

MR. SCHOLAR

I am going to a meeting at the Treasury at 2.45 this afternoon which will discuss the issue raised in the enclosed note. I do not know which way the decision will go, but I am very keen on lifting the thresholds and would like the Prime Minister to see the enclosed note before she meets the Chancellor this evening.

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18 February 1982



ALAN WALTERS



PRIME MINISTER

BUDGET

MS

PSBR AND TAX REDUCTIONS 1982/83

1. The present estimates suggest that if we aim for a £9bn PSBR in 1982/83 we shall have about £1½bn net tax reductions available this year. This gives a little more leeway than I reported in my memorandum of 10 February.

NIS VERSUS INCOME TAX THRESHOLDS

2. Nevertheless the issue remains the same as I mentioned in my memo of 10 February. The contrast now is between having a 1½% reduction in NIS together with Rooker-Wise plus 1%, or a 1% reduction in NIS and Rooker-Wise plus 5%.
3. The pressure for the 1½% NIS and only 1% more than Rooker-Wise is considerable. Terry Burns has argued the case strongly on the grounds of redressing the balance between the personal and corporate sector and of course, reducing labour costs. (I am doubtful about the corporate/personal sector balance argument. A fall in the oil price, the rapid reduction in real wages, the increase in productivity and the probable fall in material prices and interest rates should transform the relative balance of the sectors.) There was, as you recall, considerable pressure from colleagues for as big a reduction in NIS as we could afford.
4. I would, however, much prefer that we put as first priority the increase of the income tax thresholds of 5% above Rooker-Wise (ideally I would prefer two Rooker-Wise, which was strongly urged as an absolute priority by Nigel Lawson in the pre-Budget Cabinet meeting). Rooker-Wise plus 5% would bring the basic threshold to the level of the national insurance pension, this is also the subsistence level determined for supplementary benefit purposes. It seems wrong that the state, having increased incomes to this "subsistence level" should then reduce them below that level by imposing tax. The marginal effective rates of tax-cum-benefits at that rate of income are very high indeed.

/5. It may

5. It may be argued, per contra, that the best way of tackling the "Why Work?" problem is to reduce the benefit levels. Or at least avoid indexing those levels to the rate of inflation. But granted that politically one cannot do that, then one must take the benefit levels as given and adjust the tax system so it does not produce these considerable disincentives. Rooker-Wise plus 5% would bring the main thresholds in real terms back to where they were in 1978/79.

POLITICAL CONSIDERATIONS

6. One of the arguments for not increasing the thresholds above the Rooker-Wise plus 1% is that there has been no pressure for it, compared with the enormous CBI etc pressure which has been exerted on behalf of the nationalised and private industries. I think this is true. But the perception of the increase in tax thresholds will be very much more widespread than the change in the NIS. Furthermore, you will be able to present this Budget as a measure which has a very strong "caring" element. It will take many people at the lower end of the income scale out of the tax net and give them incentive to work again.
7. Both measures have a positive effect in increasing employment. The thresholds measure will have more effect at the lower end, whereas the NIS measure will be fairly wide-ranging - including nationalised industries, etc. As far as I can judge, from Minford's work and other publications, the actual number of jobs created in both cases would be about the same per million pounds PSBR cost.

CONCLUSION

8. I believe that now we have a little more leeway, the case for going to Rooker-Wise plus 5% is very strong. We can at the same time afford a 1% reduction from August in the NIS. While I agree that a 1½% increase in NIS, at the cost of reduced thresholds, would go a way towards satisfying the industry lobby, I believe that the cost, social, economic and political, of not taking this opportunity to raise the thresholds would be much larger than the benefit to industry of the ½%.

18 February 1982

  
ALAN WALTERS