

I believe that no part of progress are ever taken out of the other. SECRET Prime Minister

13 November 1981

① IA

SECRET No - there are too many documents about ALAN WALTERS

PRIME MINISTER

Shall I ask the Treasury for their comments assuming any except Alan's theoretical analysis,

NIC AND NIS - THE CHANCELLOR'S PROPOSALS OF 12 NOVEMBER are they arguing that practical considerations

1. I agree with the Chancellor's proposal that the NIC be raised - justifying and about 1 per cent seems correct. their proposal?
2. Some of the arguments that are used by the Chancellor, however, seem to me to be incorrect and inconsistent with basic analysis. MUS (3/1)
3. The Chancellor urges an increase in the NIC because, as distinct from NIS, the NICs are paid primarily by employees rather than employers. Consequently, he argues, the burden would fall on employees rather than firms.
4. That is not correct. Under competitive conditions it does not matter who pays the tax; the burden or incidence of any tax is completely independent of how it is collected (administrative problems and cost aside). Analogously, it would not matter if the brewer, the retailer or the drinker actually paid the same tax on beer. The burden and incidence would not be affected.
5. The question "who bears the burden" of a tax on employment depends entirely on the extent to which the employers find it profitable to reduce employment and the degree to which workers respond by varying, if at all, their job-acceptance-(real) wages.
6. Probably the most frequently asserted assumption about the latter is that there is an infinitely elastic supply of labour at the going real wage. Variations in the demand for labour, at least over the range we are considering and with the present level of unemployed, will then have no effect on the real wage rate. In this case, the volume of employment will fall and business, and the newly unemployed, will bear the burden of the tax. If the employees' NIC is increased then gross real wage rates will rise pari passu but real wages, excluding the NIC increase, will be constant. If the employers' NIS is increased, then although real wage rates, both gross and net, remain the same, profits are reduced by the NIS to exactly the same extent. Whether we use NIC or NIS is irrelevant.

/7. There are

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7. There are a number of alternative views about the wage-employment supply process which we could explore. But they all amount broadly to the same proposition: the greater the response of the supply of labour to different wage rates the more will those with jobs bear the burden. Correspondingly the smaller the effect on both employment and profits.
8. I am inclined to think that the caricature of paragraph 6 is rather more consistent with the evidence than that in paragraph 7. (But the fact that it is also the common prejudice should give us cause to be sceptical). In other words imposing an increased NIC or NIS will not much reduce real take-home wage. The real wage paid out by industry rises almost as much as the NIC or NIS increase. Business then bears the substantial burden of the tax.

AW

ALAN WALTERS

cc Mr. Wolfson
 Mr. Hoskyns
 Mr. Duguid
 Mr. Scholar

- why? Copy of the original memo sent only to Sir Robert Mansel?

SECRET

May I have a list of everyone to whom these documents are being copied and all who see them? I will then discuss with the channels.