn Statement proposed that from April 1989:

- employees pay no NICs below weekly earnings of £43 (the lower earnings limit, which is in line with the single pension rate).
- from £43 to £75 earnings employees pay 5% NICs on all their earnings, i.e. there is a "diff edge" as you cross the £43 threshold.
- from £75 to £115 earnings employees pay 7% NICs on all earnings - i.e. another diff edge as you cross the £75 threshold.
- from £115 to £325 (the upper earnings limit) employees pay 9% NICs; another diff edge at £115.
- above £325 employees pay no more NICs (though employers do).

5. ~~The~~ The only changes in this package were normal updating of the lower and upper earnings limits and the 5/7/9% thresholds.

6. Apparently the Chancellor now proposes:

- to retain the 5% "diff-edge" threshold at £43. ~~Sub~~ This step is justified on the "passport" to entitlement to pensions and other benefits.
- to get rid of the remaining "diff-edges". Instead of a jump to 7% contribution on all earnings at £75 introduce a marginal NICs rate at £75 of 9%. This marginal 9% rate would then apply right up to the upper earnings limit.
- this means that everyone earning over £115 will gain £3 a week; i.e. they currently pay 9% on all earnings but in future would pay only 5% on the first £75 - $\therefore$ they save $£75 \times 4\% = £3$.
- Between £75 and £115 the impact is not complex. But there are no losers. Those just below £115 gain the least; those just over £75 gain more e.g. £1.35 gain at £80 a week.
- The Chancellor has not yet decided whether to couple these changes with an increase in the upper earnings limit. If that stays at £325 the £3 gain would also go to all top earners. But the UEL could be increased from £325 sufficient to offset the gain for top earners; an increase of £33 to £358 would balance the sums. The case for a UEL increase

would be to reduce the cost slightly and, if this was wished, target the gain on lower earnings. The case against is that raising the UEL brings complications, eg increasing future SERPs entitlements.

- These changes would come into effect on 1 October 1989.

With no UEL increase the cost in 89-90 would be £1.1b. and £2.2b. in a full year; with a UEL increase the figures are roughly £1b. and £2b.

Line to Take

7. You will want to consider the respective merits of this NICs package and "spending" an equivalent sum on more than indexing allowances:

- in tax policy terms the NICs package involves a notable reform.
- it also provides, via a UEL increase, a means of not giving any benefit to top earners. In any event, even with the UEL unchanged, top earners would only get the same £3 cost gain as the majority; whereas higher allowances are worth more to those on a 40% marginal rate.
- at the bottom end the NICs package does nothing for those below £75, and more for those over £115 than those between £75 and £115. Tax allowances have similar effects except ^{that} those earning just under £115 might do better from higher allowances than the NICs change.