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Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

5 November 1980

T. Lankester, Esq.,
Private Secretary,
10, Downing Street

Dear Tim,

The Chancellor proposes to raise with the Prime Minister tomorrow the possibility of increasing employees national insurance contributions (ENIC) as one step to close the "PSBR gap" in 1981-82.

There are, of course, a variety of inter-related issues involved here: I am therefore attaching some papers which the Chancellor hopes the Prime Minister will find useful as background to their talk.

Yours ever,

Richard Tolkien

R.I. TOLKIEN

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as PM written on this one

SECRET

1. MR BAILEY AMD 5/11

2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State(C)
Minister of State(L)
Sir D Wass
Sir A Rawlinson
Mr Middleton
Mr Battishill
Mr Unwin
Mr C D Butler
Mr Ridley
Mr Cardona
Mr Cropper
Mr Green (IR)
Mr Gracey(IR)
PS/Inland Revenue

EMPLOYEES NATIONAL INSURANCE CONTRIBUTIONS (ENIC)

Following your meeting yesterday we have put together the attached note intended as aide memoire for any discussion you may have with the Prime Minister or other colleagues.

Decisions.

2. The question for decision is whether you want to go for more than £250 million for 1981-82 by this route. We assume that you will want to go at least for this, which can be secured without immediate primary legislation, either by way of a "normal" increase in employees contribition rates or (subject to further legal advice) as an addition to the "health stamp" .

3. Whether or not you want to go for more depends on your assessment of:-

(a) your need for help with the 1981-82 PSBR in the light of other factors such as the outturn of the current public expenditure discussion;

(b) the relative disadvantages of ENIC compared with other taxation and quasi taxation measures (bearing in mind of course that in the light of (a) then there might not be too much choice);

(c) the desirability, notwithstanding (a) and (b), of playing safe and not giving up these additional 1981-82 funds now - if it turned out that you did not need them you could always, come Budget time, "give them back".

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4. Our advice would be that if the fiscal stance is to be held, the risk of

giving up say £500 million or £750 million of 1981-82 revenue now is very great. It would seem wiser to go for the safer course, standing ready to make other concessions in your Budget if this proved possible when the time came. And there is the point, made at your meeting yesterday, that this measure would not, technically, count as a "Budget measure" which presentationally would ease the position next March anyway.

5. As for amount, you could go for £750 million,(or 0.75% on the employees rate);made up of £250 million "normal" increase, £250 million health, and £250 million Treasury supplement to the fund. Or, if you wanted, to go for £1000 million,(or 1.0% on the employees contribution),the Treasury supplement to the fund. could be made to raise £500 million.

6. The table attached to the the note below shows how these would effect people at different levels of income, and how the position would look after tax thresholds had been held back to 11% increase. This holding back of itself, of course, yields a further £700 million.

7. This route requires early primary legislation, ideally to be obtained before Christmas but at any rate by around the middle of January. We are told that technically it would be extremely simple to draft.

Consultation.

8. I attach a letter below for you to send to Mr Jenkin. This is on the basis that you will want to go for either £750 million or £1000 million. Mr Jenkin may not be happy, but he is not in a position to challenge your judgement as to what you need to carry through your fiscal strategy. The letter to Mr Jenkin also makes it clear that you are looking for an upper earnings limit of £200 per week; any lower figure loses money and arguably increases regressivity.

9. Because of legislation, it is also necessary at an early stage to consult with Mr St John Stevas and Mr Jopling. They are already on notice that you may want to do this, and it does not seem that any further approach to them is needed until a firm decision has been reached. We will continue to keep in touch with their officials. But it would be very desirable for sufficiently firm decisions to be taken now for Counsel to start drafting early next week.

Down-rating of Social Security Benefit.

10. Of itself the down-rating proposal is not, strictly speaking, relevant to ENIC. It is for settlement in the public expenditure context, and will come up at Cabinet tomorrow. But assuming that the down-rating is agreed we need to get the PSBR savings as well as the public expenditure savings - Mr Jenkin has agreed to this - which means not letting this down-rating lead to lower contributions than would otherwise be the case. There are two approaches:-

(a) carry through the "normal" contributions on the basis of no down-rating, and let the PSBR benefit of the down-rating work through by way of a larger surplus than would otherwise happen;

(b) allow the down-rating to affect the "normal" re-rating, but pick up the "loss" through a bigger reduction in the Treasury supplement than would otherwise be the case.

11. The choice really depends on whether a decision and announcement about the down-rating has been taken/made before the Parliamentary process in respect of the ENIC ~~re-rating~~ (whether Order or legislation) comes before the House in December. If it has, then the second course appears preferable. Immediate decisions are not required.

Summary.

12. To summarise, the position is as follows:-

(a) if you want to raise no more than £250 million through ENIC no early primary legislation is needed and we can run the normal contribution review and/or the health stamp idea with little difficulty (~~no later~~ subject to legal advice);

(b) but if you want more, early primary legislation is needed;

(c) it seems likely, in the light of current difficult developments, that you will need at least £500 million or £750 million more. A decision on this is needed;

(d) the table attached below shows the effects on individuals of various levels of ENIC against an 11% threshold increase;

(e) if you decide to go for £750 million or £1000 million, you will need to discuss it with the Prime Minister (as you intend) and obtain her agreement;

(f) As a quasi-budgetary matter it does not appear that the agreement of other colleagues is necessary. But clearly you will want to carry Mr Jenkin with you and a draft letter is below, which might be despatched after your talk with the Prime Minster. You will also have to carry the Leader of the House and the Chief Whip in order to get the necessary legislative time and to secure the services of Counsel.

(g) The down-rating of social security benefits is a slightly different matter, but could affect the detail and presention of ENIC depending on what is decided.

(h) Final decisions whether to go for additional sums under ENIC, or whether to abandon obtaining a full year's income for 1981-82, must be taken by 14 November. However, it would be very desirable indeed for you and the Prime Minister to decide now that the likelihood of going ahead is sufficiently strong for Parliamentary Counsel to embark on drafting.

13. As a post-script, I should add that DHSS officials say their Solicitors have grave doubts whether Mr Jenkin, as he apparently suggested in Cabinet, can increase the health stamp without very early primary legislation. Their view is that while after the event it might be possible to turn part of the insurance contribution into a health contribution, this could only be justified if no previous decision to do so had been been taken. If there were such a decision, it would not be proper to use the existing legislative machinery. The attached note covers the doubt on this point by referring to the need for further legal advice in the matter. But since you are likely to go for more than £250 million anyway, the point is academic.

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E P KEMP
5 November 1980

EMPLOYEES NATIONAL INSURANCE CONTRIBUTIONS

This note considers ways of raising further sum from employees via the national insurance machinery (ENIC) to benefit the PSBR for 1981-82.

2. There are three inter-linked considerations:-

(a) The normal national insurance contribution review. The Government Actuary estimates that without change in present rates (and assuming the upper earnings limit goes from £165 per week to £200 per week, and that there is full uprating of benefits - see paragraph 7 below) the Fund will run at a deficit of about £200 million in 1981-82. Given the current year's surplus and the accumulated surplus, this does not demand an increase in contribution rates, but it could justify an increase in employees rates (at present 6.35% and 3.85% for contracted in and contracted out employees respectively) of 0.25%, on the grounds that the balance in the Fund should be maintained in real terms. This would raise about £250 million, and would be permissible without further primary legislation.

(b) An increase in the so-called "health stamp". Ministers have decided that in lieu of cutting gross spending on the health service and in order to replace lost income from charges, the health stamp could be increased. An increase in the employees health contribution (at present 0.40%) of, again 0.25% would be required to raise £250 million to cover this. Primary legislation would certainly be needed in due course for this; whether or not very early legislation is required is for legal advice. (Note: it is certainly not possible to do 2(a) and 2(b) together without very early primary legislation).

(c) A reduction in the Treasury supplement to the Fund. A reduction of 1.7% or 3.3% would reduce the supplement paid into the Fund by respectively £250 million and £500 million, which would benefit the PSBR; the difference on the Fund would be made up by an increase in employees contributions, which would have to go up by 0.25% or 0.5%. Very early primary legislation would be required for this. (By very early it is meant by ideally Christmas and certainly not later than around the second or third week of January).

On the employee the effects of (a), (b) and (c) taken together would be to increase his overall contribution from the present 6.75% by 0.75% or 1.0%, depending on what is decided under (c), to 7.50% or 7.75%. These percentages apply to earnings between the lower earnings limit, likely to be around £27 per week, and the upper earnings limit (assumed to be £200 per week). The total raised would be £750m or £100m.

3. The attached table shows the effects on individuals of various combinations of 2(a) to 2(c), giving the immediate reduction in take home pay at various levels and inserting it alongside the increase in take home pay of tax thresholds were, for example, raised by 11% next year.

4. 11% would be the amount required on present forecasts to give the full increase in social security benefits at November 1981. A threshold increase on this level would roughly halve the "clear water" between the single pension and the single persons tax threshold but still leave something; if social security benefits are held back to 8%, as is proposed, then comfortable clear water is maintained.

5. Holding back most social security benefits by 3% gives savings on the public expenditure forecast of some £200 million in 1982-82 and over £500 million in later years. Decisions on this are to be taken separately as part of the public expenditure exercise. But it is relevant here to consider how the PSBR saving consequent on this holding back should be obtained. There are two ways:-

- (a) as in 2(a) above, assuming full uprating of benefits and letting the PSBR advantage arise as a surplus on the fund.
- (b) Reflect the down-rating at 2(a), but take a bigger reduction in supplement at 2(c).

The same PSBR advantage is obtained. The choice depends on whether and when decisions/announcements on the down-rating are taken/made.

Decisions.

6. The questions for decision are:-

- (a) How much should be sought to be raised through this route;
- (b) if £250 million or less. It appears that early primary legislation is not needed if the normal national insurance contribution route is followed (2(a) above). Legal advice is required as to whether this

amount could be raised through the health element (2(b)) without very early primary legislation;

(c) if more than £250 million is required then legislation is needed before the second or third week in January 1981. The question for decision is how the amount sought to be raised should be split between the normal contribution (2(a) above), the health element (2(b)), and the Treasury supplement approach (2(c)).

Timing and Announcement.

7. Final decisions are needed by 14 November if they are to be reflected in the Government Actuary's report and the Industry Act forecast and the necessary legislation put on course. (Indeed it would be desirable to have a decision in principle earlier than then for legislative purposes in order that Counsel be put to drafting.) The announcement could be associated with the clutch of announcements to be made around 25/26/27 November.

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Notes

① Net + indicates an increase in take-home pay;
② " − " " decrease " " " ";
③ These changes are in money of the day, ie they say nothing about the real burden of NI contributions and income tax.

Cash effect on a single person at different income levels of:

(i) increasing tax thresholds by 11% and
(ii) raising ENIC by various percentages

ENIC increase	revenue raised by ENIC change	revenue raised (compared with full indexation) by holding down increase to 11%	£50 per week			£75 per week			£100 per week			£150 per week			£200 per week		
			NIC	Tax	Net	NIC	Tax (pence	Net	NIC per	Tax	Net week)	NIC	Tax	Net	NIC	Tax	Net
¼%	250	600	−12½	+86½	+74	−18¾	+86½	+67¾	−25	+86½	+61½	−37½	+86½	+49	−50	+86½	+36½
½%	500	600	−25	+86½	+61½	−37½	+86½	+49	−50	+86½	+36½	−75	+86½	+11½	−100	+86½	−13½
¾%	750	600	−37½	+86½	+49	−56¼	+86½	+30¼	−75	+86½	+11½	−112½	+86½	−26	−150	+86½	−63½
1%	1 000	600	−50	+86½	+36½	−75	+86½	+11½	−100	+86½	−13½	−150	+86½	−63½	−200	+86½	−113½

i. For married men, add 52p to net figure in all cases (because an 11% increase in the married allowance is worth more than in the single allowance).

ii. For higher incomes (above about £250 a week) the increase in personal allowance is worth more in cash terms because of higher rate tax, but NIC remains the same as for £200 a week. Eventually the net cash losses are eliminated and become net cash gains at the highest levels (though not, of course, in real terms).

Notes

1. An increase in ENIC is proportionate (ie neither progressive nor regressive) on earnings between £27 and £200 a week (the earnings ceiling). Above £200 the amount does not increase (ie it becomes regressive).

2. An increase in ENIC has no staff cost.

3. An increase in ENIC affects earners only - not pensioners or unemployed.

4. A tax threshold increase gives a flat rate amount to everyone in the basic rate band (taxable income up to £11,250). Within this band less than full indexation is regressive as compared with full indexation; and hits hardest those brought into tax for the first time.

5. To those above the higher rate threshold, a threshold increase gives more (in absolute terms) than to basic rate taxpayers, the amount depending on the individual's marginal rate.

6. Putting up thresholds by full 15% indexation saves 290 staff, and reduces taxpayer numbers by 400,000. 11% indexation cuts the staff saving to 50 and reduces taxpayers by 100,000.

7. Present "clear water" between single allowance and widow's pension is £90. To keep the gap at £90 needs 13½% on thresholds, if pensions go up by 11%. 11% on benefits and thresholds cuts the gap to £56. If benefits increase by 8%, the gap compared with 11% on thresholds becomes at least £75.

DRAFT LETTER FOR CHANCELLOR TO SEND TO SECRETARY OF STATE FOR SOCIAL SERVICES

cc Prime Minister

NATIONAL INSURANCE CONTRIBUTIONS

We have spoken informally about the options for reducing the PSBR in 1981-82 through employees national insurance contributions. I am now writing with a formal proposition.

2 The proposal is that we should take legislation to reduce the Treasury Supplement to the National Insurance Fund so as to reduce the PSBR by a clear £500 million (over and above the £500 million that may be necessary for Fund and NHS purposes) and make up the difference in income to the Fund by raising the rate of employees' contributions payable from 1 April 1981.

3 There are two reasons for this:

(a) If we are to achieve the desired target for the PSBR next year we shall certainly have to reduce public expenditure. I may also have to contemplate increases in taxation. To the extent that Cabinet cannot agree to the full public expenditure reductions, the option of raising taxation through less than full revalorisation of personal tax thresholds becomes more likely. If I can achieve a contribution from the National Insurance Fund, my taxation options become easier.

(b) The Treasury Supplement to the NIF has stood at 18% of net contributions since 1975, despite a rapid growth in the volume of non-contributory (i.e. Exchequer-financed) benefit payments. There is a case for re-adjusting the Exchequer contribution to contributory benefits and placing the burden of readjustment on employees. Industry has carried a considerable share of the burden of economic adjustment so far. It is right that we should relieve employers of the additional contributions and ask those in employment to contribute more to the costs of payments to the unemployed.

4 You will be considering, in the light of information from the Government Actuary, what the levels of contribution should be for 1981-82 as part of your normal review. You will also be considering what the NHS contributions should be, following Cabinet's decisions on Tuesday 4 November. I should be grateful if you would also take my proposals into account. The level of contributions will of course be your responsibility. I hope however that you will aim to set the level of normal contribution so as to maintain the b alance in the Fund in real terms and to go to the maximum permissible under the legislation for the upper earnings limit (i.e. to £200 pw). I attach a note setting out the inter-relationship between these three issues in more detail (though not the table).

5 If we are to secure the increase in contributions from 1 April 1981 and give employers the usual notice for adjustment of payrolls etc, the legislation will have to be passed through its main stages by very early in the New Year. And we shall have to be ready to introduce it soon after the start of the new Session.

/The Prime Minister has agreed that Parliamentary Counsel should draft the necessary legislation. I suggest we aim to go to Legislation Committee on 18 November./

6 I am sending copies of this to the Prime Minister /and the Leader of the House and Chief Whip and Sir Robert Armstrong./