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PART A

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PART A

1989 BUDGET NATIONAL
INSURANCE CONTRIBUTIONS.

13.3.89

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McINTYRE 4/11

FROM: J P MCINTYRE

DATE: 4 November 1988

I am most grateful for the work done. I agree Rand option (1) (or some variant) looks the best. But it is not without its drawbacks. Above all, I do not believe we can get a satisfactory package to deal with the lower end

This boils down to Option I (with variants) or nothing. (If you conclude that you would prefer to leave things unchanged, I shall dress up the minute [illegible] out to register fulsome thanks for work done, etc). [illegible] 4/11

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Byatt
Mr Phillips
Mr Scholar
Mr Culpin
Miss Peirson
Mr Gilhooly
Mr Riley
Mr Ramsden
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Mace (IR)
PS/IR

NIC problem until we are less PSBR-constrained than we will be in the 1989 Budget. So, regretfully, no further work on this [illegible] for 1989. N.

**NICS: POSSIBLE LOWER END MEASURES**

Mr Taylor's minute of 4 July recorded your agreement that further work should be done on the options for reform at the lower end, though you commented that the cost looked daunting. The attached paper, prepared with the help of ETS, has also been seen by FP and the Revenue.

2. The paper focuses mainly on the first of the options we identified in the Summer, namely an allowance of £43 which would be withdrawn when earnings reached £227. Within this earnings band, a marginal rate of 11.1% would be payable. This option would eliminate all the NIC steps and cut NICs for 11 million employees. About half would gain over £1 a week.

3. The paper re-examines each of the five problems we identified earlier, including the cost. It raises the following questions which you may like to consider:

/ if any

i. **Which Option(s) to consider further?**

The paper suggests that Option I is the most promising of the three options to pursue if you are interested in lower end reform. This is on grounds of simplicity and least cost. Are you content with this, or would you like further work done on Options 2 and 3? (see paragraphs 3 to 6, and Annexes A and B). Focusing on Option I, the paper discusses the following issues:

ii. **Marginal Rates**

Very roughly, something like 1½ million employees, a quarter of those earning less than £115 a week (the upper limit of the employee reduced rate bands), are bunched - within £3 - below the employee steps and so face very high marginal rates, often over 100 per cent. (This problem may be aired publicly in the coming weeks as a result of a forthcoming IFS paper on NIC reform - see para 40 of main paper and Annex D). Option I would eliminate the steps but result in increases in marginal rates for the majority of employees earning upto £227 week. The increase faced by most would be only 2 per cent, but those in the lowest NIC band (over 1 million) would face an increase from 5 per cent to 11.1 per cent. These increases in marginal rates would probably be a much less powerful disincentive than the steps are at present for those bunched just below them. Are you prepared to see slightly higher marginal rates for roughly 9½ million employees (all on below average earnings) in the interests of eliminating extremely high marginal rates for the sizeable minority (around 1½ million) earning just below the NIC steps? (see paras 9-20 of the paper).

iii. **Contributory Principle**

Are you content that Option I poses no serious difficulties in terms of the contributory principle, or are you attracted by the possible variants of Option I we have designed to reconcile the reform more comfortably with the principle? (see paragraphs 21 to 25).

iv. <u>Employers</u>

Option I as it stands would leave employers NICs unchanged, because we have assumed you would want to give priority to employees within cost constraints. But the employer steps are also damaging in economic terms. Parallel changes in employer NICs (avoiding losers) would be very expensive (£2½ billion), but would you like to consider less expensive or revenue-neutral ways of removing the employers steps? (paragraphs 26 to 30). Employers might also complain about the administrative costs of changing over to the new system, especially if it were in mid-year.

v. <u>Self employed</u>

The self employed would argue that their contribution rates should also be reduced. The paper concludes that, although there are no necessary implications for self employed rates, some concession might have to be made. Would you be content with no change in the self employed rates, or would you like us to review possible easements? (paragraphs 30 to 31).

vi. <u>Cost to the PSDR</u>

Option I (assuming no action on employers or self employed) would reduce NIF income by about £800 million in a full year. But the first year cost would be roughly half this, because implementation would not be possible before October, assuming a Budget day announcement (see paragraph 6 below). There would also be public expenditure savings on income-related benefits of around £30 million in a full year. The paper looks at a number of ways in which the cost to the PSDR might be wholly or partly offset. Within the NIC system, the possibilities appear to be an increase in the main 9 per cent employee rate and an increase in the UEL. Neither look attractive. But would you like us to pursue them further?

Do you agree that we could not load the cost onto employers NICs (as with the 1985 reforms)? In any case, you would need to look at this in the context of the overall Budget arithmetic (paragraphs 32 to 38).

4. Another consideration is the large prospective NIF surplus, even after Treasury Supplement abolition. The annual surplus may be around £3 billion this year and £1½ billion in 1989-90, with the balance in the Fund at the end of next year reaching 41 per cent of outgo (the GAD's recommended minimum is 17½ per cent.) We are looking separately at uncapping the annual increase in the NHS allocation, which could help with this problem. Mr Moore has also asked his officials to look at the options for cutting the surplus. But it would be preferable from the point of view of the surplus not to offset the loss of NIF income from lower end reform by raising NIC income elsewhere in the system.

5. Your judgment on lower end reform may depend partly on how it measures up against the yardstick of a cut in the basic rate of tax and an increase in tax allowances. Paragraph 39 of the paper and Annex C review the distributional and incentive effects of these different measures. Essentially, Option I would be better for the low paid and would remove (at least for employee NICs) the worst disincentives left in the tax/NICs system. It would be particularly well directed at the "Nearly Poor", above benefit levels, who have featured in recent discussions on child benefit, health charges etc. (Those on half and also three quarters of average earnings have a higher proportion of their income taken in tax and NICs than in 1978-79.) The basic rate cut and allowances increase would spread the same amount of revenue more thinly among a much larger number, with bigger gains to the more highly paid.

**Timing of implementation**

6. Option I would require primary (DSS) legislation. If the necessary provisions could be prepared in time, they might be added at a late stage to the already planned Social Security Bill in the next Session. More likely, a special Bill would be needed. Either way, October 1989 would be the earliest date for

implementation. DSS would of course need to be consulted about the feasibility of achieving this.

**Conclusions**

7. The conclusion we have drawn from the work so far is that Option I would have a good deal of merit if your priorities were to remove the labour market distortions caused by the steps and focus gains on the low paid. But although the majority of those affected (roughly 9½ million) would also gain by paying lower NICs, their marginal NIC rate would increase by at least 2 per cent. That would be presentationally difficult against the 1988 basic rate reduction. It would have to be defended by reference to the considerable improvement in incentives for the sizeable minority of employees (1½ million or so) affected by the steps.

8. The PSDR cost is clearly a problem. Offsetting action within the NIC system does not look attractive. But October implementation would halve the first year cost to £400 million. The full year cost would be reduced by about £30 million of benefit savings.

JM

J P MCINTYRE

**NICS: POSSIBLE LOWER END MEASURES**

Mr Taylor's minute of 4 July recorded the Chancellor's agreement that further work should be done on this, although the cost of any changes looked daunting. This paper looks at the options again in the light of this further work.

2. Mr Macpherson's paper of 1 July set out 3 options for lower end reform. The main aim of each would be to eliminate or reduce the number of NIC steps and thus the disincentive effects of very high marginal rates faced by those earning just below the steps.

3. In summary, the options were (converting to 1989-90 earnings limits):

I. A withdrawable allowance of £43 (equivalent to the current Lower Earnings Limit) for all employees earning upto £227. On earnings between £43 and £227, a marginal NIC rate of 11.1 per cent. No change above £227. Cost: £0.8 billion.

II. A withdrawable allowance of £43 for all employees earning between £43 and £241. Marginal NIC rates within this band would be: 8 per cent (£43-£75); 10 per cent (£75-£115); and 12 per cent (£115-£241). No change above £241. Cost: £1.5 billion.

III. The £43 step retained, along with the existing 5 per cent band up to £75. Marginal NIC rates above this would be: 9 per cent (£75-£115); and 11 per cent (£115-265). No change above £265. Cost: £1.1 billion.

4. The table at Annex A compares these 3 options with the existing system in terms of marginal rates and shows the number of employees affected in each band. Annex B illustrates with graphs.

5. When we discussed the options with the Financial Secretary in July, his preliminary view was to favour Option I, and we have focused further work on this. It has the merit of being the least

expensive and the least complex. In its pure form, it would get rid of all the steps. It would reduce NICs for some 11 million low paid employees, earning between £43 and £227 gross. Over 5 million would gain by over £1 a week; the maximum gain would be £2.36 to those on £115 a week.

6. Apart from being twice as expensive, Option II involves a larger increase in marginal rates for most employees affected than Option I. Those in the £115-£241 band (roughly 9½ million out of the 13 million paying reduced rate NICs) would face a 3 per cent increase in their marginal NIC rate instead of 2.1 per cent with Option I. (On the other hand, the increases in marginal rates for the minority in the lower bands, £43-£75 and £75-£115, would be smaller than with Option I.) Option III has the disadvantage of retaining the step at the LEL, which affects probably half of the total number of employees with earnings just below the steps. However, Options II and III could be pursued further if Ministers wanted.

7. If Option I is to become a real possibility, there are five problems or issues we need to resolve - or else decide that they are not overriding:

a. the increase in marginal NIC rates for the majority of employees earning between £43 and £227 who are not affected by the steps at present;

b. the effect on the contributory principle;

c. the position of employers;

d. the position of the self employed;

e. the cost to the PSDR.

8. The first part of this paper (paras 9-38) addresses each of these issues in turn. Paragraph 39 and Annex C look at the distributional and incentive effects, compared with a cut in the basic rate and an increase in allowances of equivalent cost. A

new IFS study on the subject is previewed in paragraph 40 and Annex D. Conclusions are at paras 41-44.

**Marginal Rates**

9. The key question here is whether we should trade off a relatively small increase in marginal rates for the majority in exchange for a substantial improvement in the position of the sizeable minority now affected by the steps. Annex A shows the working population in each NIC band and how marginal NIC rates for the majority of the low paid would increase under Option I.

10. Perhaps the most important point to emerge from this is that the majority of those affected would see their combined marginal tax/NIC rate increased by 2.1 per cent. Roughly 7½ million (over two thirds) are in the £115 - £227 band, whose combined rate would rise from 34 per cent to 36.1 per cent (assuming the basic rate of tax were unchanged).

11. The group worst affected by Option I's increase in marginal rates (£43-£75) totals over 1 million (about 10 per cent of the total affected). Their marginal NIC rate would more than double from 5 per cent to 11.1 per cent (for those also paying tax, from 30 per cent to 36.1 per cent). Half of these work part time, many of them married women. Only around 30,000 married men over 21 in this group work full time, and the married men generally in this band will not be taxpayers because they earn less than the tax threshold.

12. The picture is different in the £75-£115 band, which has 90 per cent working full time, though only a small minority are married men over 21 (250,000 out of 2 million). But the increase in the marginal NIC rate would be less, from 7 per cent to 11.1 per cent. For taxpayers, the combined tax/NICs marginal rate would rise from 32 per cent to 36.1 per cent.

13. We also need to bear in mind that for some employees on low pay their marginal rates are determined not by tax/NICs but by benefit withdrawal rates, which are over 70 per cent for those on

family credit and up to 96 per cent (for the relatively few) on both family credit and housing benefit.

14. For example, a married man with 2 children (one under 11 and one over 11) will be able to claim family credit in 1989-90 up to a net income of about £130 a week. If he pays average rent and rates, he will qualify for housing benefit if he has a net income of upto £115 a week including family credit or £75 excluding family credit. A single person could claim housing benefit (assuming lower than average rent and rates, reflecting smaller accommodation) on net income of up to £60 a week.

15. For this reason, we should expect Option I to have little impact on incentives for roughly 80,000 heads of tax units in the £43-£75 band and 170,000 in the £75-£115 band, because their marginal rate is determined by benefit withdrawal rates. The associated savings in benefits would be around £30 million a year.

16. For some low paid employees, Option I would not mean higher marginal rates. This is the substantial minority earning just below the NIC steps. Looking at the employee steps only (£43, £75 and £115), there are up to 1½ million employees in this position, with earnings within £3 of the steps. These people would be the main beneficiaries of Option I. They would face a marginal NIC rate of 11.1 per cent instead of over 100 per cent in many cases now.

17. Two examples may help to show the impact of Option I. They contrast the dramatic improvement in the marginal rate of someone just below one of the steps with the relatively small worsening of the position for someone presently unaffected by the steps.

18. First, the effect on a married woman working part time for £74 a week gross (ie just under the £75 step).

| | | Current position | Option I |
|---|---|---|---|
| Tax | : | £5.98 | £5.98 |
| NICs | : | £3.70 | £3.44 |

Given a £1 a week pay increase

| | | | |
|---|---|---|---|
| Tax | : | £6.23 | £6.23 |
| NICs | : | £5.25 | £3.55 |
| Marginal tax/NIC rate: | | 180 per cent | 36.1 per cent |
| Average tax/NIC rate: | | 15.3 per cent | 13.0 per cent |

19. Second, take a married man on £180 a week gross (ie clear of the steps).

| | | Current position | Option I |
|---|---|---|---|
| Tax | : | £25.31 | £25.31 |
| NICs | : | £16.20 | £15.21 |

Given a £10 a week pay increase

| | | | |
|---|---|---|---|
| Tax | : | £27.81 | £27.81 |
| NICs | : | £17.10 | £16.32 |
| Marginal tax/NIC rate: | | 34 per cent | 36.1 per cent |
| Average tax/NIC rate: | | 23.6 per cent | 23.2 per cent |

20. There is one other labour market consideration. To the extent that we are interested in attracting additional married women and others into employment in the next few years (because there will be fewer young people entering the labour market), average rather than marginal tax/NIC rates are important in helping to influence decisions on whether to take up jobs. A lower average tax/NIC rate, which Option I achieves for all the lower paid, would make it more worthwhile to get a job. More generally, it would also mitigate the unemployment trap.

**Contributory Principle**

21. Option I would arguably be at odds with the contributory principle. The basic retirement pension and entitlement to other contributory benefits could be bought for 1p a week by someone earning £43 a week, because the LEL would become a threshold, with no NICs payable on the first £43 of earnings.

22. There are counter-arguments:

a. Many people may start work at earnings just above the LEL but go on to earn much more and so, over a lifetime, pay an average of considerably more than 1p a week.

b. The financing of contributory benefits is already progressive as a result of the 1985 reforms; Option I would simply take this a stage further.

23. If, however, it was felt that Option I went too far in infringing the contributory principle, one possibility would be to drop the idea of a threshold at the LEL and instead lower the initial step at the LEL, perhaps by halving it to 2½ per cent, thus mitigating the disincentive effects. Employees whose pay increases took them over the LEL at £43 would then face an initial NIC payment of £1.08 instead of £2.15 as at present. 2½ per cent NICs would be payable on total earnings until the threshold was introduced at £56 (to avoid a step), with Option I as before.

24. Alternatively, we might retain the threshold at £43 but introduce a basic £1 "stamp", payable by all those in the £43-£52 bracket. The 11.1 per cent marginal rate would then be introduced for those earning £52 or more (to avoid a step).

25. Either of these variants would have the advantage of being slightly cheaper than Option I itself. The 2½ per cent band would save £20 million, and the £1 stamp would save £10 million. The main disadvantage would be additional complication, because an extra band would be introduced above the LEL. A further disadvantage of the £1 "stamp" would be that, unless we uprated

it, its real value would be eroded over time. Nonetheless, each of these variants offers a means of making Option I more acceptable in terms of the contributory principle.

**Employers**

26. At present, the reduced rates apply to employers NICs as well as employees. In 1989-90, the rates will diverge at £165 where the higher (10.45 per cent) rate comes in for employers. Proposals to cut employees NICs at the lower end might well result in pressure from employers for equal treatment (as well as complaints about the administrative cost of the change, particularly if it came in mid-year). Moreover, removing the employee steps only would leave in place the distortions caused by the employer steps, and the resulting NIC structure might be hard to defend:

**Average NIC rates**

| £ per week (1989-90) | Employees | Employers |
|---|---|---|
| 0-43 | 0 | 0 |
| 43-75 | 0-4.7% | 5% |
| 75-115 | 4.7%-6.9% | 7% |
| 115-165 | 6.9%-8.2% | 9% |
| 165-227 | 8.2%-9.0% | 10.45% |
| 227-325 | 9% | 10.45% |
| 325+ | 9% on 325 | 10.45% |

27. Of the alternatives, full equal treatment would be extremely expensive. If we wanted to avoid any employers paying more NICs as a result of the changes, they too would need a marginal rate of 11.1 per cent above the LEL. But this would have to extend up to £734 a week in order to avoid a step. (£734 is the point at which 10.45 per cent of total earnings equals 11.1 per cent of total earnings minus the £43 withdrawable allowance.) This would be prohibitively expensive at some £2½ billion.

28. A cheaper alternative would be to give employers the same £43 withdrawable allowance and withdrawal point (£227) as employees. This would require a marginal rate of 12.9 per cent to avoid a step and would result in some employers paying more NICs ie those with employees concentrated in the following parts of the earnings distribution: £71-£73; £95-£114, £143-£164. This would cost around £300-400 million in a full year.

29. A broadly revenue-neutral way of eliminating the employer steps would be to raise the main employers rate from 10.45 per cent to 10.8 per cent. If coupled with the £43 withdrawable allowance and the £227 withdrawal point (ie in line with employees), this would require a marginal rate of 13.3 per cent to avoid a step. The effect would be to increase the number of losers among employers, including all those whose employees earned above the withdrawable allowance.

**Self Employed**

30. The problem here is that the Class 2 contribution is derived from the minimum combined employer-employee Class 1 contribution ie in 1989-90, 10 per cent of £43 (less 5p) = £4.25. If we were to bring in a withdrawable allowance for employees of £43 on the lines of Option I, the self employed might well argue that Class 2 should be abolished or at least reduced, because the formula would then indicate a zero Class 2.

31. However, abolition of Class 2 would cost £400 million. And it would remove the self employed's basis of entitlement to NI benefits (Class 4 contributions do not count for this purpose). As you know, officials from DSS, Revenue and Treasury are looking at possibilities for merging Class 2 and Class 4, but this will almost certainly not be feasible until the mid-1990s because of the need to await further developments in the Revenue's computerisation programme. The best answer might be to leave Class 2 where it is, perhaps to be uprated in line with prices, pending decisions on a possible merger with Class 4. But a concession, involving a small cut in the Class 2 rate, might have

to be considered to make the changes acceptable to the self employed.

**The Cost to the PSDR**

32. To the extent you felt unable to pay for Option I by using up some of the fiscal adjustment, you may want to consider other ways of paying for it. In principle, there are four ways of offsetting the impact on the PSDR:

a. Increasing NIC income elsewhere in the system;

b. Reducing expenditure on NI benefits;

c. Increasing taxation.

d. Reducing non-contributory benefit expenditure.

We consider here only (a), (b) and (d). Of these, (a) and (b) have the disadvantage of not helping with the NIF surplus problem.

**(a) Increasing NIC income**

33. The 1985 reforms were paid for by abolishing the employers UEL. If employers NICs were not to be reduced as part of the lower end reforms, it would be hard to justify loading the cost on to them this time. The possibilities on the employee side are: to increase the UEL; increase the main 9 per cent rate; and extend NICs to benefits in kind. However, we assume that, in the light of last year's work, benefits in kind should not be pursued - implementation would not, in any case, be feasible for some years.

34. An increase in the UEL of £50 to £375 would bring in an extra £300 million in a full year, partly offsetting the cost of Option I. One of the consequences would be to increase SERPS expenditure in the long term, because we would be increasing pensionable earnings for SERPS purposes. But two thirds of employees earning more than the current UEL are contracted out, thus muting the expenditure consequences of raising the UEL. Very roughly, a £50 increase might increase SERPS expenditure by some £100 million a year in 2000.

35. For a contracted-in employee, earning above the new UEL, contributions would rise by £4.50 a week (from £29.25 to £33.75, a 15 per cent increase). Around 1 million employees would be taken out of the "kink", raising their marginal tax/NICs rate by 9 per cent.

36. As for increasing the main employee rate, a ½ per cent increase to 9½ per cent would bring in £700 million, so this would offset most of the cost of Option I. About 16 million employees would be affected; they would pay up to an extra £1.63 a week.

**(b) Reducing expenditure on NI benefits**

37. The only likely runner here would be a reduction in the duration of unemployment benefit from 12 to 6 months. This was considered in this year's Survey. It would reduce expenditure by about £175 million in a full year. Primary legislation would be required. In the absence of a special Social Security Bill and assuming transitional protection, the full year savings would not be available until 1992-93. We could not be certain of a decision to make these savings before the 1989 Budget, unless we could persuade Mr Moore ahead of the normal Survey process. This could be very difficult and might also prejudice the outcome of Survey discussions with DSS on other issues.

**(d) Reducing non-contributory benefit expenditure**

38. Options are now very limited, and (like (b)) would not normally be taken up or agreed with DSS before decisions were needed for the 1989 Budget.

**DISTRIBUTIONAL AND INCENTIVE EFFECTS**

39. Annex C, by Messrs Speedy and Ford, sets out the distributional and incentive effects of Option I compared with a cut in the basic rate and an increase in allowances costing a similar amount. The main points to emerge are:

ii. Threshold converted to allowance, with losers avoided by a higher withdrawable allowance (of £57). The marginal rate (14.75 per cent) is the same as in (i).

iii. Threshold converted to allowance, with losers avoided by a lower marginal rate (11.4 per cent) over an extended reduced rate band (up to £188). Our Option I is on the same lines but costed on more up-to-date figures.

iv. Threshold converted to allowance, with a single marginal rate of 10.4 per cent on all earnings between the LEL and UEL.

**CONCLUSIONS**

41. Option I provides an expensive but effective way of removing the NIC steps, a problem to which the IFS paper may attract more attention. Incentives, in so far as these are determined by combined marginal tax/NIC rates, would be considerably improved for the significant minority with earnings just below the steps. The increase in marginal rates for the majority of the low paid (those in the £115-227 bracket) would be 2 per cent, though for some the increase would be 6 per cent. However, this is likely to be much less damaging to incentives than the steps under the current system for those affected by them.

42. Option I would stretch the contributory principle but, if necessary, it could be adapted to deal with this problem, either by a new 2½ per cent band; or a £1 "stamp" for those just above the LEL.

43. There are ways of offsetting the loss of income resulting from Option I, in whole or in part. But none of the possibilities for doing this within the NIC system look attractive. And from the point of view of the NIF surplus, it would be preferable to minimise offsetting action elsewhere in the NIC system.

a. The gains from a cut in the basic rate and an increase in allowances are much more thinly spread (over 20 million or so tax units) than from the NIC changes in Option I (11 million).

b. In Option I, the biggest gains, in both absolute and proportionate terms, are in the £4,000 to £7,000 a year bracket (average of 62p a week) and £7,000 to £10,000 (74p). By contrast, the biggest gains in absolute terms from a cut in the basic rate and an increase in allowances are for those on £20,000 a year plus (an average of £1.01 for allowances, £1.71 for the basic rate). The low paid gain more, proportionately, from an increase in allowances than the high paid but still less than under Option I.

c. Relative to Option I, the basic rate and allowance changes would give very small gains for those on £2,500 to £10,000 a year.

d. Option I would float roughly 25,000 out of the poverty trap, rather more than an increase in allowances or a cut in the basic rate.

**IFS Study**

40. The IFS is due to publish later this month a study of NIC reform possibilities by Dilnot and Webb. A draft is at Annex D (toy copy only). Part of the paper looks at the scope for top end reform, by abolishing the employees UEL. But it also considers lower end reform. It argues that "if a way could be found to remove [the NIC steps] without either spending very large amounts of money or causing problems for the contributory principle, it would have much to recommend it." Pages 11-20 consider 4 possible reform options, without coming down in favour of any particular proposal:

i. Threshold converted to allowance at zero net cost. The problems here are that it produces some losers and a significantly higher marginal rate (14.75 per cent) for all those paying reduced rate NICs.

44. Option I would bring larger average gains to those on low incomes than either a cut in the basic rate or an increase in allowances with similar cost. It would therefore be more effective in taking people out of the poverty and employment traps.

ST/ETS DIVISIONS
4 November 1988

ANNEX A

## EMPLOYEE NICS: OPTIONS FOR REFORM

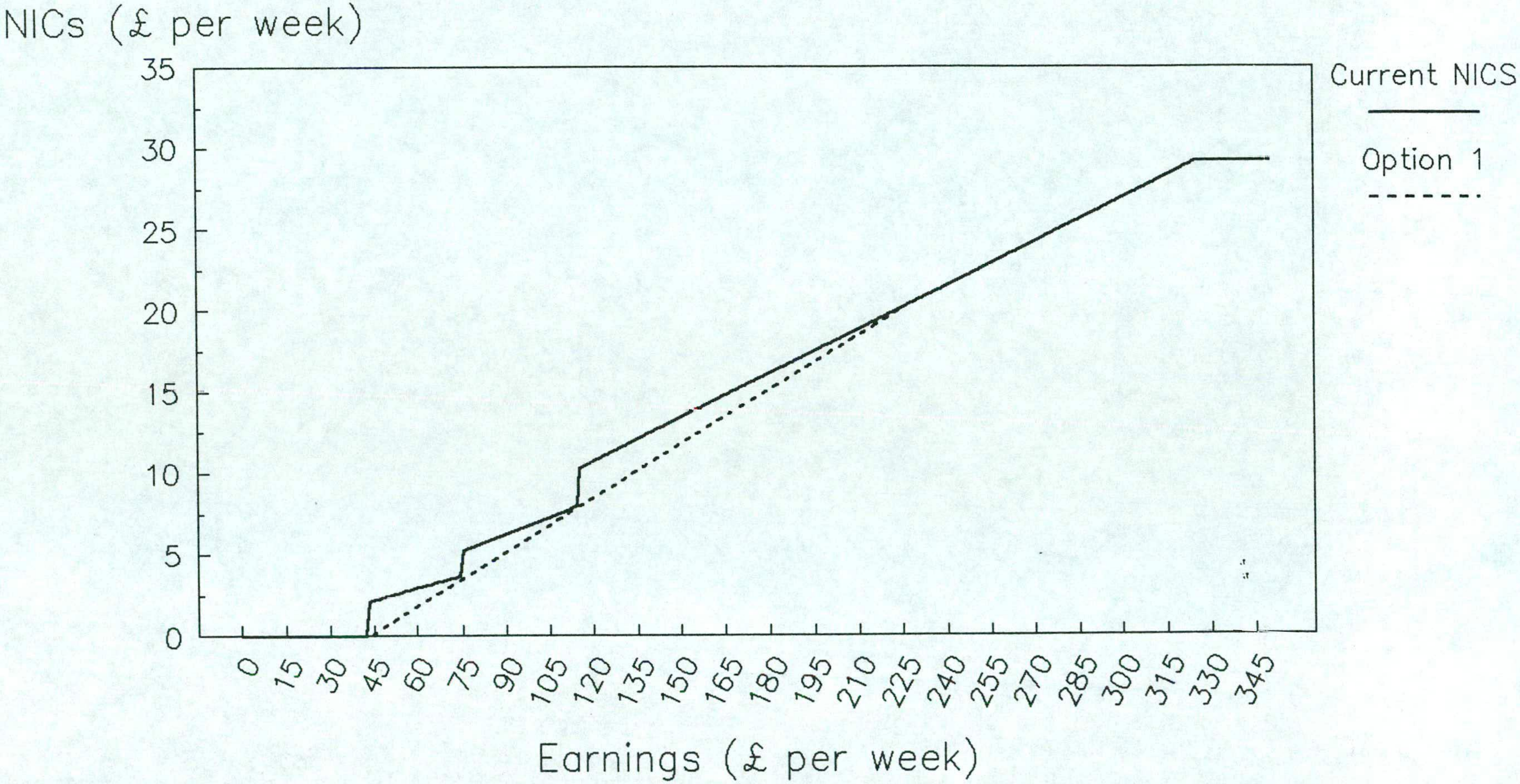
**Employee Marginal NIC rates (%)**

| £ per week (1989-90) | Number of employees in band† (millions) | Current system | Option I | Option II | Option III |
|---|---|---|---|---|---|
| 0-43 | 2.4 | 0* | 0 | 0 | 0* |
| 43-75 | 1.5 | 5* | 11.1 | 8 | 5 |
| 75-115 | 1.9 | 7* | 11.1 | 10 | 9 |
| 115-227 | 7.4 | 9 | 11.1 | 12 | 11 |
| 227-241 | 2.0 | 9 | 9 | 12 | 11 |
| 241-265 | 1.1 | 9 | 9 | 9 | 11 |
| 265-325 | 2.4 | 9 | 9 | 9 | 9 |
| 325+ | 2.6 | 0 | 0 | 0 | 0 |

† excluding married woman optants. Pending further data from CSO, these figures are based on the 1988-89 earnings distribution and are therefore very approximate.

* steps mean that marginal rates for those earning near the limits can be considerably higher.

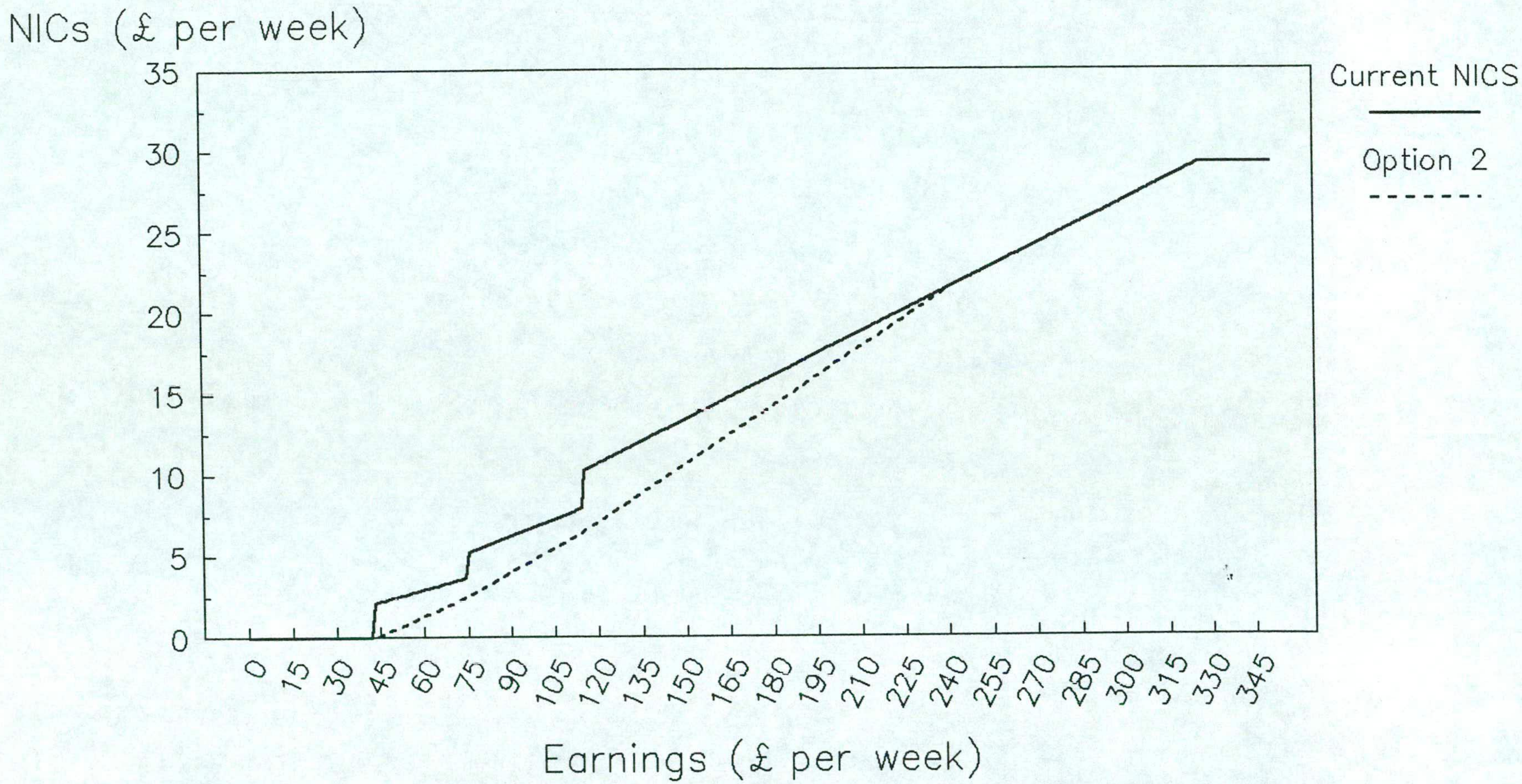
# Option 1




Allowance of £43
Marginal rate of 11.1%
Allowance withdrawn at £227

ANNEX B

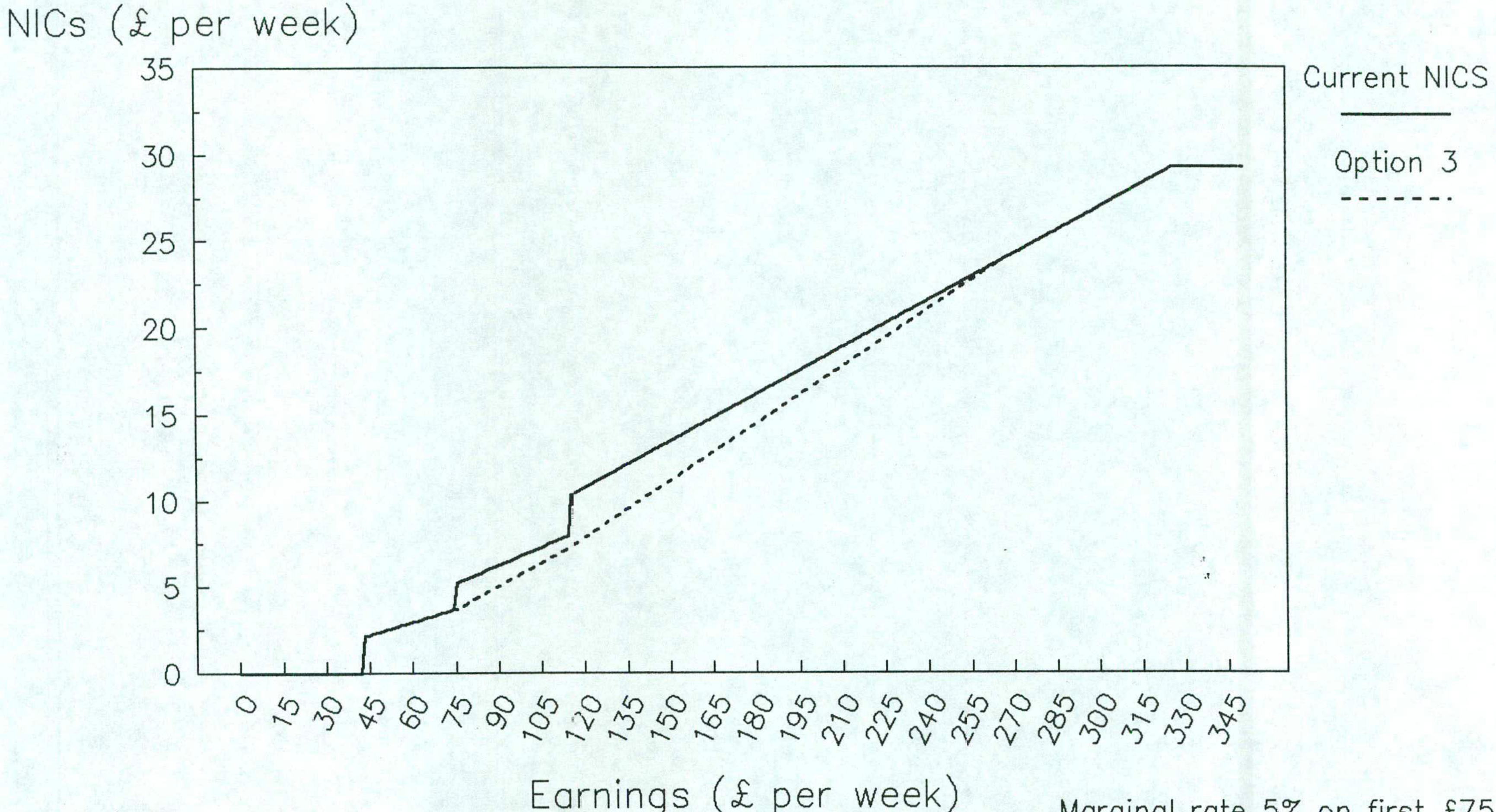
# Option 2




Allowance of £43
Marginal rates of 8%, 10% and 12%
Allowance withdrawn at £241

£43 to £75 marginal rate 8%
£75 to £115 marginal rate 10%
£115 to £241 marginal rate 12%

# Option 3




Earning under £75 and over £265 NICs unchanged
For others see marginal rates

Marginal rate 5% on first £75
9% from £75 to £115
11% from £115 to £265

ANNEX C

ANNEX C

## COMPARISON OF CHANGES TO NICS, BASIC RATE AND ALLOWANCES

### Introduction

This note compares the effects of option 1 with a cut in the basic rate and increases in allowances. As a 1989-90 database was not yet available the changes were modelled for 1988-89. This does not have a material impact on the conclusions.

2 To facilitate comparison equal cost changes to the basic rate and allowances were considered. Because the non-NIC changes were constrained to cost the same as option 1 they are very small and may not in practice be realistic options. The basic rate option involved a cut to 24.45 pence. The allowance option involved a 3½ per cent increase in married man's allowance, single person's allowance and wife's earned income allowance. Age allowance was left unchanged because the objective was to look at measures whose main impact was on those in work. If age allowance was also changed there would be more impact on pensioners in the allowance change example.

### Distributional Consequences

3 Tables 1 to 3 show the types of tax unit who gain and the amounts they gain for each option. The cut in the basic rate spreads the gain thinly across all tax units with over 19 million gainers. Most gain less than a pound a week, but the gain rises steadily with income up to the basic rate limit. The gains from the change in allowances are spread almost as widely but fewer pensioners gain because age relief is unchanged; the gain to married men is some £0.69 if they are basic rate taxpayers and £1.10 in the case of higher rate taxpayers. The NIC option has more concentrated gains. There are 11 million gainers of whom over 5 million gain over a pound a week. Pensioners do not gain because they do not pay NICS (the few pensioner gainers in the table arise where the head of the tax unit is a pensioner but the spouse works and pays NICS).

Table 1 NIC Change

| Tax unit type | No of tax units (thousands) with gains per week: less than £1 | £1 to £2.50 | more than £2.50 | total gainers | average gain (£ per week) |
|---|---|---|---|---|---|
| Single | 2,800 | 3,100 | 0 | 5,900 | 0.54 |
| Married no children | 1,000 | 1,200 | 200 | 2,300 | 0.62 |
| Married with children | 1,400 | 1,000 | 100 | 2,500 | 0.43 |
| Lone parent | 200 | 100 | 0 | 200 | 0.15 |
| Single pensioner | 0 | 0 | 0 | 0 | 0.00 |
| Pensioner couple | 0 | 0 | 0 | 0 | 0.01 |
| Total | 5,400 | 5,400 | 300 | 11,100 | |

Table 2 Basic Rate Change

| Tax unit type | No of tax units (thousands) with gains per week: less than £1 | £1 to £2.50 | more than £2.50 | total gainers | average gain (£ per week) |
|---|---|---|---|---|---|
| Single | 7,100 | 600 | 0 | 7,700 | 0.31 |
| Married no children | 2,700 | 1,200 | 100 | 3,900 | 0.69 |
| Married with children | 3,600 | 1,400 | 100 | 5,000 | 0.67 |
| Lone parent | 200 | 0 | 0 | 300 | 0.09 |
| Single pensioner | 1,200 | 100 | 0 | 1,300 | 0.08 |
| Pensioner couple | 1000 | 200 | 0 | 1,100 | 0.20 |
| Total | 15,700 | 3,400 | 100 | 19,300 | _ |

Table 3 Allowances Change

| Tax unit type | No of tax units (thousands) with gains per week: less than £1 | £1 to £2.50 | more than £2.50 | total gainers | average gain (£ per week) |
|---|---|---|---|---|---|
| Single | 7,700 | 0 | 0 | 7,700 | 0.28 |
| Married no children | 1,700 | 2,200 | 0 | 3,900 | 0.76 |
| Married with children | 3,500 | 1,670 | 0 | 5,200 | 0.68 |
| Lone parent | 300 | 0 | 0 | 300 | 0.14 |
| Single pensioner | 400 | 0 | 0 | 400 | 0.03 |
| Pensioner couple | 300 | 110 | 0 | 400 | 0.11 |
| Total | 13,800 | 3,980 | 0 | 17,800 | |

Table 4 Average gain (£ per week) by income band

| | less than £2500 | £2500 to £4000 | £4000 to £7000 | £7000 to £10000 | £10000 to £15000 | £15000 to £20000 | over £20000 |
|---|---|---|---|---|---|---|---|
| NIC option | 0.03 | 0.24 | 0.62 | 0.74 | 0.47 | 0.47 | 0.24 |
| Basic rate | 0.00 | 0.02 | 0.16 | 0.37 | 0.62 | 1.00 | 1.71 |
| Allowances | 0.00 | 0.10 | 0.25 | 0.44 | 0.68 | 0.84 | 1.01 |

4 Table 4 shows the average gain by income band. The NIC option has the main gains at the lower end of the earnings range. All those earning up to £195 a week would pay lower NIC. In contrast the other options have the biggest gains for those at the higher end of the earnings distribution, more so for the basic rate cut than for allowances.

Incentive effects

5 Changes lowering average NICs at the lower end of the income distribution widen the gap between earnings in and out of employment. This will encourage more people to enter the work

fo[illegible]e. This effect may be particularly important in the case of married women.

6 Our usual definition of the poverty trap is those with a marginal rate of tax and benefit withdrawal in excess of 70% (the high marginal rates created by the NIC steps are excluded). The impact on the poverty trap of all these measures would be small However, because it benefits the low paid more than the other options the NIC option floats slightly more off benefit, and hence out of the poverty trap than the other options. Similarly the increase in allowances reduces the numbers more than the cut in the basic rate because more of the reduction in tax is concentrated at the lower end.

7 The steps in NIC at the lower end of earnings range will have strong disincentive effects on those earning just above or below them. In those cases where the marginal rate is above or close to 100% overtime or extra hours are unlikely to be attractive to the employee. They also may be expected to affect pay bargaining and there is evidence of bunching of earnings below the lower earnings limit. The NIC option would remove these very high marginal rates and lower the average rate of NIC for those affected.

8 But the NIC option involves a marginal rate of 11.1% for all those earning less than £227. Apart from those at present affected by the high marginal rates near the steps this involves higher marginal rates. The 1989-90 contribution rates are 5% on earnings of £43-£75, 7% on earnings of £75-£115 and 9% on earnings above £115 but below the upper earnings limit of £325.

9 Thus the present NIC structure has most people at the low end of the earnings range facing a low marginal contribution rate but a considerable number facing very high marginal rates. The proposed change would remove the very high marginal rates, and lower average rates for all below £227 a week but raise marginal rates for many. In principle it is unclear which would be better for incentives overall. But probably the adverse effects of very high marginal rates for those few affected will be proportionately greater than the effects of small changes in the marginal rate for the many.

10 Any eventual impact on employment and unemployment will depend not only on how individuals react to changes in incentives but also on the reaction of employers. (It will also depend on whether employer NIC are changed). Other things being equal, employers could be expected to react to the induced increase in

labour supply by raising wages less, so increasing labour demand and employment. But the extent to which this occurs depends on the efficiency of the labour market, and the relative effects on the different measures will depend among other things on the relative efficiency of the labour market at different points of the income distribution. If the market works more efficiently at the top end for example this would tend to favour the cut in basic rate; if the converse is true this probably favours the NIC option.

ANNEX D

ANNEX D

# RATIONALISING THE NI SCHEDULE

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Preliminary Draft: not to be cited without authors' permission.

## INTRODUCTION

This paper attempts to set out a number of routes to reforming the structure of employee National Insurance contributions. We begin in Section II with a brief description of the NI system as it stands. In Section III we move on to discuss some of the problems to which it gives rise, emphasising in particular the jumps in NI liability at low earnings and the impact of the NI ceiling on average rates of direct tax. Section IV examines the cost, and impact on marginal tax rates and the distribution of income, of a number of changes to the structure.

## SECTION II - THE PRESENT NATIONAL INSURANCE SCHEME

National Insurance contributions (NICs) are made by employees, employers and the self-employed. Together with a relatively small supplement from general taxation revenues, these contributions are used to finance the National Insurance Fund. This in turn provides for the payment of contributory benefits including retirement pensions, widows' benefits, unemployment benefit and various sickness and invalidity benefits. In this section we provide a brief description of the contributory system, of the benefits available and of the workings of the National Insurance Fund.

### 1. National Insurance Contributions

There are four "classes" of NICs. Class 1 contributions are paid by employees below retirement age and employers, and provide around 97% of the total revenue from NICs. Employees with gross earnings in excess of a "lower earnings limit" (LEL) (currently £41 per week) are required to pay contributions of a given percentage of their earnings. For those with earnings between £41 and £69.99 the rate is 5%, between £70 and £104.99, 7%, and between £105 and £305, 9%. No further contributions are payable above this "upper earnings limit" (UEL), and so those with incomes above this level simply pay 9% of £305. A similar pattern of contributions applies to employers (these are known as "secondary contributions"), the only differences being that a higher rate of 10.45% is payable by the employer when an employee earns in excess of £155 p.w., and that there is no UEL or "ceiling" on employer contributions.

An adequate record of employee Class 1 contributions carries entitlement to various benefits, although the precise contribution record required is different for each of the benefits. All employees paying Class 1 contributions may acquire rights under the State Earnings-Related Pension Scheme (SERPS), but they may choose to "contract out" of this part of the scheme and to opt instead for an approved personal or occupational pension scheme. Those employees who contract out in this way are entitled to pay a lower rate of class 1 NICs, currently two percentage points lower than the relevant contracted-in rate.[1] A similar rebate applies to employer contributions and the reduction is currently 3.8 percentage points.

The main group of employees whose NI regime may differ from that set out above are certain married women and widows. Before 1977, married women could opt to pay a reduced rate of NICs and in return for this concession forgo entitlement to the principal contributory benefits. This option no longer exists, but those women who made this choice and who have continued in employment or

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1 In fact, those who are contracted out pay the full contracted-in rate on earnings up to the LEL and then the reduced rate on earnings in excess of this figure.

self-employment since then are still able to make contributions at a reduced rate. In the case of Class 1 contributions the rate is currently 3.85%. The number of women to whom this applies is diminishing steadily as those who made the election leave the labour force or revoke the election in order to improve their contribution record. In 1985 there were 1.7 million women paying Class 1 NICs at this reduced rate.

Class 2 and Class 4 contributions are payable by the self-employed. The Class 2 contribution is a flat-rate weekly amount (currently £4.05 p.w.), paid by all those self-employed with profits in excess of a "small earnings exemption" (currently £43.27 p.w.). Married women who made the reduced rate election before 1977 need not pay Class 2 NICs. Class 4 contributions are related to profits and are currently charged at a rate of 6.3% on the amount of any profits in excess of the "lower profits limit" (£91.35 p.w.) but below the "upper profits limit" (£305 p.w.). Half of any Class 4 contributions may, however, be offset against any income tax liability.

Class 3 contributions are purely voluntary and may be paid by those wishing to improve their record of contributions. They are paid at a flat rate, currently £3.95 per week. Such contributions are made by those concerned about future entitlement to the basic State retirement pension and to widows' benefits.

The system of NI contributions has changed considerably since it was introduced in 1948. Initially, contributions were on a flat-rate basis, and only in 1961 were income-related contributions introduced. The present system of graduated contributions has only been in existence since Autumn 1985.

**2. National Insurance Benefits**

The main benefits where entitlement is conditional on a specified record of NI contributions are retirement pensions, sickness and invalidity benefits, unemployment benefit and widows' benefits. As noted above, the specific link between contributions made and benefit received varies between the different NI benefits.

For unemployment benefit, sickness benefit, widows' benefits and the basic State retirement pension, the rules are, however, broadly similar. Entitlement to any of these benefits is dependent on satisfaction of two conditions. The first condition is that NI contributions of a relevant class and of a specified minimum amount must actually have been made during any one year of the claimant's working life. This is essentially a test to see if the claimant has actually participated in the contributory scheme at some point. The relevant classes of contributions are as follows:

| | |
|---|---|
| Unemployment benefit | Class 1 |
| Sickness benefit | Classes 1 and 2 |

One consequence of this definition of "relevant" contributions is that the self-employed (who pay Class 2 and Class 4 contributions) will not generally be able to claim unemployment benefit.[2]

The second condition requires a certain minimum of contributions to have been made or credited in the previous tax year.[3] If these two conditions are satisfied then benefit is payable in full, together with any additions for dependants. It is worth noting that if these conditions are satisfied, the presence of any contributions in excess of these basic requirements will not generate any addition to the basic rate of either unemployment benefit or sickness benefit. Contributions in excess of these minimum requirements will, however, generate entitlement to a payment of SERPS according to a complex formula.

**3. The National Insurance Fund**

The National Insurance Fund is used primarily to finance the payment of contributory benefits, with 80% of total expenditure from the Fund accounted for in this way. A small part of total revenue is, however, used for other benefits (including various industrial injuries benefits and statutory sick pay), for administration, and to make a contribution to NHS funds. Within the £24bn of expenditure on contributory benefits in 1987/88, expenditure on retirement pensions accounted for more than £18bn, with invalidity benefit costing £3bn and unemployment benefit around £1.5bn.

The two main sources of income for the NI Fund are NI contributions and the so-called "Treasury supplement" from general taxation. In 1987/88 NICs accounted for around 90% of the Fund's £30bn revenue, with the Treasury supplement contributing around 7%. The amount of the Treasury supplement is defined as a proportion of total NIC revenues, and this proportion has fallen sharply in recent years from 18% in 1980/81 to 5% in 1988/89. Expenditure from the Fund has thus become increasingly dependent on the revenue from NICs. The balance of the Fund was around £6.4bn in 1987/88, and this figure has been rising steadily since 1982.

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2 The contribution requirements for the earnings-related component of the State pension are also designed so that the self-employed acquire no rights under the scheme.

3 NICs may be "credited" to an individual in certain circumstances where he/she is unable to make contributions. Such circumstances include periods of unemployment or periods spent looking after a dependent child.

## SECTION III – PROBLEM AREAS

In this section we consider a number of frequently made criticisms of the NI contribution system, and attempt to assess their significance. Four problem areas can be distinguished: first, the jumps in NI liability at low earnings levels and their potential impact on the labour market; second, the drop in average tax rates caused by the ceiling on NI contributions at £305 p.w.; third, the bias in favour of payments of income in kind, which avoid liability to NI contributions; finally, the exclusion of certain forms of income from the NI system, either completely, as in the case of investment income, or for most benefit entitlement purposes, as in the case of self-employment income. These exclusions may deny access to State insurance benefits to some who need them.

### 1. Distortion of the Labour Market

We consider first the impact of the jumps in NI liability at low earnings levels. The important point here is that the lower earnings limit is not an allowance like those for income tax. When earnings reach £41.00 p.w., NI is due not just on the excess of earnings over £41.00 p.w., but on the whole of earnings. Thus, at earnings of £40.99 p.w. no NI contributions are due, while at earnings of £41.00 p.w., NI contributions of £4.10 p.w. are due: £2.05 from the employee and £2.05 from the employer.[4] A similar jump occurs from £69.99 to £70 p.w., when NI jumps from £7.00 p.w. to £9.80, as the rate rises from 5% to 7%, again split £4.90 from the employee and £4.90 from the employer. A further jump comes at £105 p.w. when the rate rises from 7% to 9%, with joint NI payments from employee and employer rising from £14.70 to £18.90. This pattern can be seen in Figure 1, which shows the relationship between earnings and employees' NI contributions for someone not contracted out of SERPS. At £41 p.w., £70 p.w. and £105 p.w. the schedule rises vertically, as the rate of NI charged increases. The pattern for employers' NI liability is similar, but with a further jump at £155 p.w., where the contribution rate rises to 10.45%.

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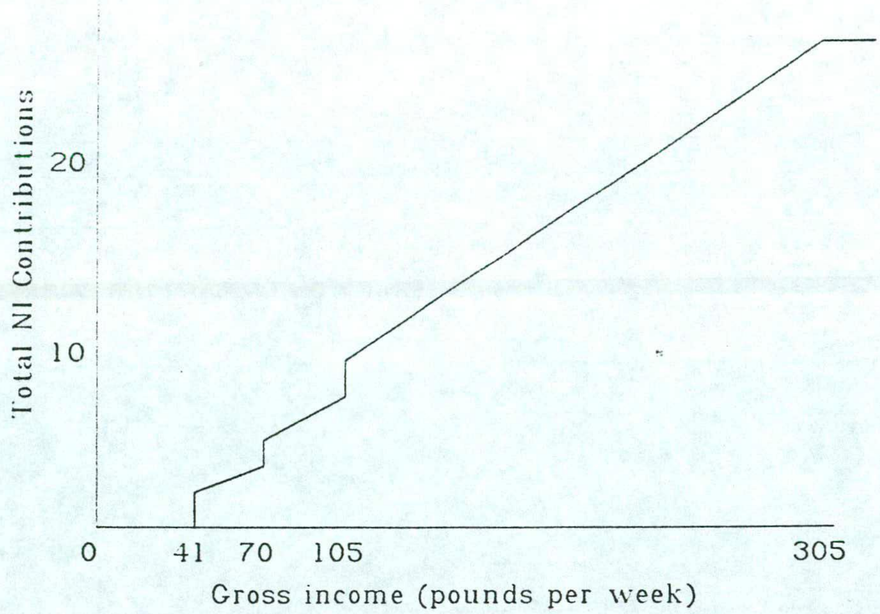
4 Here and throughout we refer to the contracted-in rates of NI contribution for simplicity. In the modelling of possible reforms the full range of NI regimes is included. Further details are available from the authors.

Figure 1

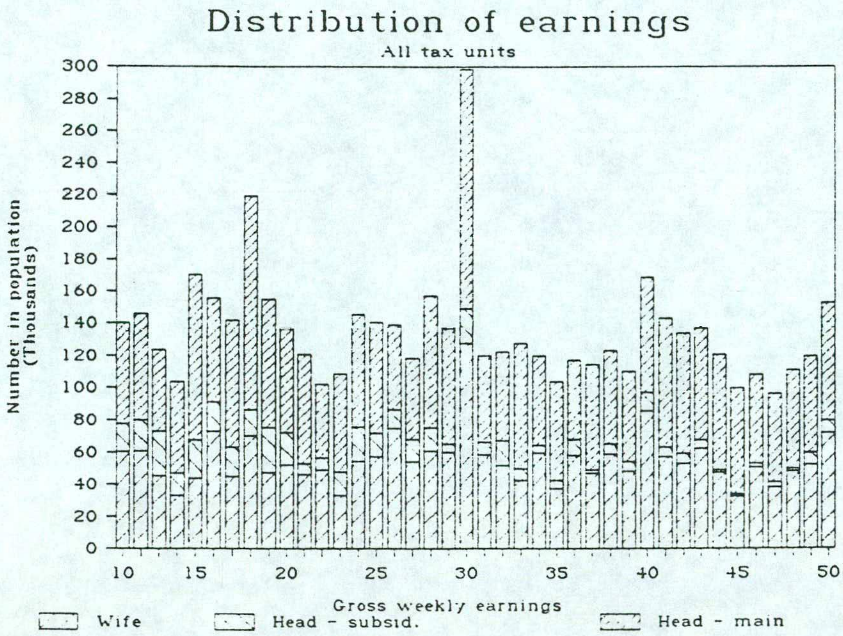
Current NI schedule




There are a number of reasons for thinking that such a system is not ideal. Perhaps the most obvious is that there is inequity involved when an individual earning £41.00 has a net income £2.04 less than an individual earning £40.99. A more serious problem may relate to the operation of the labour market. Consider an individual earning £40 p.w. Were his or her employer to offer an extra hour's work, at a wage of £2.00 p.w., the individual's NI liability would rise from 0 to £2.10 p.w. The rise in the employee's NI would more than offset the increase in gross earnings. Now consider the employer's position. The increase in gross wages will cost the employer the £2.00 of wages and £2.10 in NI contribution. The product of the extra hour's work would have to be worth more than twice the wage paid for it to have any net value for the employer. And even if that condition were met, the employee would be better off refusing the offer of an extra hour's work. A similar argument applies at each of the subsequent jumps in NI liability.

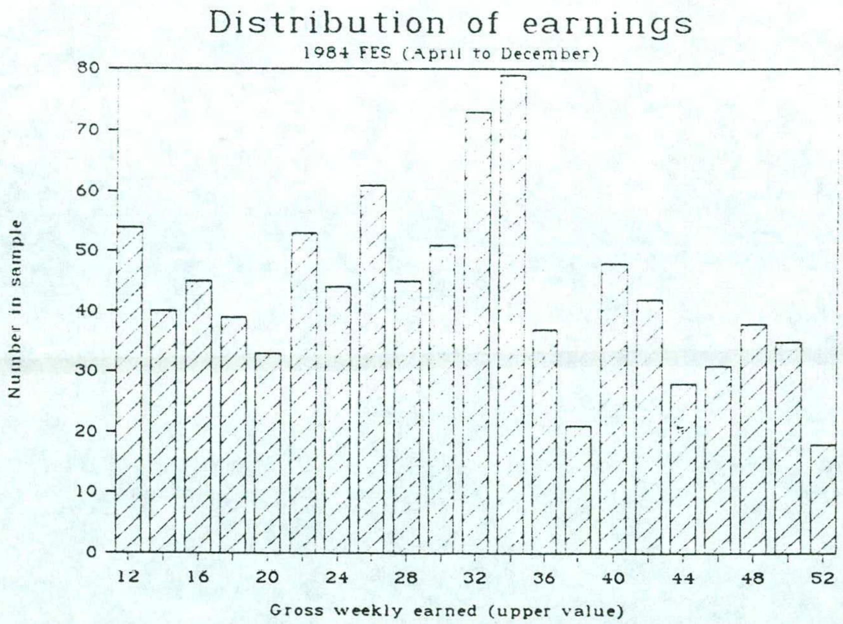
If the argument set out above is a valid one, we would expect to be able to see evidence of its impact on the labour market. The likely pattern would be of bunching of individuals just below each jump in the NI rate, with relatively few just beyond the earnings level where the rate increases. Figure 2 presents evidence of this effect. The data are taken from the 1982/83 Survey of Personal Incomes (SPI) Public Use Tape, which contains details of the incomes of some 53,000 tax units for the financial year 1982/83. The data are not ideal, for two main reasons. First, they relate to the whole year, while NI is based on either weekly or monthly earnings. We have attempted to derive weekly earnings by simply dividing annual earnings by 52. This is necessarily inaccurate, since some individuals will have worked for only a part of the year. The second problem is that the NI structure in 1982/83 was rather different from that we see now. Most importantly, there were no reduced rates at lower earnings levels; NI became due at 8.75% for employees and 10.2% for employers at the LEL of ~~£31~~ 29.50 p.w. Thus the jump in liability was more severe than it is at present. None the less, Figure 2 presents striking evidence of the impact of NI contributions on the labour market. There are more than twice as many individuals in the £1 p.w. range of earnings immediately below the LEL as there are immediately above it. Given the inevitable distortion introduced by the fact that the SPI provides details of annual income, and that many non-taxpayers are simply not covered by the survey, this figure is an important one.

Figure 2




Because of the problem with the SPI data, and because of the weight we attach to this issue, we have also examined the distribution of earnings in the Family Expenditure Survey (FES). The FES is a smaller survey, of only around 7,000 households per year, but provides details of weekly earnings, thus avoiding the problem of using annual income figures. However, since the data we use are for 1984, the new system for those at lower earnings levels was still not in place: there was a single LEL of £34 p.w. A similar picture emerges, with very few individuals in the area just above the LEL, and the peak in the earnings distribution immediately below the LEL.

Figure 3




The combination of these two figures, drawn from completely independent data sets, seems to us to give conclusive evidence that the NI structure had a substantial distorting impact on the labour market prior to the 1985 changes.[5] Although those changes will have improved the position at the LEL somewhat, by reducing the jump in liability, they introduced three new jumps, at £70 p.w., £105 p.w. and £155 p.w. If a way could be found to remove these jumps without either spending very large amounts of money or causing problems for the contributory principle, it would have much to recommend it.

## 2. Falling Average Tax Rates

The second problem area we identified was the drop in average tax rates which results from the ceiling on NI contributions. Figure 4 shows the combined structure of income tax and employee marginal tax rates for a married man. At earnings above £41 p.w. the marginal rate is simply 5%, being NI; this rises to 7% at £70 p.w., and 32% at £78.75 p.w. when income tax becomes payable at 25%. At £105 p.w. the NI rate rises to 9%, implying a combined rate of 34%. This is constant up to earnings of £305 p.w., beyond which point no further NI contributions are due, so the rate drops to 25%. Assuming no mortgage or pension contribution, higher rate income tax at 40% becomes due at weekly earnings of

5 There is no evidence that the bunching is by hours rather than income: the distribution of hours for those earnings just below the LEL is widespread.

Figure 4

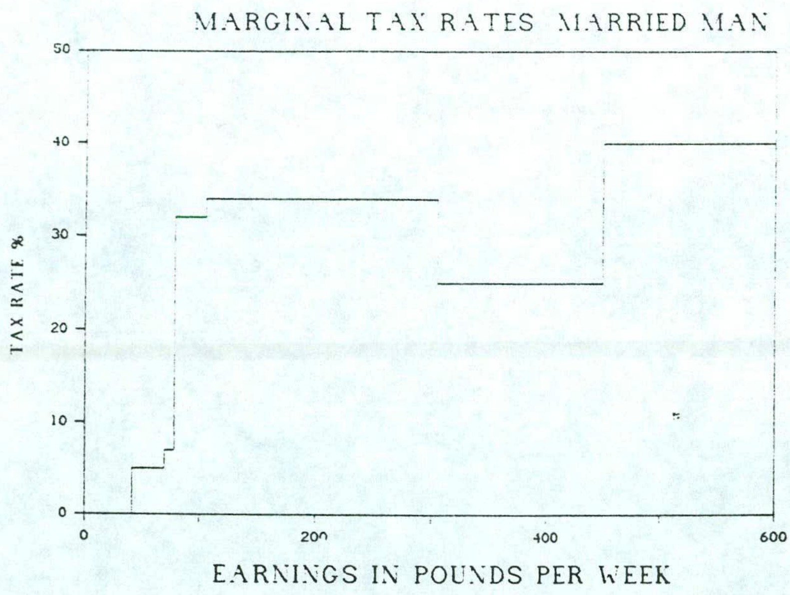
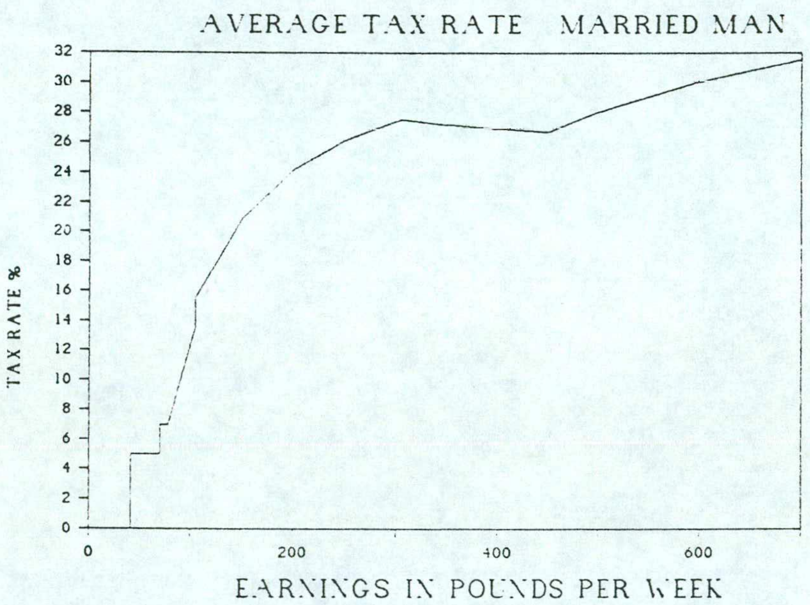



Figure 5




£450. Figure 5 traces the average tax rate for income tax and employees' NI contributions, and shows that the average tax rate actually falls between earnings of £305 p.w. and £450 p.w. Although the correct degree of progression in a tax system is a matter for political decision, few would dispute the suggestion that the average tax rate should at least not fall as income rises. It is not easy to construct attractive ways of removing the NI ceiling, although we should remember that the ceiling was removed for employers' contributions in the 1985 Budget.

### 3. Bias in Favour of Income in Kind

The third problem area mentioned above was the bias in favour of payment of income in kind. Although such payments are subject to income tax, they are not subject to NI contributions. With a combined rate of NI contribution of approaching 20%, the incentive for both employee and employer to use payment in kind rather than in cash is substantial. This problem has increased since the 1985 changes when the ceiling on employers' NI contributions was removed, introducing this bias for those on higher incomes as well as those below the NI ceiling. The most obvious problem area here is probably the provision of company cars, but all provision of income in kind escapes NI contribution liability. This was true at least until 11 May 1988, when Mr Michael Portillo, Parliamentary Secretary for Social Security, announced that "There has been an increase in the practice of paying part of remuneration in gilts to Directors and other highly paid personnel. This is a device which avoids National Insurance contribution liability. I have therefore today laid before the House regulations, withdrawing the exemption from NI contributions which currently applies to gilts and other debt instruments." (DHSS Press Release 88/152, 11 May 1988.) This appears to be a welcome breach in the principle of not charging NI on non-wage income.

### 4. Exclusion of Some Forms of Income

The fourth problem area concerned the exclusion, either in full or in part, of certain forms of income from the National Insurance system. The most obvious is investment income. While it would clearly be inappropriate to provide coverage for unemployment, and perhaps sickness, it might be desirable for those dependent on investment income to contribute and thus build entitlement for retirement. The question of the extent to which the NI contribution is a tax, as opposed to a contribution, is important here. If NI is a tax, it seems odd to exclude investment income from its base; if a contribution, such exclusion seems more natural. Similar difficult issues are raised by self-employment.

Our limited aim in the remainder of this paper is to examine some ways of tackling the first two areas of difficulty outlined above. We hope to return later to the latter two areas.

## SECTION IV – POSSIBLE REFORMS

In this section we examine a number of possible changes to the structure outlined in Section II, aiming to alleviate some of the problems discussed in Section III. We start by considering the jumps in liability at low earnings, and then move on to discuss the NI ceiling.

### 1. Restructuring the Lower End

The principal problem identified with the lower end of the NI structure was the way in which NI liability jumps at the LEL and the thresholds for higher NI rates. We examine four possible alternatives.

#### (i) Threshold converted to allowance

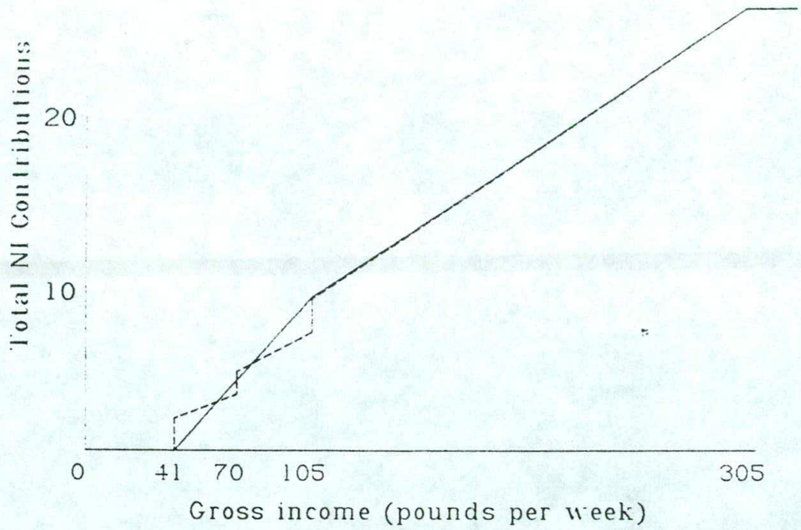
This first reform is a minimum change suggestion. The threshold at the LEL becomes an allowance. However, it is not possible to charge the normal 9% rate on all earnings beyond this, since in this case all with earnings over the LEL of £41 p.w. would gain, thus imposing a substantial revenue loss. Our solution is to charge a rate of 14.75% on earnings between £41 p.w. and £105 p.w., and 9% thereafter. This structure leaves all on incomes of £105 or more almost completely unaffected, since .1475 x (105 – 41) = 9.44 while .09 x 105 = 9.45. This structure is illustrated in Figure 6. The reform has a zero net cost, with the losses offset by the gains. The pattern of gains and losses is shown in Table 1. Over 95% of tax units are unaffected. The bulk of the losers are in tax units with gross incomes between £80 p.w. and £120 p.w., which is as we would expect, given Figure 6. Most gainers have incomes less than £60 p.w., which is again consistent with Figure 6. The largest proportionate gains go to those immediately above the old LEL.

One obvious objection to such a scheme is that it increases marginal tax rates, thus worsening incentives. Although the explicit rate of NI might in some cases be rising from 5% to 14.75%, this is simply the result of ironing out the jumps. In the present scheme there are marginal tax rates approaching infinity at each point where the NI rate increases. Each of the reforms examined here removes these infinite marginal rates, and with them major distortions to the labour market.

It is also worth noting that for any individual at present in the poverty trap, it is social security benefit withdrawal rates which determine the overall marginal tax rate. For an individual paying income tax and NI (at 5% at present) the overall marginal rate would rise from 30% to 39.75%, still lower than the higher rate of income tax. For an individual paying income tax and NI and entitled to family credit and housing benefit, the overall marginal tax rate would rise from 96.85% to 97.29%, an increase of less

Figure 6

Reform 1: Threshold converted to allowance




| Table 1 Impact of Reform 1 | | | | | | | |
|---|---|---|---|---|---|---|---|
| upper range of tax unit gross income £ p.w. | % of sample gaining or losing | | | | | | |
| | loss as % of net income | | | unaffected | gain as % of net income | | |
| | more than 5% | 3-5% | 1-3% | | 1-3% | 3-5% | more than 5% |
| 40 | – | – | – | 100.0 | – | – | – |
| 60 | – | – | – | 85.8 | 8.7 | 4.6 | 1.0 |
| 80 | – | – | 1.4 | 93.9 | 4.7 | – | – |
| 100 | – | – | 24.5 | 74.1 | 1.2 | 0.2 | – |
| 120 | – | – | 15.8 | 83.6 | 0.6 | – | – |
| 140 | – | – | 1.4 | 97.7 | 0.9 | – | – |
| 160 | – | – | 0.5 | 99.1 | 0.5 | – | – |
| 180 | – | – | 0.3 | 98.3 | 1.4 | – | – |
| 200 | – | – | 0.8 | 98.4 | 0.8 | – | – |
| 250 | – | – | 0.9 | 99.0 | 0.1 | – | – |
| 300 | – | – | – | 100.0 | – | – | – |
| 350 | – | – | – | 100.0 | – | – | – |
| Total | – | – | 2.8 | 95.3 | 1.4 | 0.4 | 0.1 |

Source: IFS tax and benefit model, see IFS Working Paper 87/9 for details of the model.

than half of one percentage point. Changes in income tax and NI rates now have very little effect on marginal tax rates of those in the poverty trap, because of the net income base for benefit entitlement in the post-April 1988 social security system.

Table 2 gives the proportion of heads and wives facing different marginal tax rates before and after Reform 1. The ranges of marginal tax rates shown are different for heads and wives. The number of heads with marginal tax rates between 90% and 100% increases very slightly, and between 70% and 80% falls slightly. Overall, the marginal rate distribution for heads of tax unit is little changed. A similar picture is seen for wives, with a slight increase in the number facing marginal rates of between 80% and 100% and a slight fall between 60% and 80%. The major shift is seen in the reduction in the size of the 10% to 30% group and corresponding increase in the 30% to 45% group. This is largely those going from 9% NI and 25% income tax to 14.75% NI and 25% income tax. The changes in the marginal rate structure do not seem sufficient to cause great concern.

Table 2
Reform 1

Marginal Tax Rates of Head

| | % of sample with marginal tax rate | | | | | | |
|---|---|---|---|---|---|---|---|
| | less than 50 | 50-60 | 60-70 | 70-80 | 80-90 | 90-100 | over 100 |
| current | 96.6 | – | 0.4 | 1.1 | 1.3 | 0.6 | – |
| reformed | 96.5 | 0.1 | 0.4 | 1.0 | 1.3 | 0.7 | – |

Marginal Tax Rates of Wife

| | % of sample with marginal tax rate | | | | | | |
|---|---|---|---|---|---|---|---|
| | less than 10 | 10-30 | 30-45 | 45-60 | 60-80 | 80-100 | over 100 |
| current | 69.0 | 13.5 | 11.7 | 0.2 | 3.1 | 2.5 | – |
| reformed | 67.2 | 8.0 | 18.7 | 0.5 | 3.0 | 2.6 | – |

Source: IFS tax and benefit model.

Reform 1 removes the problem of jumps in NI liability and has no revenue cost. However, there are a number of losers at relatively low levels of income. We turn now to reforms that aim to avoid losers.

(ii) Threshold converted to allowance, no losers

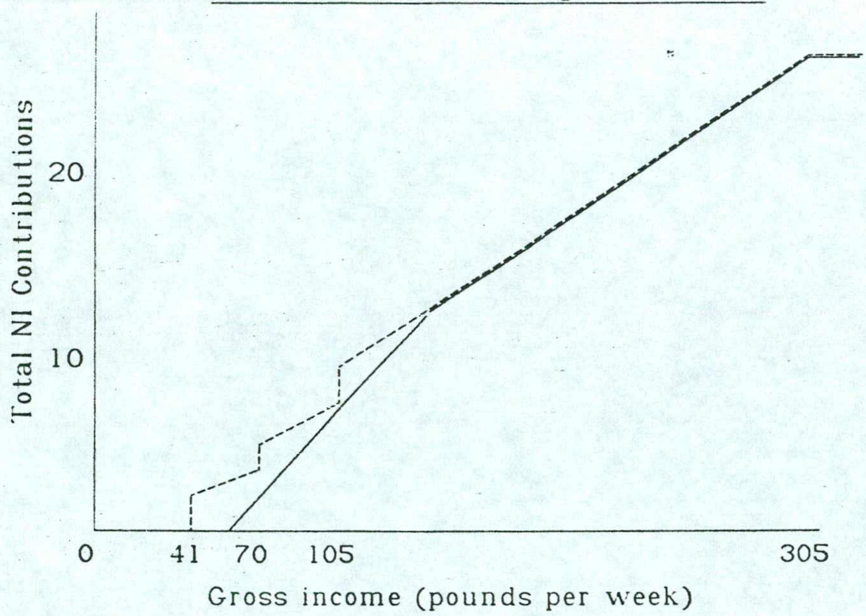
One way of avoiding losers is simply to increase the level of the NI allowance, while retaining a rate of 14.75%. Increasing the allowance from £41.00 p.w. to £57.35 p.w., and charging 14.75% from £57.35 p.w. to £141.50 p.w. gives a schedule as in Figure 7. The net cost of the scheme is some £650 million p.a.

with the distribution of gainers and losers as in Table 3. There are no losers. Slightly less than 15% of the tax unit population gains. The gains at higher incomes accrue to tax units with two or more earners. The largest proportionate gains are for those in the income range £40 p.w. to £60 p.w. Many of these are unaffected, however, since many are pensioners and therefore not subject to NI.

The impact of this reform on marginal tax rates is illustrated in Table 4. The pattern is similar to that resulting from Reform 1, although the magnitude of the changes is slightly greater.

Figure 7

Reform 2: No losers, higher allowance



| upper range of tax unit gross income £ p.w. | % of sample gaining or losing | | | | | | |
|---|---|---|---|---|---|---|---|
| | loss as % of net income | | | unaffected | gain as % of net income | | |
| | more than 5% | 3–5% | 1–3% | | 1–3% | 3–5% | more than 5% |
| 40 | – | – | – | 100.0 | – | – | – |
| 60 | – | – | – | 81.6 | 0.7 | 5.3 | 12.4 |
| 80 | – | – | – | 65.2 | 5.6 | 26.5 | 2.7 |
| 100 | – | – | – | 55.7 | 36.7 | 7.6 | – |
| 120 | – | – | – | 60.5 | 38.2 | 1.2 | – |
| 140 | – | – | – | 72.5 | 27.6 | – | – |
| 160 | – | – | – | 90.0 | 9.5 | 0.5 | – |
| 180 | – | – | – | 92.2 | 7.2 | 0.6 | – |
| 200 | – | – | – | 89.0 | 11.0 | – | – |
| 250 | – | – | – | 82.1 | 17.9 | – | – |
| 300 | – | – | – | 87.5 | 12.5 | – | – |
| 350 | – | – | – | 97.2 | 2.8 | – | – |
| Total | – | – | – | 85.2 | 10.3 | 3.2 | 1.3 |

Table 3
Impact of Reform 2

Table 4
Reform 2

Marginal Tax Rates of Head

| | % of sample with marginal tax rate | | | | | | |
|---|---|---|---|---|---|---|---|
| | less than 50 | 50–60 | 60–70 | 70–80 | 80–90 | 90–100 | over 100 |
| current | 96.6 | – | 0.4 | 1.1 | 1.3 | 0.6 | – |
| reformed | 96.6 | 0.1 | 0.4 | 0.7 | 1.5 | 0.6 | – |

Marginal Tax Rates of Wife

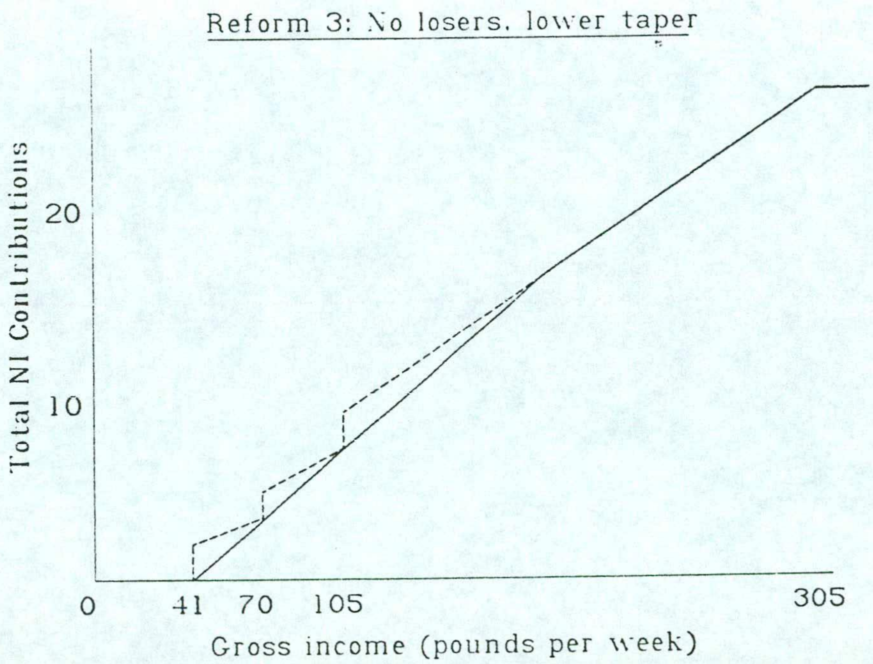
| | % of sample with marginal tax rate | | | | | | |
|---|---|---|---|---|---|---|---|
| | less than 10 | 10–30 | 30–45 | 45–60 | 60–80 | 80–100 | over 100 |
| current | 69.0 | 13.5 | 11.7 | 0.2 | 3.1 | 2.5 | – |
| reformed | 67.5 | 8.6 | 17.9 | 0.5 | 3.0 | 2.5 | – |

Source: IFS tax and benefit model.

(iii) Threshold converted to allowance, lower rate, no losers

Reform 2 avoided losers by increasing the NI allowance. An alternative, illustrated in Figure 8, is to have a lower rate than 14.75%. This reform imposes a rate of 11.5% on earnings between £41.00 p.w. and £188.60 p.w. The net cost is lower than that of Reform 2, at only some £580 million p.a. Although gains continue further up the income distribution, the gains at lower income levels are much smaller. The distribution of gains and losses is shown in Table 5. There are far fewer large gains as a result of this reform than from Reform 2.

Figure 8



| upper range of tax unit gross income £ p.w. | % of sample gaining or losing | | | | | | |
|---|---|---|---|---|---|---|---|
| | loss as % of net income | | | unaffected | gain as % of net income | | |
| | more than 5% | 3-5% | 1-3% | | 1-3% | 3-5% | more than 5% |
| 40 | – | – | – | 100.0 | – | – | – |
| 60 | – | – | – | 81.7 | 9.5 | 7.8 | 1.0 |
| 80 | – | – | – | 75.0 | 24.9 | 0.1 | – |
| 100 | – | – | 0.2 | 75.3 | 24.3 | 0.2 | – |
| 120 | – | – | – | 62.4 | 37.6 | – | – |
| 140 | – | – | – | 45.1 | 54.9 | – | – |
| 160 | – | – | – | 74.0 | 26.1 | – | – |
| 180 | – | – | – | 87.7 | 12.3 | – | – |
| 200 | – | – | – | 90.4 | 9.7 | – | – |
| 250 | – | – | – | 86.4 | 13.6 | – | – |
| 300 | – | – | – | 92.9 | 7.1 | – | – |
| 350 | – | – | – | 99.6 | 0.4 | – | – |
| Total | – | – | – | 86.1 | 13.1 | 0.7 | 0.1 |

Table 5
Impact of Reform 3

There was a single loser from the reform, in the income range £80-£100 p.w. The couple in question had a single earner, but was initially entitled to income support. The reduction in NI liability removed entitlement to income support, and with it entitlement to assistance with mortgage payments.

Table 6 illustrates the impact on marginal tax rates. The pattern for heads of tax unit is similar to that for Reforms 1 and 2. The pattern for wives is significantly changed, with the shift from the 10% to 30% range to the 30% to 45% range much less marked. In addition, there is a fall in the number of wives in the 60% to 80% range, as a result of reductions in NI liability floating tax units off entitlement to means-tested benefits.

Table 6
Reform 3

Marginal Tax Rates of Head

| | % of sample with marginal tax rate | | | | | | |
|---|---|---|---|---|---|---|---|
| | less than 50 | 50-60 | 60-70 | 70-80 | 80-90 | 90-100 | over 100 |
| current | 96.6 | – | 0.4 | 1.1 | 1.3 | 0.6 | – |
| reformed | 96.7 | – | 0.4 | 0.7 | 1.5 | 0.7 | – |

Marginal Tax Rates of Wife

| | % of sample with marginal tax rate | | | | | | |
|---|---|---|---|---|---|---|---|
| | less than 10 | 10-30 | 30-45 | 45-60 | 60-80 | 80-100 | over 100 |
| current | 69.0 | 13.5 | 11.7 | 0.2 | 3.1 | 2.5 | – |
| reformed | 67.7 | 11.9 | 14.8 | 0.2 | 2.9 | 2.5 | – |

Source: IFS tax and benefit model.

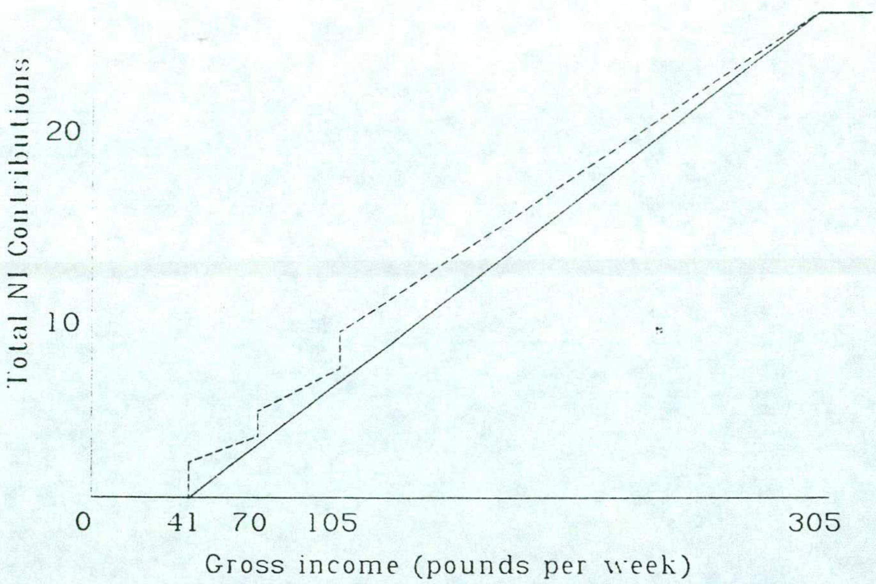
(iv) Threshold converted to allowance, no losers, single taper

The final reform avoids a dual rate of NI, imposing a 10.4% rate on all earnings between the LEL and the current ceiling. The structure is illustrated in Figure 9. The net cost of this scheme is some £1.25bn p.a.

Table 7 shows the distribution of gains and losses. The loser is the same unit as in Reform 3, and for the same reason. The bulk of the gains are relatively small. The impact of the reform on the distribution of marginal tax rates is given in Table 8. The pattern illustrated is very like that in Table 6 for Reform 3.

Figure 9

Reform 4: No losers, single taper.




| Table 7<br>Impact of Reform 4 | | | | | | | |
|---|---|---|---|---|---|---|---|
| upper range of tax unit gross income | % of sample gaining or losing | | | | | | |
| £ p.w. | lose as % of net income | | | unaffected | gain as % of net income | | |
| | more than 5% | 3-5% | 1-3% | | 1-3% | 3-5% | more than 5% |
| 40 | – | – | – | 100.0 | – | – | – |
| 60 | – | – | – | 81.7 | 8.5 | 8.2 | 1.6 |
| 80 | – | – | – | 69.2 | 25.8 | 5.0 | – |
| 100 | – | – | 0.2 | 52.1 | 47.6 | 0.2 | – |
| 120 | – | – | – | 55.6 | 20.9 | 23.5 | – |
| 140 | – | – | – | 41.4 | 58.1 | 0.5 | – |
| 160 | – | – | – | 31.6 | 68.1 | 0.2 | – |
| 180 | – | – | – | 19.2 | 80.8 | – | – |
| 200 | – | – | – | 31.6 | 68.4 | – | – |
| 250 | – | – | – | 70.5 | 29.5 | – | – |
| 300 | – | – | – | 63.1 | 37.0 | – | – |
| 350 | – | – | – | 72.3 | 27.7 | – | – |
| Total | – | – | – | 70.4 | 27.0 | 2.5 | 0.2 |

Table 8
Reform 4

Marginal Tax Rates of Head

| | % of sample with marginal tax rate | | | | | | |
|---|---|---|---|---|---|---|---|
| | less than 50 | 50-60 | 60-70 | 70-80 | 80-90 | 90-100 | over 100 |
| current | 96.6 | – | 0.4 | 1.1 | 1.3 | 0.6 | – |
| reformed | 96.7 | 0.1 | 0.4 | 0.7 | 1.4 | 0.7 | – |

Marginal Tax Rates of Wife

| | % of sample with marginal tax rate | | | | | | |
|---|---|---|---|---|---|---|---|
| | less than 10 | 10-30 | 30-45 | 45-60 | 60-80 | 80-100 | over 100 |
| current | 69.0 | 13.5 | 11.7 | 0.2 | 3.1 | 2.5 | – |
| reformed | 67.8 | 12.0 | 14.8 | 0.2 | 2.8 | 2.5 | – |

Source: IFS tax and benefit model.

The four reforms discussed above are by no means an exhaustive set, but aim to give some indication of the possibilities. The cost of such reform is not so great as to render it impossible. The changes examined would not have any significant impact on the poverty trap, while Reforms 2, 3 and 4 would all alleviate the unemployment trap by increasing incomes in work. However, the most important point is that all would remove the jumps in NI liability which exist at present, and seem to have a significant and deleterious impact on the labour market.

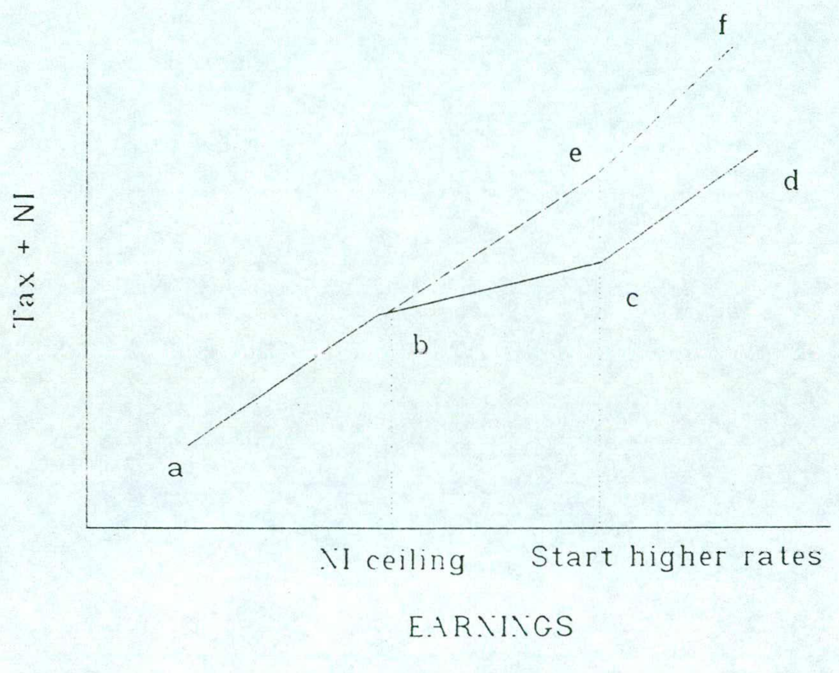
2. Restructuring the Top End

While it is probably the discontinuities in NI liability at the lower end of the income distribution which cause most problems, it is worth considering ways of removing the potential vertical inequity caused by the existence of the NI ceiling at its current level.

One major problem with the abolition of the NI ceiling is that such a change would impose very large losses on those affected by it. In effect the tax rate on earnings in excess of £305 p.w. would rise by some 9%. For those who pay higher rate income tax this problem can be removed by a corresponding reduction in the higher rate. However, for those in the NI "gap", no such compensation would be possible. The length of the "gap" can be quite large: a married man with mortgage interest of £3,000 p.a. would not start to pay higher rate income tax until earnings of around £26,500, while the NI ceiling is only £15,860.

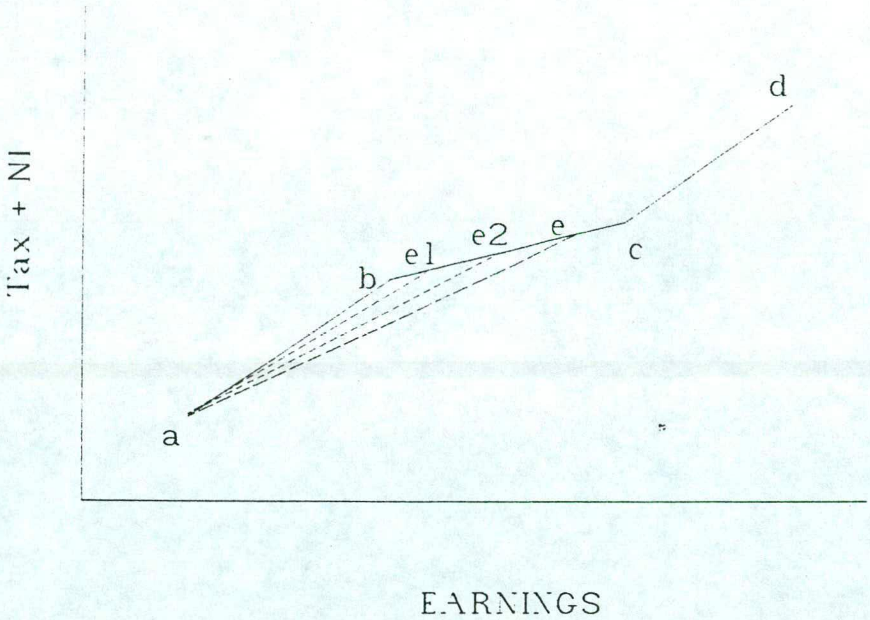
Consider Figure 10 which is a schematic representation of income tax and employees' NI for higher paid employees. At present the schedule runs abcd, with the overall tax rate at 34% between a and b, 25% between b and c, and 40% between c and d. If the NI ceiling was simply abolished with no compensation, giving a schedule abef, the extra tax payments would be very large indeed.

Figure 10




One solution to this problem arises out of the Government's declared aim of reducing the basic rate of income tax to 20%. Consider a reform which reduces the basic rate of income tax to 20% while increasing the NI ceiling to £510 p.w. (£26,520 p.a.). Figure 11 illustrates such a reform.

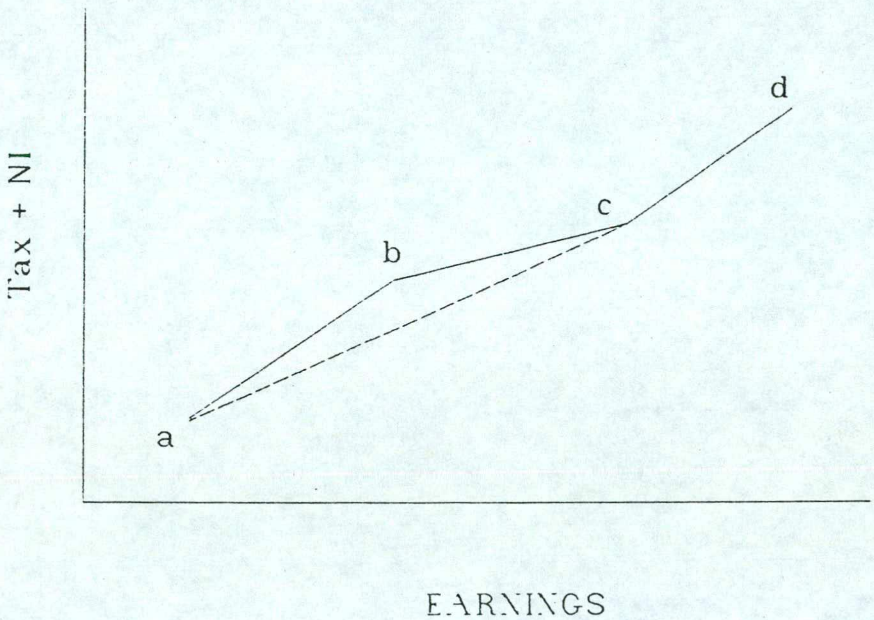
Figure 11




The current scheme is abcd, the reform aecd. The loss of income which results from the increase in the NI ceiling is offset by the reduction in the basic rate. Table 9 illustrates the distributional impact of the reform. There are no losers, with the bulk of the population gaining, while the increase in the NI ceiling offsets the reduction in the basic rate of income tax for those at very high levels of income. We are unlikely ever to witness a five point reduction in the basic rate in a single Budget, but if the NI ceiling were raised each time the basic rate were cut, we could move from abcd to aecd in a series of steps via $e_1$ and $e_2$ as shown in Figure 11. If the government were to undertake to raise the NI ceiling in this way with each basic rate reduction from now on, the anomaly would be gradually and painlessly removed.

| Table 9<br>Impact of Reform: basic rate to 20%<br>NI ceiling to £510 | | | | | | | |
|---|---|---|---|---|---|---|---|
| tax unit gross income<br>£ p.w. | % sample of gaining or losing | | | | | | |
| | lose as % of net income | | | unaffected | gain as % of net income | | |
| | more than 5% | 3-5% | 1-3% | | 1-3% | 3-5% | more than 5% |
| 200-250 | – | – | – | 0.7 | 52.3 | 40.1 | 6.9 |
| – 300 | – | – | – | 0.3 | 38.0 | 54.8 | 6.9 |
| – 350 | – | – | – | – | 23.7 | 69.1 | 7.2 |
| – 400 | – | – | – | – | 25.8 | 70.9 | 3.3 |
| – 450 | – | – | – | 1.1 | 32.6 | 60.9 | 5.4 |
| – 1000 | – | – | – | 17.2 | 36.9 | 44.5 | 1.4 |
| over 1000 | – | – | – | 59.0 | 40.9 | – | – |
| Total | – | – | – | 41.6 | 27.7 | 27.89 | 2.8 |

Figure 12




This reform removes most of the "gap", but still leaves some untidiness in the link between the NI ceiling and the higher rate of income tax. The final reform we look at combines a 5 per cent reduction in the basic rate of income tax, to 20 per cent, with the abolition of the NI ceiling and a reduction in the higher rate of income tax from 40% to 30%.[6] This is illustrated in Figure 12.

6 In this, as in the previous reform, a SERPS ceiling is retained at £305 p.w. with the full contracted-in rate charged above this.

This reform would have a net cost of some £5.5bn. The distributional impact is shown in Table 10. There are a very small number of losers amongst those with the highest incomes. These losers have such a high level of allowances and deductions that the reduction of 5p in the basic rate fails to compensate for the imposition of NI on income in excess of the NI ceiling but previously subject to basic rate income tax.

This reform would significantly improve the coherence of the income tax and employees' NI structures, and remove the peculiarity which currently allows average tax rates to fall. It would require the injection of substantial amounts of money, but would be possible in the context of the Government's new aim of a basic rate of income tax of 20%. The structure of marginal and average tax rates produced by this reform is shown in Figures 13 and 14.

Figure 13

MARGINAL TAX RATE MARRIED MAN

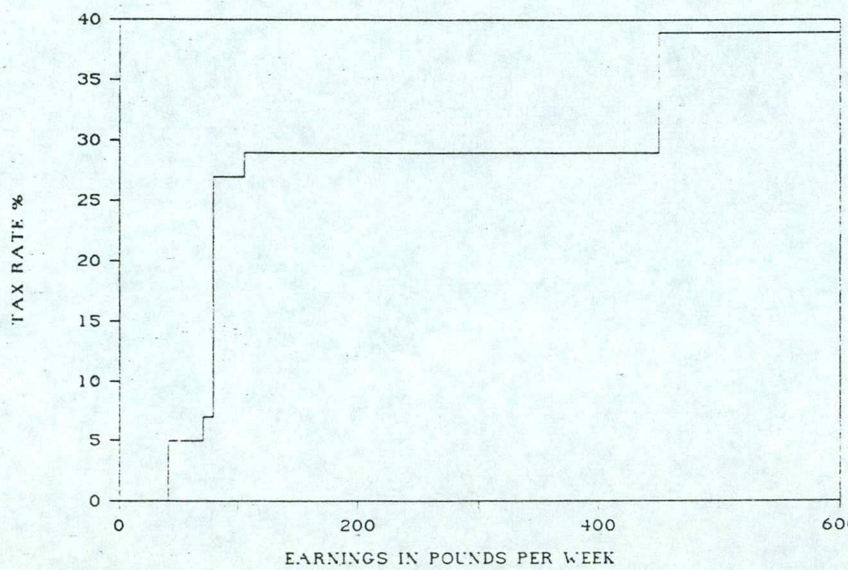


Figure 14

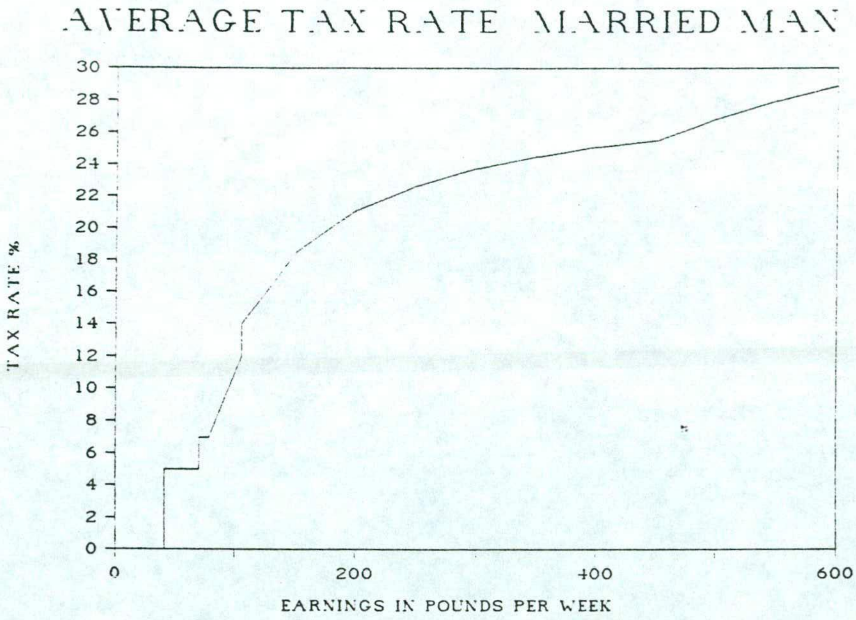



Table 10
Impact of Reform: Abolition of NI ceiling
10% off higher rate
5% off basic rate

| tax unit gross income £ p.w. | % of sample gaining or losing | | | | | | |
|---|---|---|---|---|---|---|---|
| | lose as % of net income | | | unaffected | gain as % of net income | | |
| | more than 5% | 3-5% | 1-3% | | 1-3% | 3-5% | more than 5% |
| 200-250 | – | – | – | 0.7 | 52.3 | 40.1 | 6.9 |
| – 300 | – | – | – | 0.3 | 38.0 | 54.8 | 6.9 |
| – 350 | – | – | – | – | 24.5 | 68.4 | 7.0 |
| – 400 | – | – | – | – | 28.8 | 67.6 | 3.6 |
| – 450 | – | – | – | 5.4 | 31.0 | 57.1 | 6.5 |
| – 1000 | – | – | 0.9 | 17.2 | 28.2 | 42.3 | 11.6 |
| over 1000 | – | – | 4.6 | 4.6 | 9.1 | 18.2 | 63.6 |
| Total | – | – | – | 41.6 | 27.4 | 27.6 | 3.4 |

## CONCLUSION

Our aim in this paper has been twofold. First, to outline problems with the present system; second, to outline solutions. We have presented evidence which suggests that the structure of NI liabilities at low earnings does have an impact on the labour market. We have illustrated the reduction in average rates of direct tax at moderately high incomes as a result of the NI ceiling. In response to the first problem, we have described and modelled a number of options which remove the jumps in NI liability without excessive revenue cost; we believe the approach described to be worth considering further. The NI ceiling is perhaps more difficult to deal with. None the less, in the context of a substantial reduction in the basic rate of income tax we have shown that it would be possible to construct a no-loser reform which would greatly increase the coherence of the NI and income tax structures. Reforms along the lines of those discussed above would carry further the improvement in the structure of direct tax in the UK.

chex.md/jmt/94 **CONFIDENTIAL**

**FROM: J M G TAYLOR**

**DATE: 8 November 1988**

pmp

**MR MCINTYRE**

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Byatt
Mr Phillips
Mr Scholar
Mr Culpin
Miss Peirson
Mr Gilhooly
Mr Riley
Mr Ramsden
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Mace
PS/IR

AA / Lsr Spdnr.

**NICS: POSSIBLE LOWER END MEASURES**

The Chancellor has seen your minute of 4 November, and the enclosed paper.

2. He is most grateful for all the work done. He agrees with your conclusion that Option I, or some variant, looks the best bet. But, he thinks, it is not without its drawbacks. Above all, he does not believe we can devise a satisfactory package to deal with the lower end NIC problem until we are less PSDR-constrained than we will be in the 1989 Budget. His conclusion, regretfully, is that no further work should be done on this for 1989.

JT

**J M G TAYLOR**

est.ld/james/31 Jan/FST

BUDGET CONFIDENTIAL

FROM: S M A JAMES
DATE: 1 February 1989

PS/FINANCIAL SECRETARY

cc: PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Gilhooly
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

We looked @ this a considerable detail last year. N.

**NICS**

The Economic Secretary has seen John Redwood's PQ answered by the Financial Secretary on 30 January (OR attached).

2. This shows a revenue yield on raising the NIC threshold. The Economic Secretary wonders whether this is worth looking at. In any case, we will need defensive briefing if this is not done.

S M A JAMES
PRIVATE SECRETARY

## NATIONAL FINANCE

### Taxation Reform

**Mr. Redwood:** To ask the Chancellor of the Exchequer what would be the cost to the Exchequer in *(a)* 1989-90 and *(b)* a full year if: (i) the starting point for national insurance were raised from £43 a week to £55 a week, (ii) the starting point for the 7 per cent. rate of national insurance were raised from £75 a week to £85 a week, (iii) income tax thresholds were raised by 10 per cent., (iv) the standard rate of income tax were reduced to 24 per cent., (v) each individual's capital gains tax free allowance were doubled, (vi) the threshold for inheritance tax were raised to £300,000, (vii) stamp duty on securities were halved but extended to gilt-edged securities, and (viii) any adult were allowed to save £1,000 free of tax each year.

**Mr. Norman Lamont:** Estimates are as follows:

*Direct revenue effect, at 1989-90 levels of income*

*£ million*

| | | *1989-90* | *Full year* |
|---|---|---|---|
| (i) | Lower earnings limit for National Insurance Class 1 contributions raised from £43 per week to £55 per week[1] | +80 | +90 |
| (ii) | Starting point for 7 per cent. rate of National Insurance Class 1 contributions raised from £75 per week to £85 per week | −70 | −80 |
| (iii) | Income tax thresholds[2 3] raised by 10 per cent. | −1,970 | −2,540 |
| (iv) | Basic rate of income[3] tax reduced to 24 per cent. | −1,400 | −1,530 |
| (v) | Capital Gains Tax exempt amount doubled for single people and married couples | 0 | −150 |
| (vi) | Inheritance tax threshold raised to £300,000 | −350 | −800 |
| (vii) | Stamp duty on securities halved but extended to gilt edged securities | [4]+200 | [4]+200 |
| (viii) | Every adult allowed to save £1,000 free of tax each year | [5]— | [5]— |

[1] Produces revenue yield because savings on contracted out rebates(which are paid on earnings between the lower earnings limit and the upper earnings limit) are greater than the cost of contributions forgone from those earning between £43 per week and £55 per week.

[2] Main personal allowances and the basic rate limit.

[3] Estimates are partly based on a projection of the 1986-87 Survey of Personal Incomes. They are provisional and include the consequential effect on capital gains tax.

[4] Highly uncertain.

[5] Cost would depend on take-up.

BUDGET CONFIDENTIAL

FROM: J P MCINTYRE
DATE: 3 February 1989

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call
PS/IR

**NICS: RAISING THE LEL**

The Economic Secretary (Ms James' minute of 1 February to your private secretary) has asked whether it is worth looking at the possibility of raising the Lower Earnings Limit (LEL), in the light of the John Redwood PQ answer showing a net revenue yield of £90 million from raising the LEL to £55 per week.

2. Towards the end of last year, we looked at the case for raising the LEL (see my minute to the Chief Secretary of 15 December, copies attached for you and other Ministers). The particular variant we looked at was the abolition of the employees' 5 per cent band. This would involve raising the LEL from £43 (the level which comes into effect in April) to £75. The conclusion was that this proposal would be difficult to run without retaining a shadow LEL for the purpose of benefit entitlements and contracted out NICs. Adapted in this way, we estimated that there would be a net revenue <u>loss</u> of about £250 million.

3. Raising the LEL to £55, as envisaged in Mr Redwood's PQ and without retaining a shadow LEL, would take about 900,000 employees earning between £43 and £55 out of NICs, with a maximum gain of £0.60 per week. Employers' contributions would be reduced in the same way. Income to the NIF would fall by some £235 million.

4. But there would be a larger inflow to the NIF from contracted-out employees and their employers. This is because the contracted-out rebate is paid on the band of earnings between the LEL and the Upper Earnings Limit, which would become narrower with the raising of the LEL. Contracted-out employees would pay an extra £0.24 per week, and their employers an extra £0.46 per week. All (around 9 million) contracted-out employees would be affected in this way, and NIF income would be increased by £325 million.

JM

J P MCINTYRE

CONFIDENTIAL

Self

FROM: J P MCINTYRE
DATE: 15 December 1988

CHIEF SECRETARY

cc Chancellor
Financisal Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Byatt
Mr Phillips
Mr Scholar
Mr Culpin
Miss Peirson
Mr Gilhooly
Mr Macpherson
Mr Francis
Mr Speedy o.r.
Mrs Chaplin
Mr Tyrie

**NATIONAL INSURANCE CONTRIBUTIONS: ABOLITION OF EMPLOYEES' 5 PER CENT BAND**

You asked me to set out the arguments for and against abolishing the employees 5 per cent NIC band (Miss Evans' minute of 7 December). I have assumed that the employers 5 per cent band would remain and that NIC rates above £75 (the upper limit of the 5 per cent band) would not be changed.

2. The advantages would be:

i. About 1.8 million low paid employees, earning between £43 and £75 a week would no longer have to pay NICs. This is nearly 10 per cent of employees paying NICs. Weekly gains would range from £2.15 to £3.75. (Relatively few of these gainers would, however, be taken out of the tax/NICs system entirely. This is because the great majority are single people or married women ie those who would not qualify for a married man's allowance. So, although single people and married women earning between £50 and £75 would no longer pay NICs, they would continue to pay tax.)

ii. Very roughly 20,000 tax units would be taken out of the unemployment trap (ie their out of work income from benefits would no longer be 80 per cent or more of their net incomes from employment).

iii. Public expenditure would be reduced in the long term, to the extent that more employees failed to establish a sufficient contribution record to earn entitlement to contributory benefits, notably the basic pension and SERPS. There would be greater reliance on cheaper means-tested benefits.

3. The **disadvantages** would be:

ii. The contributory system would become less comprehensive. About 1.8 million people would no longer be earning entitlement to contributory benefits. The earnings of some of those affected would rise above the new LEL, as their careers progress. But others may never earn consistently above the LEL. In particular, roughly half of the group are married women, many of whom are part-time and who may not see their earnings increase sufficiently to overtake the new LEL; they would become dependent on their husbands' contributions for the basic pension and SERPS. These married women would see the value of their basic pension cut by 40 per cent ie they would get the dependency addition to their husbands' basic pension (currently £24.75 a week) instead of the full basic pension in their own right (currently £41.15).

ii. SERPS entitlements for <u>all</u> employees would be reduced, because the entitlement is calculated on earnings between the LEL and UEL; this band of earnings would be narrowed if the LEL were raised to £75. Those starting work after the change and earning consistently less than £75 a week during their working lives would get no SERP on retirement. As things stand, someone earning just less than £75 can expect a SERP of upto £6.40 a week on retirement. Those earning above the LEL would also lose upto £6.40 a week; the lower paid would suffer larger proportionate reductions in their SERPS entitlements. (The full impact of these reductions would not be felt until well into the next century, by which time SERPS entitlements earned before the change would have worked themselves through.)

iii. The contributions of contracted out employees (and their employers) would be increased. This is because the contracted out rebate is calculated on earnings between the LEL and UEL. Contracted out employees would pay extra contributions of up to 65p a week or so, and employers up to £1.20 per employee. Furthermore, personal pensions providers would need to re-work their schemes to take account of the higher LEL; this could also disrupt the spread of personal pensions.

4. There is, however, a way of adapting the proposal to reduce some of the disadvantages (though not, of course, without raising other issues). We could retain the LEL not just for the purposes of employer contributions but also for establishing benefit entitlement and the size of contracted out rebates.

5. In order to leave their benefit entitlements unaffected, those earning between £43 and £75 could be given national insurance credits. As you know, credits are already given to certain groups eg those receiving invalid care allowance and maternity allowance, and those on an approved training course. We would be extending this practice to include the low paid - or at least <u>some</u> of the low paid, and this could be a source of difficulty: those earning below the LEL would not be credited, and it might be hard to defend giving credits to those earning £43 or more but not to those earning less. (There are 2 million or so people earning less than £43).

6. Another possible objection to credits is that we would be diluting the contributory principle to an unacceptable degree. We would be letting a fairly large group get contributory benefits for nothing. (Although employers would continue to pay 5 per cent contributions, these do not count for the proposes of establishing

benefit entitlement.) This would be going much further than the 1985 reforms which introduced the reduced rate bands.

7. As far as the contracted out are concerned, it would be consistent to calculate their rebate on the £43 LEL, the same LEL as for benefit entitlement and for calculation of SERPS entitlement. For nearly all of them, NI contributions would be unchanged. A few (those earning less than £75 a week) would pay no NICs and would, in fact, receive a subsidy (the 2 per cent employees' rebate), while continuing to acquire entitlement to benefits other than SERPS. This would also pose problems in terms of the contributory principle.

**Exchequer effects**

8. Adapted in this way, the main effect of the proposal on the Exchequer would be the loss of NIF income, around £250 million, arising from the ending of employee contributions by those earning between £43 and £75. (If the LEL were also raised to £75 for the purposes of the contracted-out rebate, there would be a larger flow into the NIF from higher contributions by the contracted-out: about £850 million if both employers' and employees' contributions were raised, giving a net gain to the NIF of around £600 million.)

**Distribution of Gains**

9. About half the 1.8 million gainers would be part-time workers. The total would also include about 800,000 married women. There is some evidence that improved incentives, in the form of lower marginal tax/NIC rates, might be more important for these groups than among the workforce generally. In this respect, the cuts might be well targetted. On the other hand, this part of the income distribution has relatively few main breadwinners in families with children. Annex A shows the distribution of employees across the existing NIC bands, including £41-70.

**Interaction with benefit system**

10. Of the 1.8 million gainers, only about 0.1 million are on income-related benefits. This is because the majority of gainers would be married women whose total household incomes are above benefit levels and single people many of whom are young and living

at home. Savings on the social security programme (arising from the income tapers on housing benefit and family credit) would therefore be pretty small - probably a few million. However, these savings would be made at the expense of the small minority on benefits, who would see much of the NIC gains offset by the operation of the tapers. They might be seen as including the very people the measure ought to be helping most - families with children including lone parents. But we would still be able to argue that the great majority would get the gains in full.

**Employers**

11. Employers would continue to pay their 5 per cent contributions in respect of employees earning between £43 and £75. They would no doubt complain and press for equal treatment.

**Conclusions**

12. Without adaptation to leave benefit entitlements and contracted out NICs unchanged, this proposal would be difficult to run. You would have to defend a reduction in the coverage of the contributory system and a significant move towards means-tested benefits, involving some losses to pensioners who would otherwise get a basic retirement pension and a SERP. And there might be a setback to contracting out.

13. With adaptation on the lines suggested, the main question is whether you would want to use £250 million to help this particular group. You would also have to be prepared to deal a blow to the contributory principle.

J

J P MCINTYRE

Thousands of individuals with weekly earnings (£):

| | Under 41 | 41-70 | 70-105 | 105-195 | 195-305 | Over 305 | TOTAL |
|---|---|---|---|---|---|---|---|
| **Part Time** | | | | | | | |
| Single Men | 111 | 75 | 7 | 21 | 15 | 1 | 230 |
| Married Men | 39 | 16 | 9 | 27 | 40 | 17 | 148 |
| Single Women | 337 | 155 | 49 | 26 | 36 | 3 | 606 |
| Married Women | 1,572 | 479 | 187 | 74 | 46 | 3 | 2,361 |
| Total Part Time | 2,059 | 725 | 252 | 148 | 137 | 24 | 3,345 |
| **Full Time** | | | | | | | |
| Men under 21 | 47 | 284 | 543 | 584 | 53 | 7 | 1,518 |
| Women under 21 | 45 | 276 | 686 | 287 | 11 | 1 | 1,306 |
| Single men over 21 | 10 | 26 | 241 | 1,535 | 627 | 150 | 2,589 |
| Married men over 21 | 13 | 28 | 245 | 3,356 | 2,721 | 1,278 | 7,641 |
| Women over 21 | 38 | 137 | 868 | 1,923 | 570 | 90 | 3,626 |
| Total Full Time | 153 | 751 | 2,583 | 7,685 | 3,982 | 1,526 | 16,680 |
| **Total** | 2,212 | 1,476 | 2,835 | 7,833 | 4,119 | 1,550 | 20,025 |

**Notes**

(1)Figures exclude pensioners and married women optants.

(2) Distribution is shown for 1988-89 NIC bands.

# The London School of Economics and Political Science

( University of London )

New Fax Number for FMG

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Telex: 24655 BLPES G
Facsimile line: 01-242 0392

Mervyn A. King
Professor of Economics
Co-director, Financial Markets Grou

Mr Allen cc Mr Scholar
Mr Culpin

9 February, 1989

You might like to glance at this.

TB.

PS/Sir Peter with other NICs stuff in

Sir Terence Burns
HM Treasury
parliament Street
London SW1

Dear Terry,

I enclose herewith the note about restructuring NICS which I mentioned to you in the car recently. I apologise for the delay but I have been away from work for a week with flu and only returned on Monday.

Yours sincerely,

Mervyn A King

2u7/2/5

# Restructuring National Insurance Contributions

Mervyn King
London School of Economics

Is it possible to reduce the tax burden on low-paid people in full-time employment without giving tax concessions to the groups who benefited most from the 1988 Budget? The answer is yes - by a minor restructuring of employees' national insurance contributions with a revenue cost of £2.5-3.0 billion in a full year. The scheme involves:

(1) Retain the principle that NICs are levied on all earnings above the lower earnings limit. There are sound long-run reasons for having an ability to discriminate between those in work and those out of work which is the effect of the lower earnings limit. The social security system has evolved as a mixture of contingent and income-related benefits.

(2) Alter the rate schedule such that the higher rates of NICs (7% and 9%) apply only to the relevant slices of earnings just like income tax. The spikes in marginal tax rates on earnings above the lower limit would disappear (though the marginal cost to employers would still jump unless employers' NICs were also altered.

(3) Raise the upper earnings limit so that the maximum NICs contribution is unchanged from the current system.

Note that this change retains the existing structure of a lower earnings limit, an upper earnings limit, and three rates of 5%, 7% and 9%.

The result would be to lower the NICs payment of everyone with earnings between £75 and £367 a week after April 1989. The benefits do not go to many part-time workers nor to the "better-off". Someone earning, for example, £115 a week would pay £6.55 in NICs rather than £10.35 under the current system, a gain of £3.80 a week or 3.3% of gross earnings. Between the current and the new upper earnings limit the gain from the change tapers off to zero (see the attached table).

Using data from the Family Expenditure Survey and the LSE TAXMOD model suggests that the scheme would imply a revenue cost of somewhere between £2.5 and £3 billion in a full year.

Employees' NICs (£ per week)

| Weekly Earnings (£) | Current system | Proposed system |
|---|---|---|
| 43 | 2.15 | 2.15 |
| 75 | 5.25 | 3.75 |
| 115 | 10.35 | 6.55 |
| 200 | 18.00 | 14.20 |
| 325 | 29.25 | 25.45 |
| 367 | 29.25 | 29.23 |

McINTYRE
13/2

FROM: J P MCINTYRE
DATE: 13 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Riley
Mr Gilhooly
Mr S Matthews
Mr Macpherson
Miss J Simpson
Mrs Chaplin
Mr Speedy
Mr Tyrie
Mr Call
Sir A Battishill IR
Mr Beighton IR
Mr Isaac IR
Mr Painter IR
Mr Mace (IR)
Mr Unwin C&E
Mr Jefferson SmithC&E

* Thanks. Pse have a look @ another option, where the LEL is not a threshold, so that 5% applies to all earnings up to £75 a wk (as now); but where earnings only above £75 a wk & the new UEL would be taxed @ 9% (ie a variant of M. King's, so that there is a single step @ 5% & a single threshold) [in the move from the lower to the higher rate]. N

Ch
All far too expensive. Mervyn King, on a close reading, does not propose changing the 5% step into an allowance, but only the 7% & 9% steps.
AA

[nothing in J Moore's draft either]
see bundle below

**NICS REFORM**

You asked us on Friday to look at variants of Mervyn King's idea, as reported in the Economist, for converting the Lower Earnings Limit (LEL) into a threshold and increasing the Upper Earnings Limit (UEL). The aim would be to remove the NIC steps; the key constraint was that there should be no losers.

2. One problem with this idea, which I should have recognised straightaway, is that it would add to future SERPS expenditure. While it is true that one of the parameters would be that no one should have to pay higher contributions, it is not the amount of contributions which determines SERPs entitlements. Rather, entitlements are a percentage of earnings between the LEL and UEL. If we were to increase the UEL significantly, while leaving the

LEL unchanged, the band of relevant earnings would be increased and so therefore would SERPS entitlements for those earning more than the current UEL.

3. In principle, there might be three ways round this. First, we might create a shadow UEL, at the current level, which would apply for the purposes of SERPS entitlement. This is what we had in mind last year when UEL abolition was contemplated. The difficulty, of course, would be in justifying contributions by employees which would not earn entitlements; this could be criticised as at odds with the contributory principle. We would have to defend this by pointing out that no one would be paying more NICs as a result of the changes and that in a very real sense, therefore, no additional SERPS entitlements would be earned.

4. The second option would be to combine the changes to the LEL and UEL with another cutback in SERPS in order to offset the extra cost. The case would be that the LEL/UEL changes meant a permanent loss of income from contributions which ought to be matched by some loss of entitlements. However, another change in SERPS so soon after the Fowler reforms would no doubt run into stiff opposition, particularly with the NIF currently in strong surplus.

5. A third option might be to raise the LEL, as well as the UEL, so that the band of relevant earnings for SERPS was broadly unchanged in size - we would be shifting the band to cover a higher area of the income distribution (arguing perhaps that this was justified by the increase in earnings in recent years, compared with price increases which have determined the LEL and UEL increases). One problem here would be that about 1.8 million low-paid employees would be taken out of the NIC system, with some having to rely on means-tested rather than contributory benefits.

6. For the purpose of these calculations, we have assumed that the first option is chosen and that a shadow UEL is operated. As well as limiting SERPS entitlements, it is assumed to apply to the calculation of contracted-out rebates as well. Otherwise, rebates would increase (being a percentage of the wider band between the

LEL and UEL), whereas the benefit being given up (SERPS) would be unchanged.

7. We have worked out the effect of three main options. As agreed, we have assumed that the maximum marginal rates in the current structure (9 per cent for employees and 10.45 per cent for employers) should be the maximum here, though you did not rule out some employees now in the reduced rate bands facing higher marginal rates in the new structure.

8. **Option 1:**

| Weekly earnings (£) | Employee NIC | Employer NIC |
|---|---|---|
| 0-43 | 0 | 0 |
| 43-368 | 9 | 10.45 |
| 368+ | 0 | 10.45 |

9. This is the least expensive option. It raises the UEL by £43 to offset the conversion of the LEL into a threshold, so that at the new UEL of £368, the employee (and employer) pay the same amount as they do now. There are therefore no gainers above £368. The cost would be £6½ billion in a full year. If the changes applied to employee NICs only, the cost would be around £3 billion.

10. One disadvantage of this option would be that the marginal NIC rate for employees earning between £43 and £75 would rise from 5 per cent to 9 per cent; those in the £75-115 bracket would face a marginal rate of 9 per cent instead of 7 per cent. The increase in the marginal rate for employers would be sharper still, to 10.45 per cent.

11. **Option 2:**

| Weekly earnings (£) | Employee NIC (%) | Employer NIC (%) |
|---|---|---|
| 0-43 | 0 | 0 |
| 43-115 | 5 | 5 |
| 115-400 | 9 | 10.45 |
| 400+ | 0 | 10.45 |

12. This differs from Option 1 in building in a lower rate band between £43 and £115; this corresponds to the coverage of the two existing reduced rate bands for employees. The UEL is raised to £400, at which point the employer and employee pay the same as now. The cost would be £12½ billion in a full year. If the changes applied to employee NICs only, the cost would be over £5 billion.

13. <u>Option 3</u>

| Weekly earnings (£) | Employee NIC (%) | Employer NIC (%) |
|---|---|---|
| 0-43 | 0 | 0 |
| 43-115 | 7 | 7 |
| 115-384 | 9 | 10.45 |
| 384+ | 0 | 10.45 |

14. This differs from Option 2 only in that the reduced rate is fixed at 7 per cent instead of 5 per cent which reduces the corresponding UEL to £384 and the cost to £10 billion in a full year. If the changes applied to employee NICs only, the cost would be over £4 billion.

15. The main reason why these options are so expensive is that we would be giving everyone below the new UEL (roughly 90 per cent of employees) the benefit of converting the LEL into a threshold ie of a £43 allowance. (Those earning between the current UEL and new UEL would have this benefit partly offset, because they will also be paying NICs on an extra slice of income, but they would be a small minority of those affected.) One way of cutting the cost would be to retain a step at £115, or wherever the higher rate in the new structure became payable. Thus everyone earning more than £115 would pay the higher rate on <u>all</u> their earnings, not just earnings above £43. This would make the reform less radical. Indeed, the step at £115 would be steeper than it is now. At present, the step is from 7 per cent of all earnings to 9 per cent of all earnings; under this variant, it would be from 7 per cent on earnings between £43 and £115 to 9 per cent of all earnings.

16. I should emphasise that all the costings in this note are very broad-brush.

JM

J P MCINTYRE

FROM: A C S ALLAN

DATE: 14 February 1989

MR MCINTYRE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Hardcastle
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace - IR
PS/IR

**NICs REFORM**

The Chancellor was grateful for your minute of 13 February. He would be grateful if you could look quickly at another option, where the LEL is <u>not</u> a threshold, so that the 5 per cent rate applies to <u>all</u> earnings up to £75 a week (as now); but where only earnings between £75 a week and the new UEL would be taxed at 9 per cent. This is a variant of Mervyn King's proposals, so that there is a single step at 5 per cent, and then a single threshold for the move from the lower to the higher rate.

2. He would be grateful if you could do the costings for both employee NICs only and for both employee and employer NICs.

3. The Chancellor was not attracted to the option of a shadow UEL to deal with SERPS problems. He would be grateful if you could explore how this new option might be combined with raising the LEL so that the band of relevant earnings for SERPS was broadly unchanged in size.

A C S ALLAN

FROM: J P MCINTYRE
DATE: 14 February 1989

CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Hardcastle
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace IR
PS/IR

[Tuller]

Ch
Option 5 - for employees only - is just affordable @ £2 billion. But it runs into problem of taking people out of contributory benefits.
AA

NICS REFORM

Mr Allan's minute of today asked us to cost another option, as follows:

| Weekly earnings (£) | employee NIC | employer NIC |
|---|---|---|
| 0-43(1) | 0 | 0 |
| 43-75 | 5 | 5 |
| 75(2)-358(3) | 9 | 10.45 |
| 358+ | 0 | 10.45 |

(1) LEL remains a step at £43 and is not converted into a threshold. So 5 per cent rate applies to all earnings upto £75, as now.

(2) £75 is a threshold, so that those with earnings above this level pay 5 per cent NICs on the first £75 of earnings.

phrased confusingly. but this is the right specification

(3) The new UEL of £358 is fixed at the level which ensures that employers and employees pay the same as they do now at the current (1989-90) UEL.

2. This would cost over £5½ billion in a full year. If the changes were made for employees only, the cost would fall to £2¼ billion.

3. Let us call this <u>Option 4</u>. The main features would be:

i. About 15 million employees, earning between £75 and £358 a week would pay less NICs.

ii. Makes no change to employee or employer NICs of 4½ million workers earning less than £75 a week.

iii. The step at £43 would remain, but those at £75, £115, and £165 (employer only) would be eliminated.

how much?

iv. The band of earnings between the LEL and UEL would be widened, thereby increasing future expenditure on SERPs and revenue forgone from contracted out rebates.

v. The marginal NIC rate for employees on £75-£115 would rise from 7 per cent to 9 per cent. And for employees between £325-£358 (old and new UEL), the marginal NIC rate would rise from zero to 9 per cent. Otherwise, marginal rates unchanged. See Annex A for new pattern of marginal rates.

vi. Employers would begin to pay the top marginal NIC rate of 10.45 per cent once earnings reached £75 (compared with £165 now).

vii. No offence to contributory principle.

4. You also asked us to explore how Option 4 might be combined with raising the LEL so that the band of relevant earnings for SERPs was broadly unchanged in size. To this end, we have constructed Option 5:

| Weekly earnings (£) | employee NIC | employer NIC |
|---|---|---|
| 0-75(1) | 0 | 0 |
| 75-115 | 7 | 7 |
| 115(2)-351(3) | 9 | 10.45 |

(1) LEL remains a step but is increased from £43 to £75 to leave the SERPs band of earnings unchanged.

(2) £115 is converted from a step to a threshold. So those with earnings above this level pay only 7 per cent on the first £115 of earnings.

(3) The new UEL of £351 is fixed at the level which ensures that employers and employees pay the same as they do now at the current (1989-90) UEL.

5. The cost of this option would be slightly lower than Option 4, namely £5¼ billion in a full year. For employees only, the cost would be roughly £2 billion.

6. The main features of Option 5 would be:

i. Roughly 15 million employees would pay less NICs. Of these, 1.8 million on between £43 and £75 would pay no NICs. Those earning between £115 and £351 would also gain (about 13 million).

ii. The 1.8 million earning less than £75 would be taken out of the NIC system - though some only temporarily if their earnings were to increase with career progression etc. There would therefore be more reliance on means-tested benefits.

iii. The new LEL at £75 would be a bigger step than in the existing structure. At present, the jump is from 5 per cent on £74 to 7 per cent on £75. Option 5 would mean a step from zero at £74 to 7 per cent on £75.

iv. Those in the £75-115 bracket would not gain - around 2½ million. But the conversion of the step at £115 into a threshold would be helpful to some of them.

v. The marginal NIC rate for those in the £43-75 band would fall from 5 per cent to zero. See Annex B for new pattern of marginal rates generally.

JM

J P MCINTYRE

## OPTION 4: MARGINAL RATES

| Weekly Earnings £ | EMPLOYEE Now | EMPLOYEE proposed | EMPLOYER Now | EMPLOYER Proposed |
|---|---|---|---|---|
| 0-43 | 0 | 0 | 0 | 0 |
| 43-75 | 5 | 5 | 5 | 5 |
| 75-115 | 7 | 9 | 7 | 10.45 |
| 115-165 | 9 | 9 | 9 | 10.45 |
| 165-325 | 9 | 9 | 10.45 | 10.45 |
| 325-358 | 0 | 9 | 10.45 | 10.45 |
| 358+ | 0 | 0 | 10.45 | 10.45 |

ANNEX B

## OPTION 5: MARGINAL RATES

| Weekly Earnings £ | EMPLOYEE NIC Now | EMPLOYEE NIC proposed | EMPLOYER NIC Now | EMPLOYER NIC Proposed |
|---|---|---|---|---|
| 0-43 | 0 | 0 | 0 | 0 |
| 43-75 | 5 | 0 | 5 | 0 |
| 75-115 | 7 | 7 | 7 | 7 |
| 115-165 | 9 | 9 | 9 | 10.45 |
| 165-325 | 9 | 9 | 10.45 | 10.45 |
| 325-351 | 0 | 9 | 10.45 | 10.45 |
| 351+ | 0 | 0 | 10.45 | 10.45 |

chex.ps/aa/25 BUDGET CONFIDENTIAL

FROM: A C S ALLAN

DATE: 14 February 1989

MR MCINTYRE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Hardcastle
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace - IR
PS/IR

NICs REFORM

The Chancellor was grateful for your minute of 13 February. He would be grateful if you could look quickly at another option, where the LEL is not a threshold, so that the 5 per cent rate applies to all earnings up to £75 a week (as now); but where only earnings between £75 a week and the new UEL would be taxed at 9 per cent. This is a variant of Mervyn King's proposals, so that there is a single step at 5 per cent, and then a single threshold for the move from the lower to the higher rate.

2. He would be grateful if you could do the costings for both employee NICs only and for both employee and employer NICs.

3. The Chancellor was not attracted to the option of a shadow UEL to deal with SERPS problems. He would be grateful if you could explore how this new option might be combined with raising the LEL so that the band of relevant earnings for SERPS was broadly unchanged in size.

A C S ALLAN

chex.rm/aa1/24 BUDGET CONFIDENTIAL

FROM: A C S ALLAN
DATE: 15 February 1989

MR MCINTYRE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Hardcastle
Mr Byatt*
Mr Monck*
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace - IR
PS/IR
(* with copy of earlier papers)

NICS REFORM

The Chancellor was most grateful for your minute of 14 February. He would be grateful for further information on your options 4 and 5, in both cases restricted to employees only and with a start date of 1 October 1989 (so that only half the cost falls in the first year).

2. For these two options, what he would like is: Mace-type distributional tables and charts; more information on the costs, and in particular on the implications for SERPs and contracted out rebates of the wider LEL to UEL band under option 4; a fuller discussion of the implications of taking 1.8 million people out of the NIC system and onto means tested benefits under option 5, including the costs; any other snags you see, for example in relation to the self-employed(*); and an indication of what Mr Moore's views might be on these two options.

(* or in increased burdens on employers, particularly small ones).

3. I should be grateful if you could let me have as much of this information as possible by <u>tomorrow night</u> (Thursday 16 February).

4. He would welcome any comments from others.

ACSA

A C S ALLAN

FROM M C SCHOLAR
DATE 16 FEBRUARY 1989

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Hardcastle
Mr Culpin
Mr Gilhooly
Mr McIntyre
Mr Matthews
Mr Macpherson
Mr Ford
Mrs Chaplin
Mr Tyrie
Mr Call

SCHOLAR 16/2

**NICS REFORM**

You asked for quick comments on this.

2. I advocated changes here before the 1988 Budget. But I am much less keen this year.

3. The case for removing the steps has become a good deal stronger than it was. But to remove all the steps except the LEL (as Options 4 and 5 do) may look like tinkering, given that the LEL step affects about as many people as the other steps put together.

4. There is a defence against this criticism - the contributory principle: it cannot be right for someone earning £43.10 a week over their whole working life to be entitled to a basic pension of £2,000 a year plus on the basis of lifetime contributions totalling £20. But I do not think much of this argument, and you would not wish to major on it this year if you were planning to turn the LEL into a withdrawable allowance soon (as I would favour).

5. You may be unworried by this last point, thinking that it would be better to get rid of some of the steps than none. I am still very doubtful, this year.

6. To get rid of the steps means <u>either</u>

(a) raising NIC rates for some (as Option 4 and the proposal revived by the Financial Secretary do), or

(b) raising the UEL (as Mervyn King would), or

(c) spending much larger sums than are likely to be available this year, or

(d) all or some of these.

7. Option 4 manages skilfully to contain the number of people who would face higher marginal rates. The Financial Secretary's proposal would raise them by a larger amount for more people, and looks like a bigger departure from 1985. Although we would be able to argue that all these people were, nevertheless, better off, the change would sit ill with the arguments we have advanced about the importance of marginal rates. I would keep it for a year in which you have more money for an income tax basic rate reduction.

8. There are problems about raising the UEL sharply. Some of these would be overcome by raising the LEL sharply at the same time. But we were deterred last year by the prospect of disqualifying 1.8 million people from the old-age pension and other benefits, even if most of them would not in the event be disqualified. Raising the UEL would produce more people with higher marginal rates, create some losers (or reduce gains) and would limit your scope for increases in car scales. All this would be easier in an easier year.

9. I do not think we should underestimate the problems there might be with employers if you brought down employee rates only.

10. If you decide to make a larger tax reduction than what is now in the Scorecard I think a good, but unfashionable, case could be made for reducing NIC rates or increasing the allowances. But given where we are I would vote for 24p plus, if more money still is available, some rounding up of the allowances.

MCS

M C SCHOLAR

chex.pj/drafts/15.2.1

BUDGET CONFIDENTIAL

FROM: MRS JUDITH CHAPLIN
15th February 1989

CHANCELLOR

Paymr FRI

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Culpin
Mr McIntyre
Mr Tyrie
Mr Call

**NICS**

I have been thinking further on the option of a penny off the basic rate, an increase in thresholds beyond indexation and changes in NICs.

2. As between increasing thresholds and one penny off, I am still in favour of the penny off for political impact and to reinforce the message that lower tax rates give supply side benefits. However, if the rate of inflation has moved up substantially this month, and is likely to do so again next month, the conflicting message of austerity and the need for high interest rates to bear down on inflation and the more optimistic message given by basic rate cuts, would be both politically and presentationally difficult, and would shift me away from the 1p cut in basic rate.

3. The difficulty is that the Budget comes before it is likely to be clear whether the economy is slowing down satisfactorily. From that point of view the NICs option, in one form or another, is better. It would be seen as a major reform which would make the Budget more interesting. It would be perceived as doing more for the low paid and therefore believed to be less inflationary than 1p off the basic rate, but it would also not impact on the economy until the last part of the year. It might even, I suppose, be possible to have some form of phasing which could be slowed down or speeded up to alter its impact as between this year and next in the light of developments in the first half of the year.

4. The difficulty is getting a scheme which removes the current high marginal rates and yet does not cost a bomb. I think there is considerable presentational difficulty with the schemes which were

being discussed at the end of last year, of converting the £43 ~~into~~ into an allowance and increasing the marginal rate to just over 11 per cent for those with earnings between £43 and £227. Although these people would be paying less, the marginal rate would have increased which does not sit well with the reduction in the basic rate of income tax. I think there is also a problem over the contributory principle.

5. Looking at the recent options so far proposed, Paul McIntyre's option 4 seems to me to have considerable merit. I am not as bothered as Robert Culpin is by the fact that the LEL remains a step at £43. That is the point of a contributory scheme, as the Prime Minister would doubtless point out. Earn £42 and you pay no NICs, but you also receive no contributory benefits. Earn another pound and you pay £2.15, but you gain the right to a substantial range of benefits.

6. Furthermore, earners would still be paying only 5 per cent of their earnings in NICs at this level and very few would be paying tax. Even if you come into tax before the £75 a week threshold (which only single people can do), the average tax rate is tiny, so that NICs and tax together are a very small proportion of the wage. Additionally, according to the table (which I attach) of how many and who earns what, nearly 90 per cent of those earning between £41 and £70 are working part-time or are under 21 - and presumably the figures are roughly similar for £43-£75 a week - and are therefore not the ones on whom one is trying to target help. Indeed, increases of NICs thresholds or income tax thresholds are often criticised for the fact the gain goes mainly to part-time or young workers.

7. There seems to me to be two difficulties with option 5. The first is the bigger step at £75 a week. The second is taking 1.8 million out of the contributory system. Although the young in this group would probably later in life earn enough contributions to secure reasonable benefits, working women - the vast majority in this group - with their different career patterns might not. It would look popular in the Budget to stop these low-paid women paying national insurance contributions, but from the figures it would mean a substantial number of women being disqualified from receiving such contributory benefits as pensions, maternity pay, etc.

JC

**JUDITH CHAPLIN**

Thousands of individuals with weekly earnings:

| | Under 41 | 41-70 | 70-105 | 105-195 | 195-305 | Over 305 | TOTAL |
|---|---|---|---|---|---|---|---|
| **Part Time** | | | | | | | |
| Single Men | 111 | 75 | 7 | 21 | 15 | 1 | 230 |
| Married Men | 39 | 16 | 9 | 27 | 40 | 17 | 148 |
| Single Women | 337 | 155 | 49 | 26 | 36 | 3 | 606 |
| Married Women | 1,572 | 479 | 187 | 74 | 46 | 3 | 2,361 |
| Total Part Time | 2,059 | 725 | 252 | 148 | 137 | 24 | 3,345 |
| **Full Time** | | | | | | | |
| Men under 21 | 47 | 284 | 543 | 584 | 53 | 7 | 1,518 |
| Women under 21 | 45 | 276 | 686 | 287 | 11 | 1 | 1,306 |
| Single men over 21 | 10 | 26 | 241 | 1,535 | 627 | 150 | 2,589 |
| Married men over 21 | 13 | 28 | 245 | 3,356 | 2,721 | 1,278 | 7,641 |
| Women over 21 | 38 | 137 | 868 | 1,923 | 570 | 90 | 3,626 |
| Total Full Time | 153 | 751 | 2,583 | 7,685 | 3,982 | 1,526 | 16,680 |
| **Total** | 2,212 | 1,476 | 2,835 | 7,833 | 4,119 | 1,550 | 20,025 |

Robert 7.14.02.89

BUDGET CONFIDENTAL

FROM: FINANCIAL SECRETARY
DATE: 15 February 1989

CHANCELLOR

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr McIntyre
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace - IR
PS/IR

FST 15/2

**NICs REFORM**

I have seen the recent papers on this subject.

All the options currently under consideration seem to be somewhat expensive, even if we don't act on employer's NICs as well. But in fact, the cheapest idea seems to me to be the best as well. I am more attracted to the original proposal from the Treasury, as set out in Mr McIntyre's minute of 4 November. This gave an allowance equal to the LEL which would be withdrawn when earnings reached £227 a week.

The main disadvantage of it was that it made the marginal NIC rate for everybody earning between £43 and £227 a week 11.1%. That would raise the marginal NIC rate for some 9.5 million people. Though for most of them, it would only be by two percentage points. And, on the other hand, it would drastically reduce the marginal rates of over 100% near the NIC steps. 1.5 million people are within £3 of the steps; they would have greatly increased incentives.

I believe such a change could be presented as building on the 1985 reforms. I don't think the 1985 reforms were presented as having particularly beneficial effects on marginal rates; if we had attempted to argue that, then we would certainly have been open to criticism because of the dramatic effects of the steps. Surely the purpose of them was rather to lessen the burden on the lower-paid, and so help to reduce unemployment. This change would also lessen the burden on the lower-paid; everyone earning less than £227 a week would pay less NICs, whereas everyone above that point would pay the same.

As for the marginal rate point, even if we did put them up for many people;

a) they would still all pay less NICs; and

b) would benefit from future cuts in the basic rate of income tax.

And, of course, we could point to the marginal rate gainers.

The advantages of this scheme over other options are that:

1. it is much cheaper (only £800 million in a full year);

2. there is no SERPs problem (because the LEL and UEL remain the same);

3. more of the benefit goes to people lower down the income distribution;

4. there are fewer problems with the contributory principle.

All the present options seem to me to be highly complicated. Furthermore, they are less well targeted, and they do not get rid of all the steps.

Simply cutting the rate of NICs seems to me not very attractive. We have a target to get the basic rate of income tax down to 20p. All the political attention is on income tax. Reductions in NIC rates across the board would not score much political credit. But this more modest measure would be effective in helping those below average earnings and in removing a severe incentive problem for a significant minority of lower-paid employees.

R.C.M.S.

pp NORMAN LAMONT

BUDGET CONFIDENTIAL

FROM: ROBERT CULPIN
DATE: 15 February 1989

CHANCELLOR

Pumpin FRI

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Hardcastle
Mr Scholar
Mr Gilhooly
Mr McIntyre
Mr Matthews
Mr Macpherson
Mr Ford
Mrs Chaplin
Mr Tyrie
Mr Call

NICS

You asked for quick comments on Mr McIntyre's note of yesterday.

2. Option 4 is rather elegant. It gets rid of two steps, concentrates help on the lower paid, and keeps increases in marginal rates within bounds. You could do it for employees only. We looked at something of the kind last summer.

3. But I would still not do it. Cost apart, the main reason is that it keeps what is far and away the worst distortion in the system. Earn £42 and you pay no NICs. Earn another pound and you pay £2.15. We cannot seriously defend this. It is a damaging disincentive; and it is no wonder that earnings are bunched just below this level.

4. In abolishing the smaller steps, I am afraid that Option 4 would inevitably draw attention to the very large one which would be left. There is thus a real risk that you would spend £2¼ billion only to be faulted for a half-baked reform. Ordinary people would have difficulty understanding or remembering it. Sophisticates would say it ducked the issue. You would have a lot of upheaval and a large bill, only to leave unreformed the thing which most needs reforming.

5. Among the other problems are these:

(a) The change would undo part of your 1985 reforms, by abolishing the 7 per cent reduced rate band.

(b) It would raise the marginal rate for the 2 million people in this band, and for roughly another ½-¾ million people earning a bit more than the present UEL.

(c) It would raise future expenditure on SERPs, and revenue forgone from contracted out rebates.

I just don't think it is worth it.

6. If you have, as it were, £2¼ billion to spare (and that is a pretty large if), I would much rather devote it to reducing marginal tax or NIC rates. If you were prepared to devote it to NICs (which I know is unlikely), you could take more than 1 per cent off all the rates. This would have the familiar supply side advantages; and the cash benefits would, by definition, be concentrated on those earning less than the UEL.

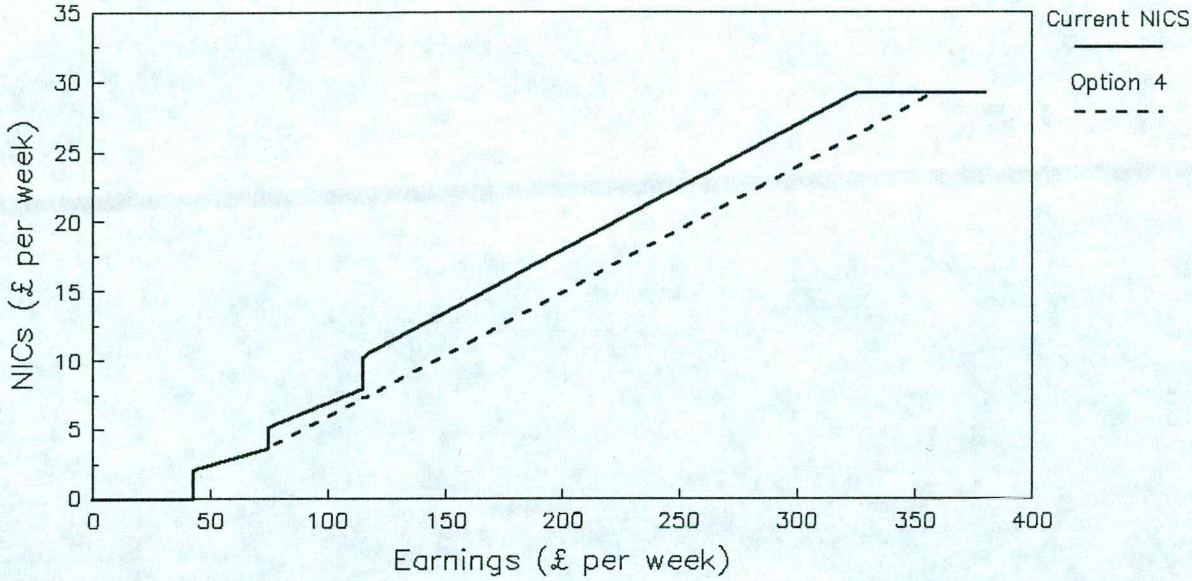
7. If, on the other hand, you think you might want to spend something of this order on changing the structure of NICs, I should be inclined to have another look at the alternatives which would abolish all steps. To take just one example: convert the LEL into an allowance, and the other steps into thresholds; retain reduced rate bands; leave the UEL unchanged; and raise the marginal rate structure from 5,7,9 per cent to 7,9,11 per cent - knowing that, as and when it is prudent, you will offset the effect on the combined marginal tax-and-NIC rate by reducing the basic rate of income tax. This would probably cost something of the broad order of £2½ billion, not terribly different from Option 4. I am not advocating it - merely suggesting that it might be a better buy than Option 4, if you want to be in this market, this year, at all.

8. I find it helpful to look at pictures for these options. I attach a quick graphic comparison.

RC

ROBERT CULPIN

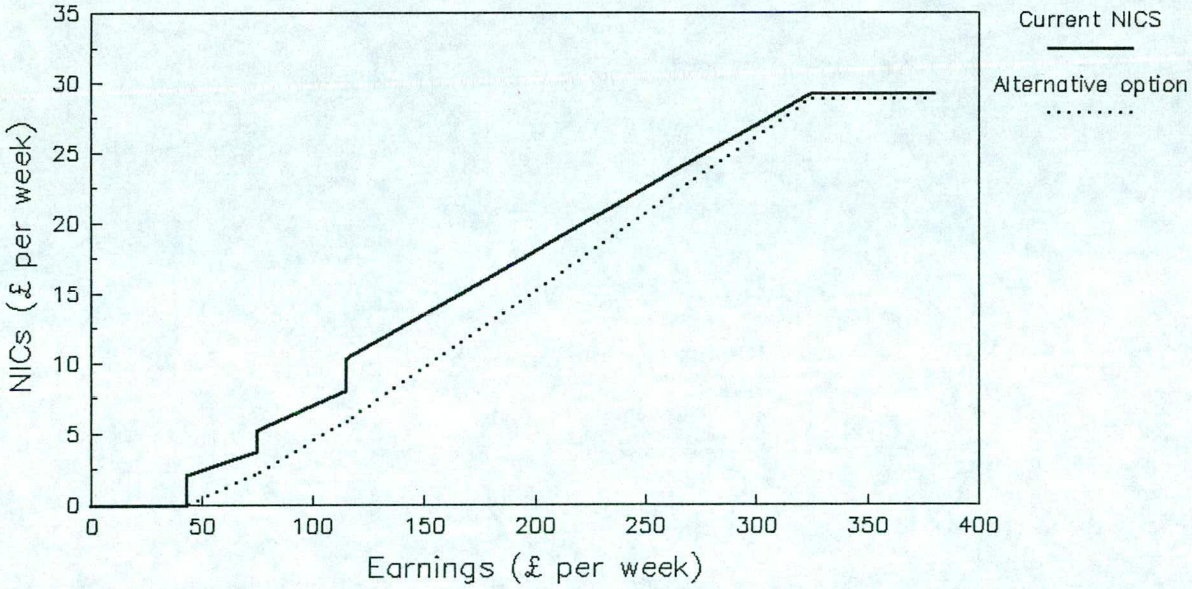
# McIntyre Option 4




For those earning under £75 NICs unchanged
No allowance

5% of first £75 of earnings
Marginal rate of 9% between £75 and £358

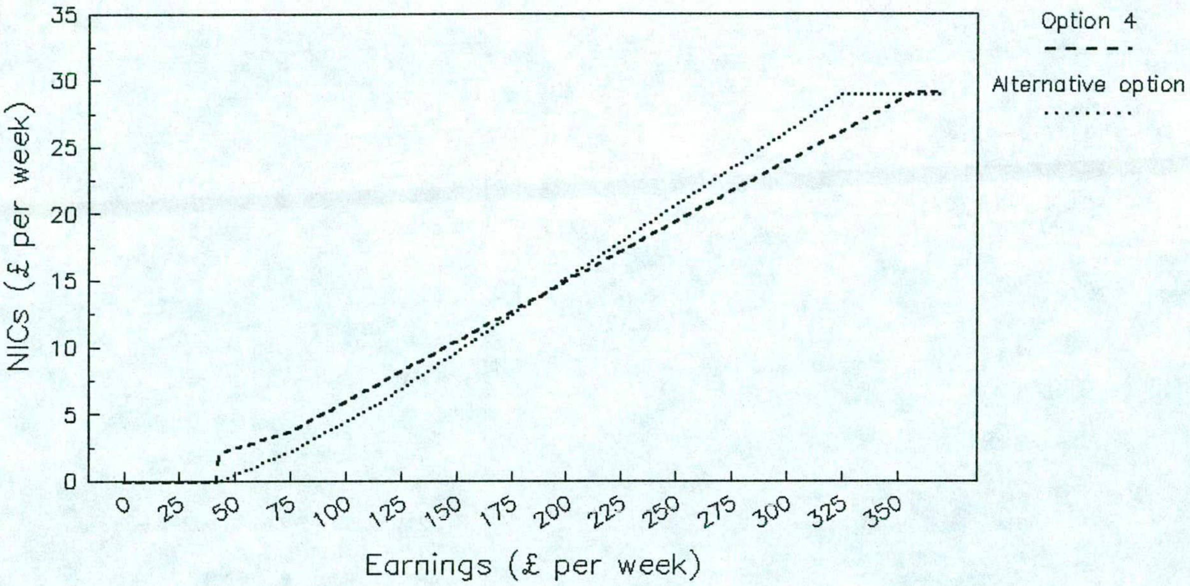
# Illustrative alternative




£43 allowance
7% rate on earnings between £43 and £75

9% rate on earnings between £75 and £115
11% rate on earnings between £115 and £325

# Alternative Options



chex.rm/aa1/24 BUDGET CONFIDENTIAL

FROM: A C S ALLAN
DATE: 15 February 1989

MR MCINTYRE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Hardcastle
Mr Byatt*
Mr Monck*
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace - IR
PS/IR
(* with copy of earlier papers)

**NICS REFORM**

The Chancellor was most grateful for your minute of 14 February. He would be grateful for further information on your options 4 and 5, in both cases restricted to employees only and with a start date of 1 October 1989 (so that only half the cost falls in the first year).

2. For these two options, what he would like is: Mace-type distributional tables and charts; more information on the costs, and in particular on the implications for SERPs and contracted out rebates of the wider LEL to UEL band under option 4; a fuller discussion of the implications of taking 1.8 million people out of the NIC system and onto means tested benefits under option 5, including the costs; any other snags you see, for example in relation to the self-employed(*); and an indication of what Mr Moore's views might be on these two options.

(* or in increased burdens on employers, particularly small ones).

3. I should be grateful if you could let me have as much of this information as possible by tomorrow night (Thursday 16 February).

4. He would welcome any comments from others.

ACSA

A C S ALLAN

FROM: A C S ALLAN
DATE: 17 February 1989

MR MCINTRYRE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace IR
PS/IR
PS/C&E

NICs REFORM

The Chancellor was most grateful for your minute of 16 February. As you know, we have put this subject on the Overview Agenda for Monday. He would want to concentrate on option 4, and feels that the other options can be forgotten, though it is perhaps just worth considering the variant of option 4 described in your paragraph 13 (not increasing the UEL).

2. On the self-employed, the alternatives are (a) keep the UPL unchanged: does this matter? Or (b) raise the UPL alongside the UEL, with compensating (presumably revenue neutral) cut in class 2 contributions. How large would the cut be? And what are the relative merits of these two options?

3. He had one or two other questions:

(i) How much do we know about the sort of people earning £75-£115 whose marginal rate would increase from 7% to 9%?

(ii) How many people will have their marginal rate increased by 9% (ie those between the old and new UEL)?

(iii) What public expenditure savings are there from option 4? (helping the low paid with NICs will presumably reduce their income support etc entitlement.)

ACSA

A C S ALLAN

**BUDGET SECRET**

COPY NO 1 OF 32 COPIES

FROM: ROBERT CULPIN
DATE: 21 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Dame Anne Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Riley
Mr Sedgwick
Mr A C S Allan
Mr Gilhooly
Mr McIntyre
Mr Matthews
Mr Macpherson
Miss Simpson
Miss Wallace
Mr Ford
Mrs Chaplin
Mr Tyrie
Mr Call

Sir Anthony Battishill )
Mr Beighton )
Mr Isaac )IR
Mr Painter )
Mr Mace )

~~£320 a wk £320 x 9% = £28.80 £25.43~~

* Thanks. The answer to X is that, subject to those constraints, I am looking @ entry fees of 2%, £1 → 2½%. N.

**NICs**

This sets out the option I mentioned at yesterday's Overview.

2. My starting point is that the step at the LEL is too big. Earn £42 - or even £42.99 - and you pay no NICs. Earn £43 and you pay £2.15. That is too steep a jump.

3. The step has increased, is increasing, and ought to be diminished. In 1978-79, it was £1.14 (6½ per cent of an LEL of £17.50). In 1989-90, it will be £2.15 (5 per cent of an LEL of £43). In future, it will go on rising in cash, as long as it remains 5 per cent of an LEL which is uprated every year.

4. The step means that no one should earn between £43 and £45.30 a week. They would be better off earning either less or more.

5. This is one reason why earnings are bunched below the LEL. It is not the only reason: people would want to avoid NIC form-filling even if they only had to pay 5p on earnings of £43. But the size of the step is a conspicuous disincentive; and Chart 1 is a picture of a distorted market.

6. We can defend some step on the ground that it buys entitlement to contributory benefits. Without it people might in theory buy a pension, as it were, for 50p. But to defend a step as large as £2.15 is to put more weight on the contributory principle than I believe it will bear.

7. The Government has got rid of most of the other withdrawal rates of over 100 per cent. On the benefits side, that was a major objective of the Fowler reforms. You are abolishing another penal rate in the Budget - the pensioners' earnings rule.

8. I still believe it is a deficiency of the leading NIC reform that it spends £2-2½ billion and yet leaves untouched one of the worst features of the system. To put it cruelly, it abolishes the steps you invented, but leaves the one you set out (in part) to reform.

9. The alternative I mentioned is this: keep a step at the LEL, but reduce it to £1; contain the cost by charging a marginal rate of 9 per cent above the LEL. So NICs would be £1 plus 9 per cent.

10. Chart 2 shows how this reform would look. For comparison, Chart 3 shows the leading option: you can see at a glance that the main difference is at the bottom of the NICs scale. Chart 4 shows how £1 plus 9 per cent would smooth out average tax-and-NIC rates.

11. We estimate that this variant should have much the same cost as the leading option. For most people it would also have much the same effects: their average NIC rate would fall, and they would therefore be significantly better off.

12. Compared with the leading option, the structure of rates and numbers affected would look like this:

| | **Lead Option £2.15+ 5%, 9%** | **Alternative £1+ 9%** | **Number of Employees in band (million)** |
|---|---|---|---|
| 0 - 43 | 0 | 0 | |
| 43 | £2.15 | £1 | * |
| 44 - 75 | 5** | 9** | 1.5 |
| 75 - 115 | 9 | 9 | 1.9 |
| 115 - present UEL | 9 | 9 | 13.5 |
| present - new UEL*** | 9 | 9 | 0.7 |

* About ½ million are just below the LEL.

** 5% on all earnings up to £75, but 9% only on earnings between £44 and £75

*** Present UEL is £325. New UEL approximately £355-£360.

13. Compared again with the leading option, the differences are briefly these:

(a) The entry fee to the National Insurance system would be reduced from £2.15 to £1. So everyone would start by being £1.15 a week better off.

(b) Most of those in the present 5 per cent band would retain some of this benefit. So they would be better off than under the present system, whereas they would be completely unaffected by the leading option.

(c) The initial benefit of £1.15 would be gradually withdrawn by charging 9 per cent NICs instead of 5 per cent immediately above the LEL. People in the present 5 per cent band (£43-£75) would thus have a higher marginal rate: but they would be better off than in either the present system or the leading option for reform, and their average NIC rate would be lower.

(d) The initial £1.15 benefit would be fully withdrawn by the top of the 5 per cent band. The break even point would be about £72. People earning less than £72 would gain more than in the leading option, and people earning more would gain slightly less than in the leading option.

(e) As I have specified it, there would be a small group of people earning between £72 and £75 who would lose very slightly. Someone on £73 would lose 5p, someone on £74 9p.

(f) People earning more than £75 would only gain trivially less - about 13p a week - than in the leading option. And, of course, they would still be much better off than under the present system.

The trivial shaving off the gains of the majority, at (f), would pay for the substantial benefit to the minority, at (a)-(c). That price could well be worth paying.

14. Needless to say, it might well be sensible to refine the precise specification. Maybe a step of 90p would be better than £1; maybe it should be defined as 2½ per cent, or something, of earnings at the LEL; maybe we should look at twiddles with the LEL



2% = 86p
3% = 1.29p
2½% = ~~[illegible]~~ £1.07½

and UEL; maybe we should explore implications for employers, the self-employed, even optants and so on. All I want to argue now is that, subject to further work, this variant seems to have two potential advantages over the leading option. It contains an extra reform, because it tackles the LEL step; and it produces a simpler system. The most obvious disadvantage is that it abolishes the 5 per cent reduced rate band. I think this could perfectly well be defended, acknowledging in effect that the 1985 reforms were a worthwhile but temporary staging post, and simply the best that could be afforded at the time.

15. If it is clear to you that the loss of a 5 per cent band is likely to prove a knockdown objection, I should be grateful if you could say so, since there is no point in wasting our time. If, on the other hand, you are content for us to explore the option further, Mr McIntyre and I will do so. As you know, we have already asked the Government Actuary to do a professional costing.

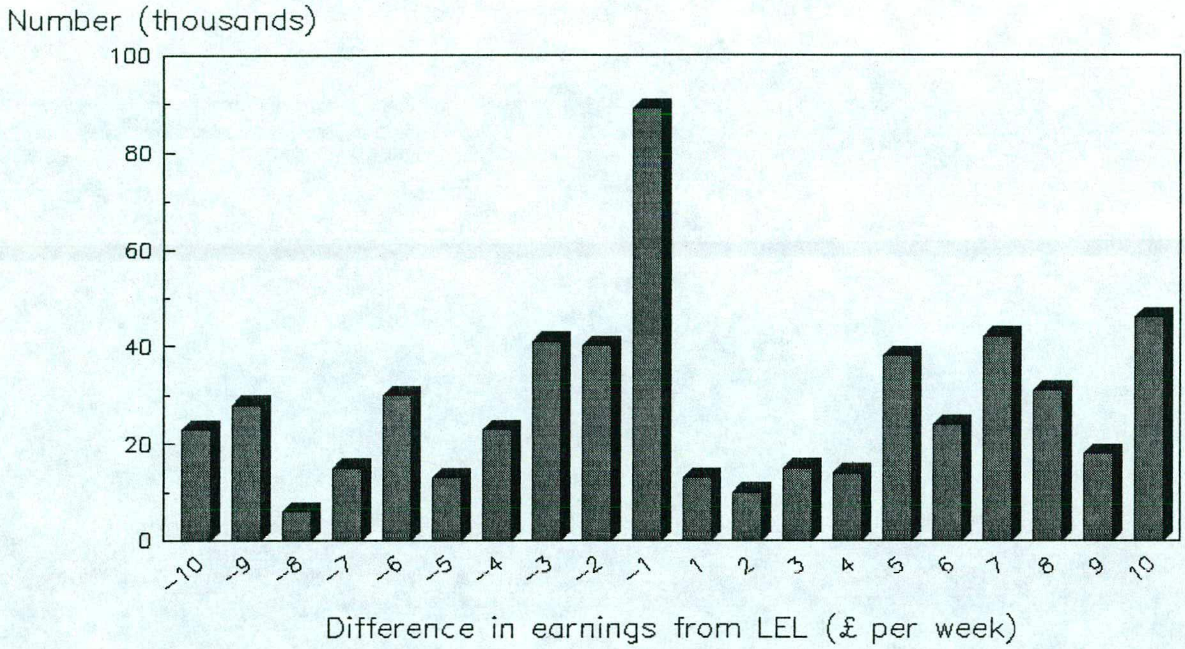
X 16. I stress that the only question I am raising now is whether you are prepared to look further at options which reduce the LEL step if (a) they do not cost more and (b) they do not raise the 9 per cent marginal NIC rate. I am not asking you to bless this particular specification - which, indeed, I have only been thinking about myself since yesterday lunchtime.

RC

ROBERT CULPIN

## CHART ONE

### Distribution of earnings of heads of tax units
**about LEL at time of interview for 1985 FES**




### Distribution of earnings of married women
**about LEL at time of interview for 1985 FES**

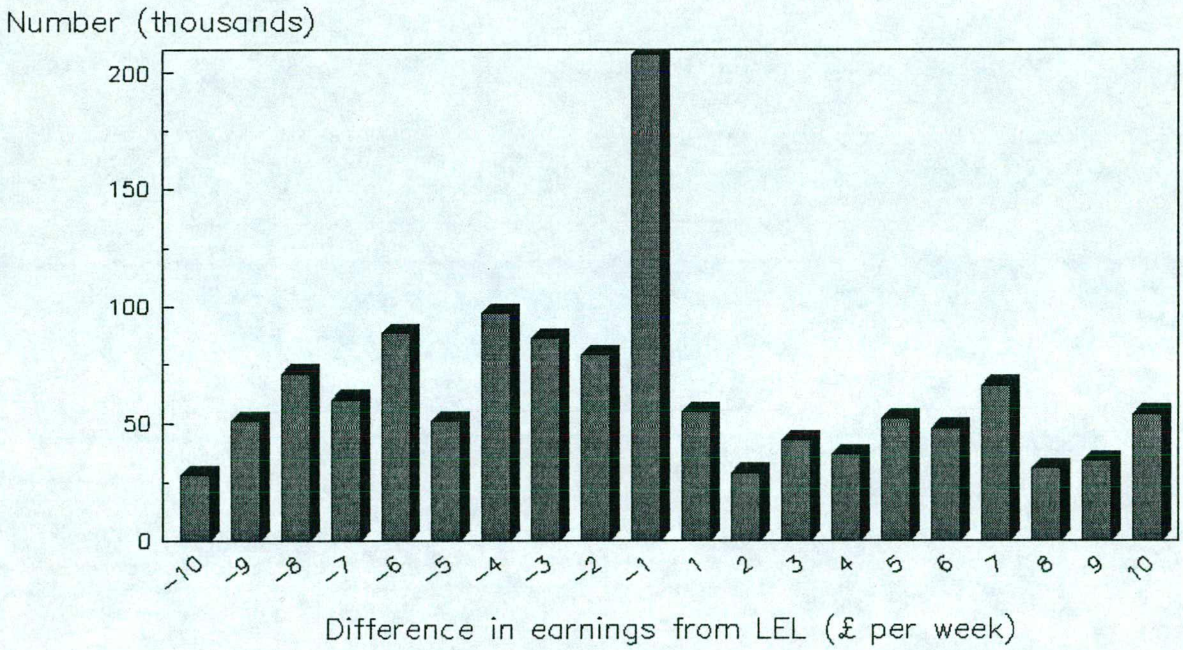
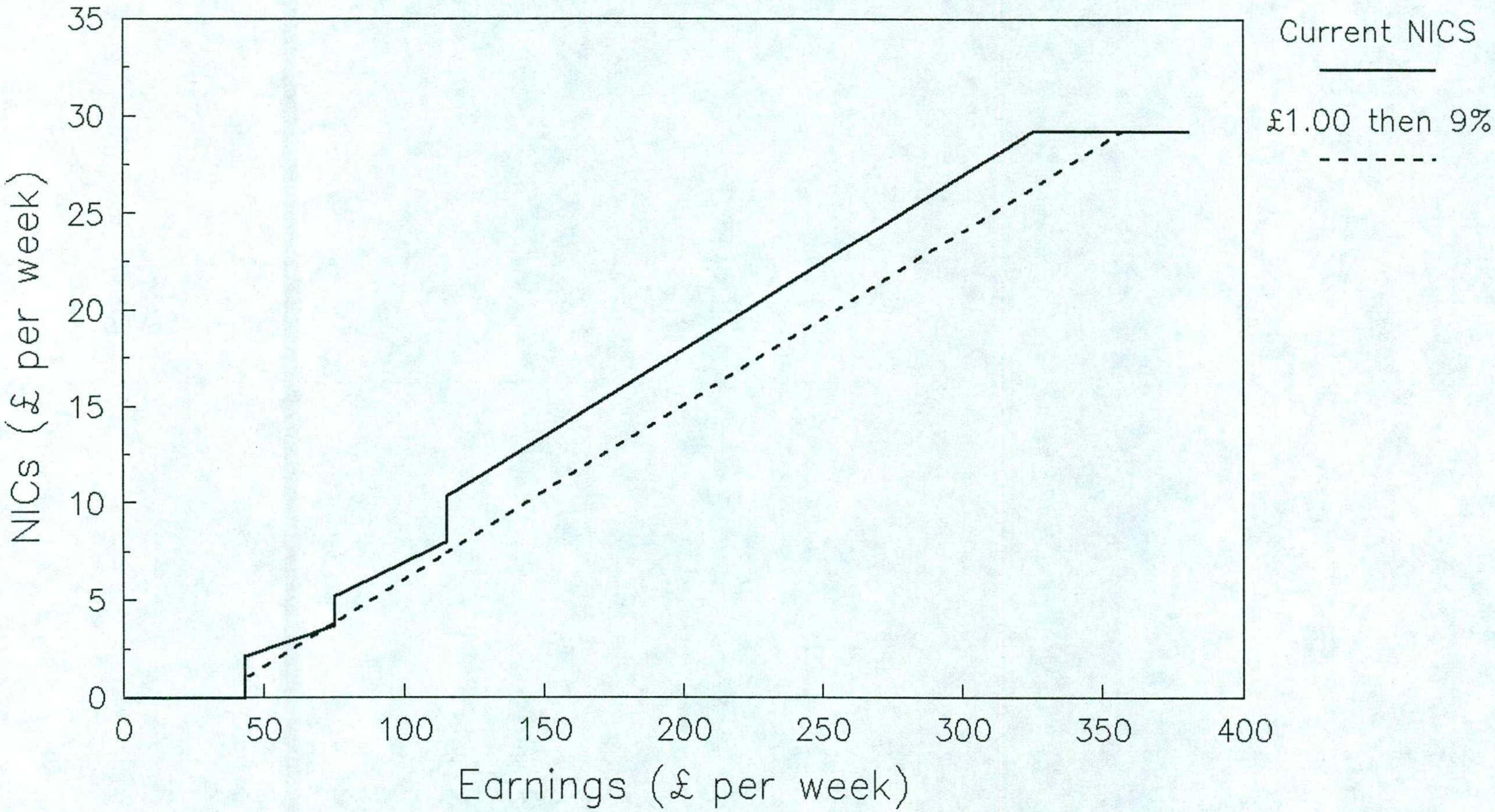


CHART TWO

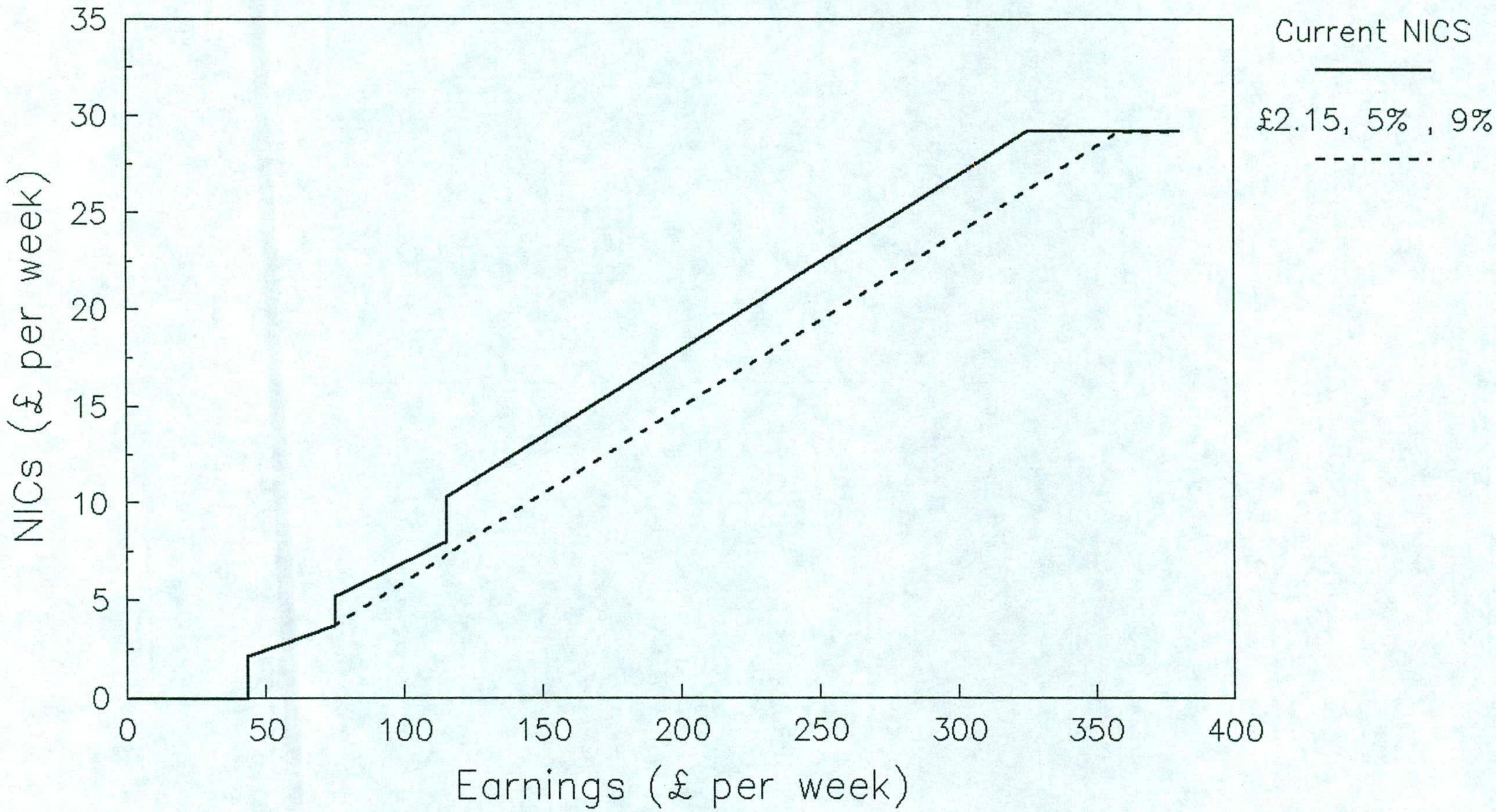
# £1.00 then 9 per cent rate




£1 "entry fee"
9% on earnings between £43 and £357

CHART THREE

# £2.15 then 5 per cent then 9 per cent



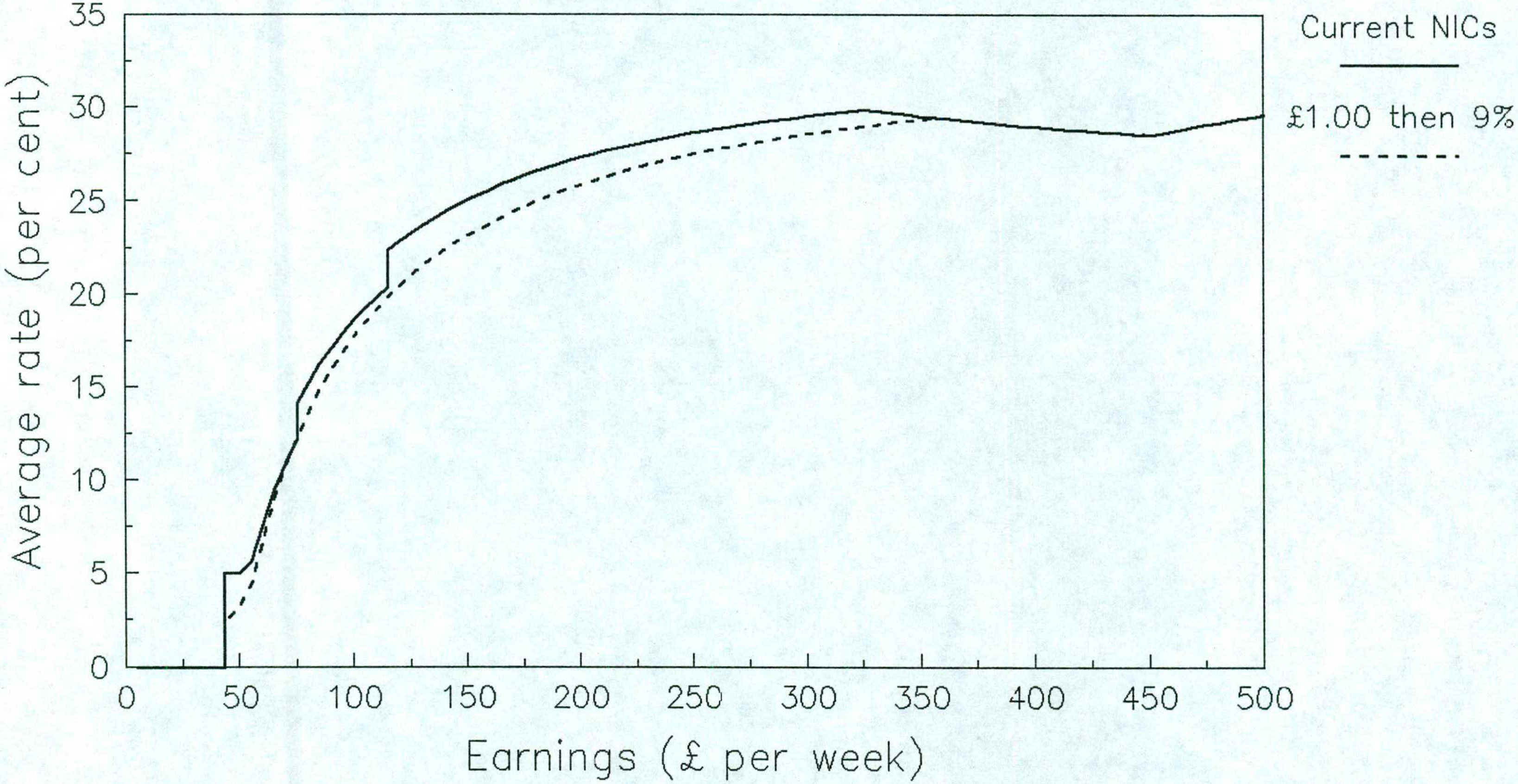

For those earning under £75 NICs unchanged
No allowance

5% of first £75 of earnings
Marginal rate of 9% between £75 and £358

CHART FOUR

# Average Income tax and NIC rates

## Single Person




Assumes statutory indexation of allowances
No other allowances or reliefs

Copy No 1 of 16

BUDGET SECRET

Thanks. All in all, I would rather leave employers alone, as originally envisaged. We shall, of course, need a good defensive line for the assumption [illegible] standing that [illegible]. I see much force in the difficulty [illegible]

Chancellor

cc CST
FST
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr McIntyre
Mr Gilhooly
Mr Matthews

FROM: N I MACPHERSON
DATE: 21 February 1989

MR CULPIN

cc: Mr Ford
Mr Macpherson
Mr Ford
Mrs Chaplin
Mr Tyrie
Mr Call

**EMPLOYER NIC OPTIONS**

You asked me to work up some employer NIC options, which could complement those being considered for employees. The ~~three~~ options set out below are broadly revenue neutral (though the costings are subject to an even wider margin of error than those of the employee options).

**Option 1: An allowance**

2. This involves turning the LEL into an allowance and charging a flat 12.6 per cent NIC rate (for illustration, see Mr Ford's Chart 1). It has the following properties:

(a) employers would have no steps at all. In contributory principle terms, this could be justified on the basis that it is employee NICs which score for benefit purposes;

(b) marginal rates would rise as follows:

| | | No. employees |
|---|---|---|
| £ 43 - 75 | + 7.6 per cent | 1.8m |
| £ 75 - 115 | + 5.6 per cent | 2.2m |
| £ 115 - 165 | + 3.6 per cent | 4.2m |
| £ 165+ | + 2.15 per cent | 11.5m |

We have argued in the past that it is the combined marginal rates which matter (the Riley doctrine). This option would result in a combined 11.6 per cent increase in marginal rates in the £43-75 band, if the Culpin option were adopted.

(c) Employers could lose in respect of employees in the following bands:

| | Max loss (£ per week) |
|---|---|
| £ 71.29 - 75 | 0.28 |
| £ 96.75 - 115 | 1.02 |
| £150.50 - 165 | 0.52 |

> £252 (for illustrative examples see Table 1)

Option 2: £2.15, 5 per cent and 12.6 per cent

3. This option parallels Mr McIntyre's Option 4. For illustration see Chart 2. It

(i) leaves the £2.15 step at the LEL in place;

(ii) keeps marginal rates unchanged in the £43 to £75 band. Otherwise it is the same as Option 1 above;

(iii) Employers would lose in respect of employees in the following bands:

| | Max loss (£ per week) |
|---|---|
| 101.79 - 115 | 0.74 |
| 158.33 - 165 | 0.23 |
| >265.11 | |

**Option 3: £1.50 entry fee, allowance of £43 and 11.7 per cent**

4. This option parallels the Culpin option. For illustration (see Chart 3). It:

(i) reduces the employer's step at £43 by 65p.

(ii) does not increase marginal rates as much as Option 1. Nevertheless, marginal rates would increase in respect of all employees paying NICs.

(iii) employers would lose in respect of employees in the following bands:

| | Max loss (£ per week) |
|---|---|
| £ 52.70 - 115 | 1.87 |
| £130.78 - 165 | 0.92 |
| > £282.48 | |

__Option 4: £3.50 entry fee, allowance of £43 and 10.45 per cent__

5. Another option paralleling Culpin (see Chart 4). It

(i) increases the employers' step at £43 by £1.35. However, the step would still be lower than under the pre-1985 regime.

(ii) does not result in an increase in marginal rates in respect of employees earning over £165. An option for Mr Lloyd Webber.

(iii) would result in losses in respect of all employees earning less than £165, with a maximum loss of £2.97 at £114.99. This would run counter to the 1985 reforms. Employers of everybody earning over £165 would gain 99 pence.

5. A compromise between Options 3 and 4 is shown in Chart 5. An entrance fee of £2 implies an 11.4 per cent marginal rate. Employers would continue to sustain losses in respect of most employees on low earnings. Again, this could be seen as a reversal of the 1985 reforms.

__Conclusion__

6 None of these options looks particularly promising. Part of the problem is that the cost of an employer's allowance is greater than that for employees (roughly £4.1 billion compared to £3.6 billion). This is because of 1 million optants who have to be included and also the higher rate on earnings above £165.

7 We could experiment with withdrawable allowances, though this would result in yet higher marginal rates for those affected. We could introduce a bigger step in Option 2 (say 7 per cent), but again this would run counter to the 1985

reforms, resulting in a bigger burden at the lower end. I am not optimistic.

Nick Macpherson

**N I MACPHERSON**

I wd rule out 1; & 4 ∵ it raises the step.

My first impression is that 5 wd be least disruptive: few problems @ the bottom.

Do you want to pursue any of these options, or variants, or wd you prefer to leave employers alone?

RC

24/2

table 1

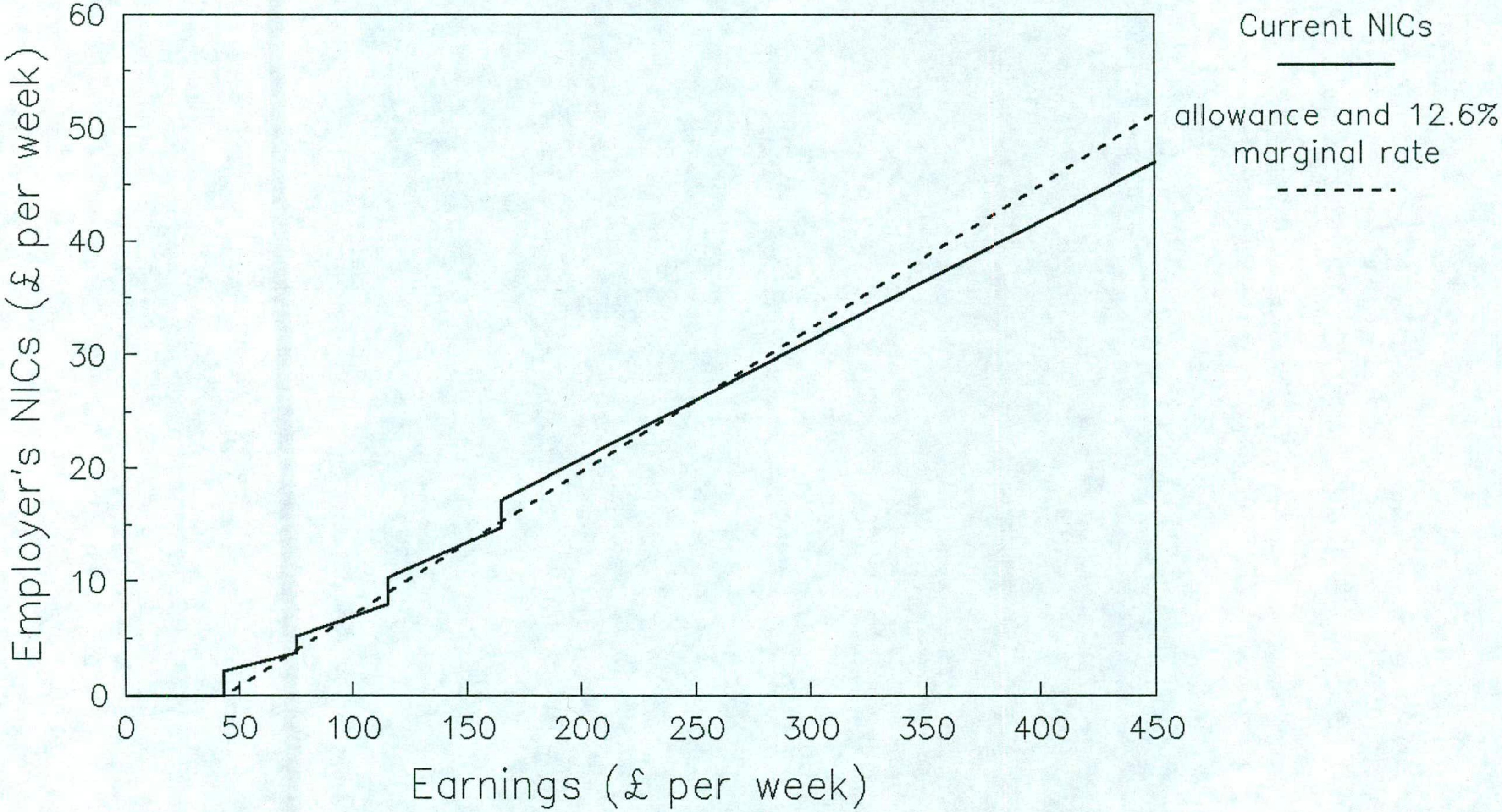
Change in NICs payable
(compared to current system)

(£ per week)

| earnings (£ per week) | Option 1 | Option 2 | Option 3 | Option 4 | Option 5 |
|---|---|---|---|---|---|
| 300 | 1.03 | 0.75 | 0.22 | -0.99 | -0.05 |
| 350 | 2.11 | 1.83 | 0.84 | -0.99 | 0.42 |
| 400 | 3.18 | 2.90 | 1.47 | -0.99 | 0.90 |

Chart 1

# Employer's NICs
# Allowance and single rate




12.6% rate on all earnings above £43

Chart 2

# Employer's NICs
# £2.15, 5 per cent and 12.6 per cent

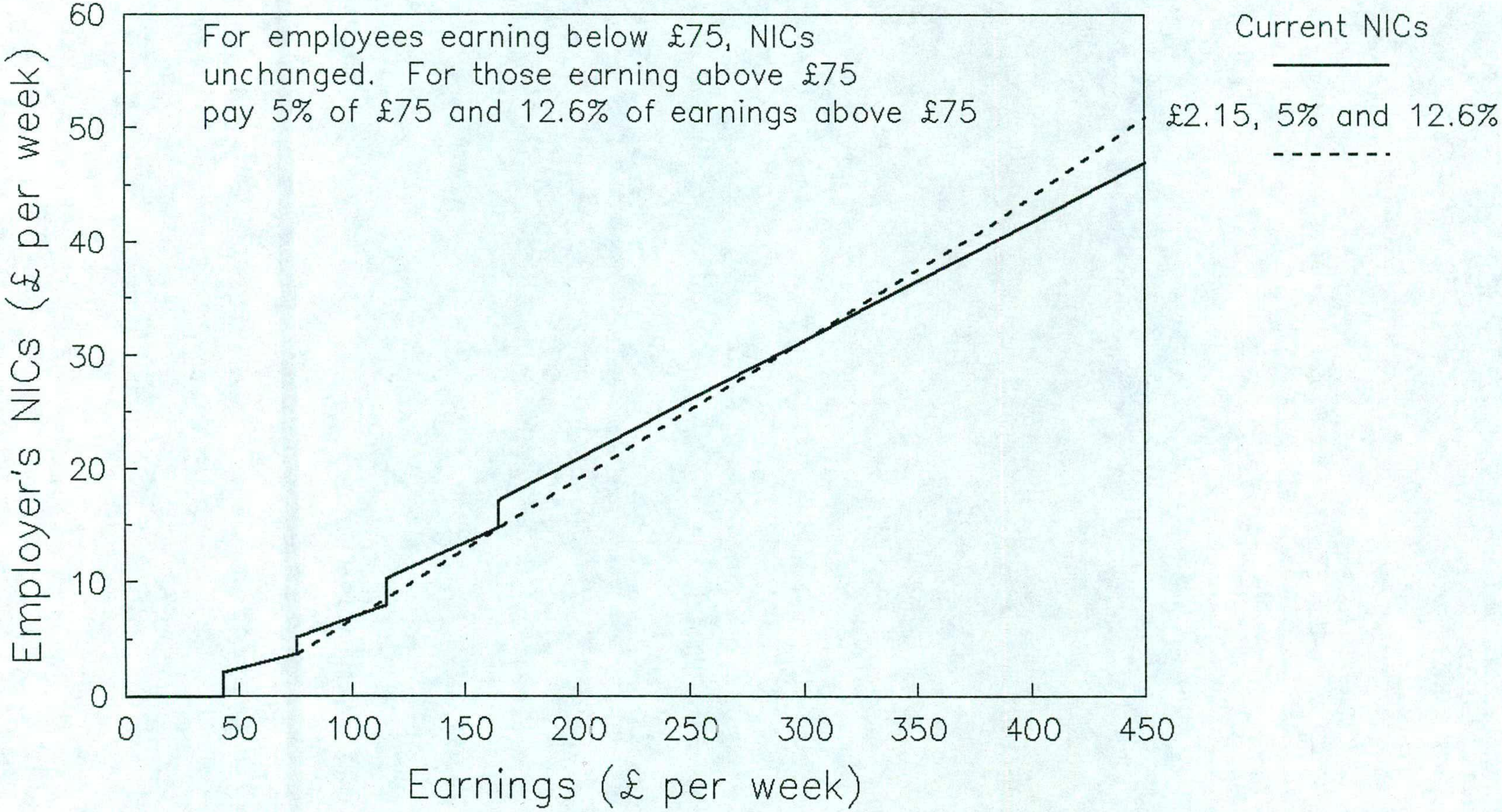


Chart 3

# Employer's NICs
# £1.50 and 11.7 per cent

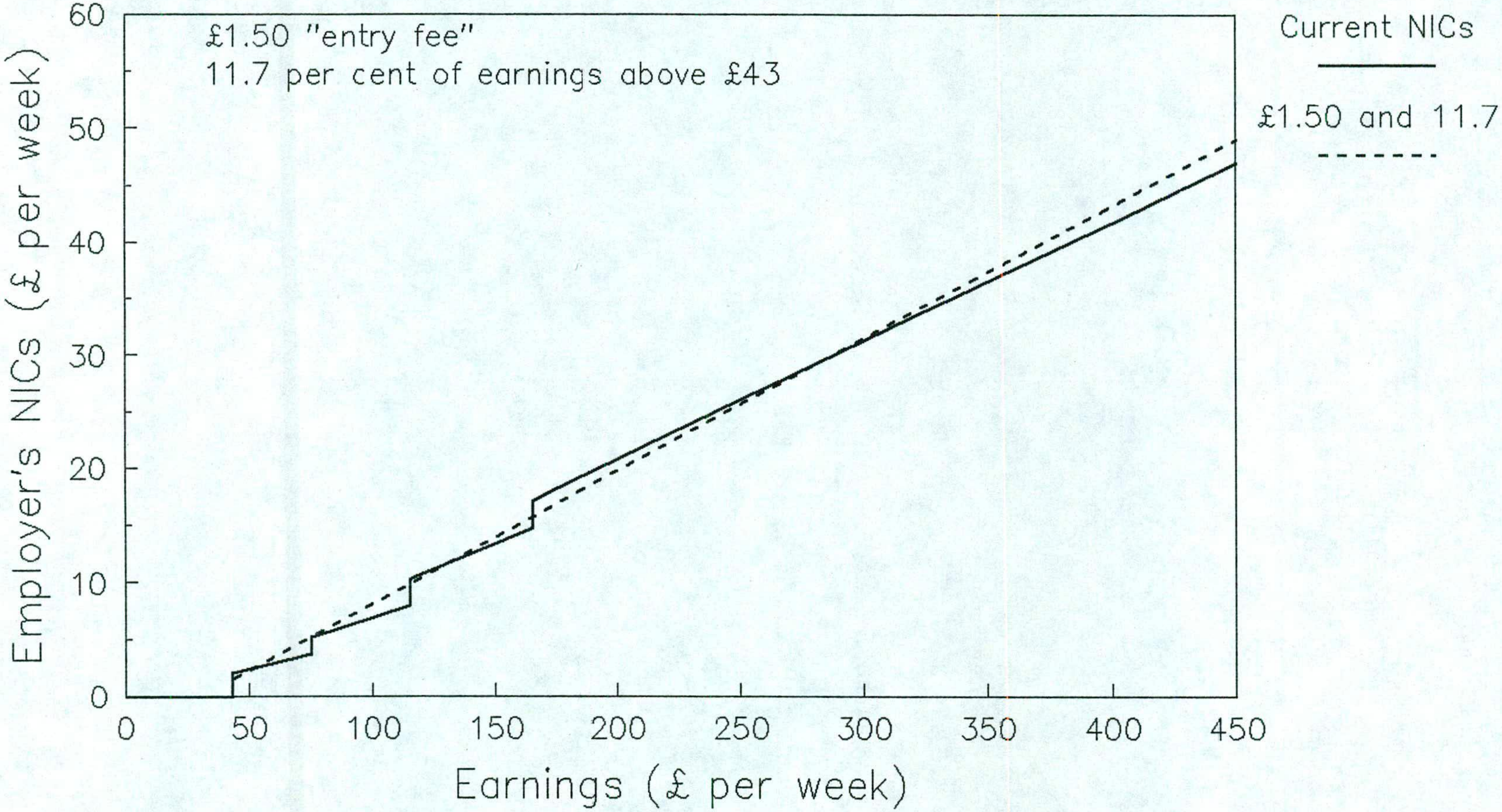


Chart 4

# Employer's NICs
## £3.50 and 10.45 per cent

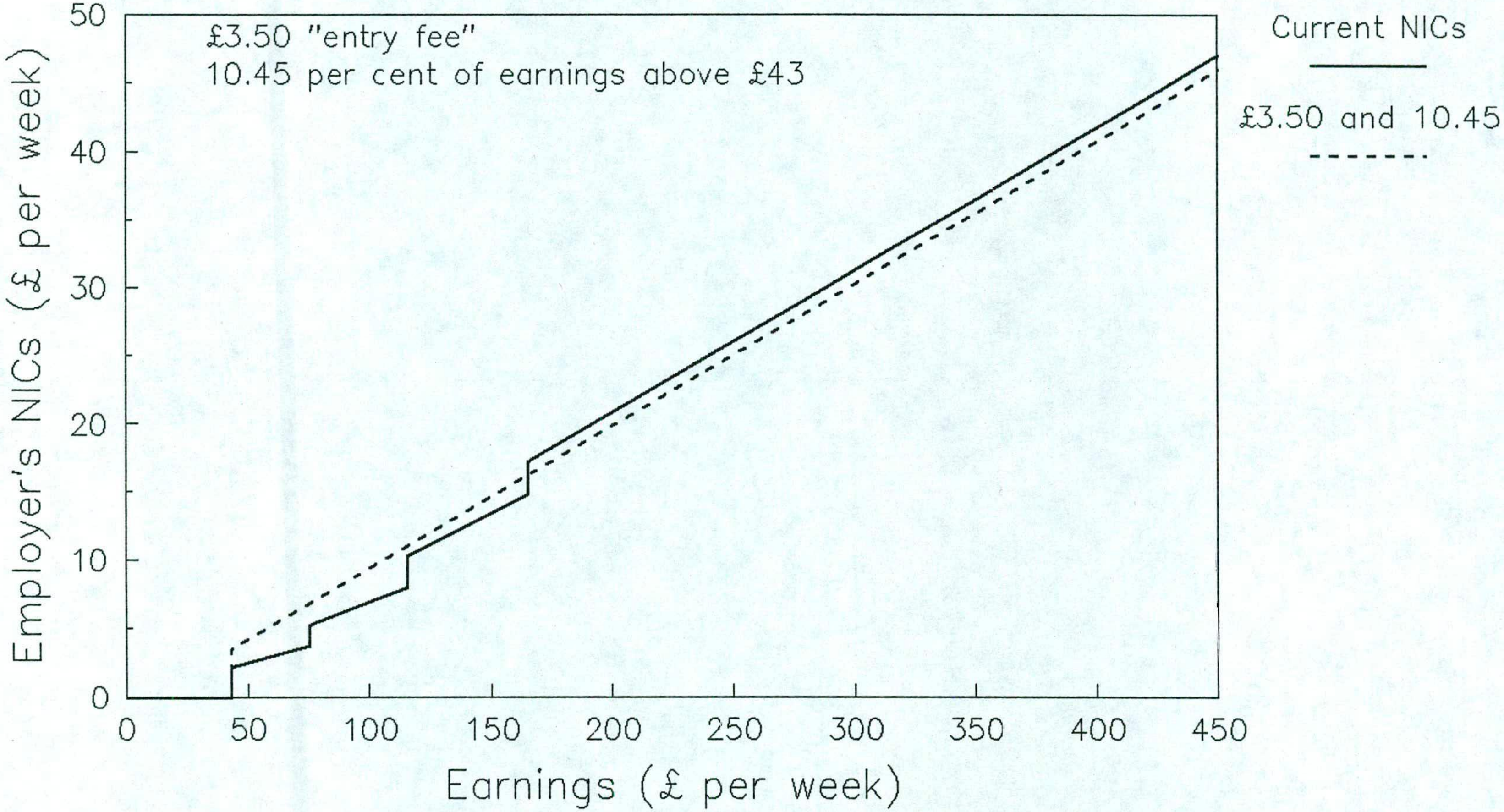
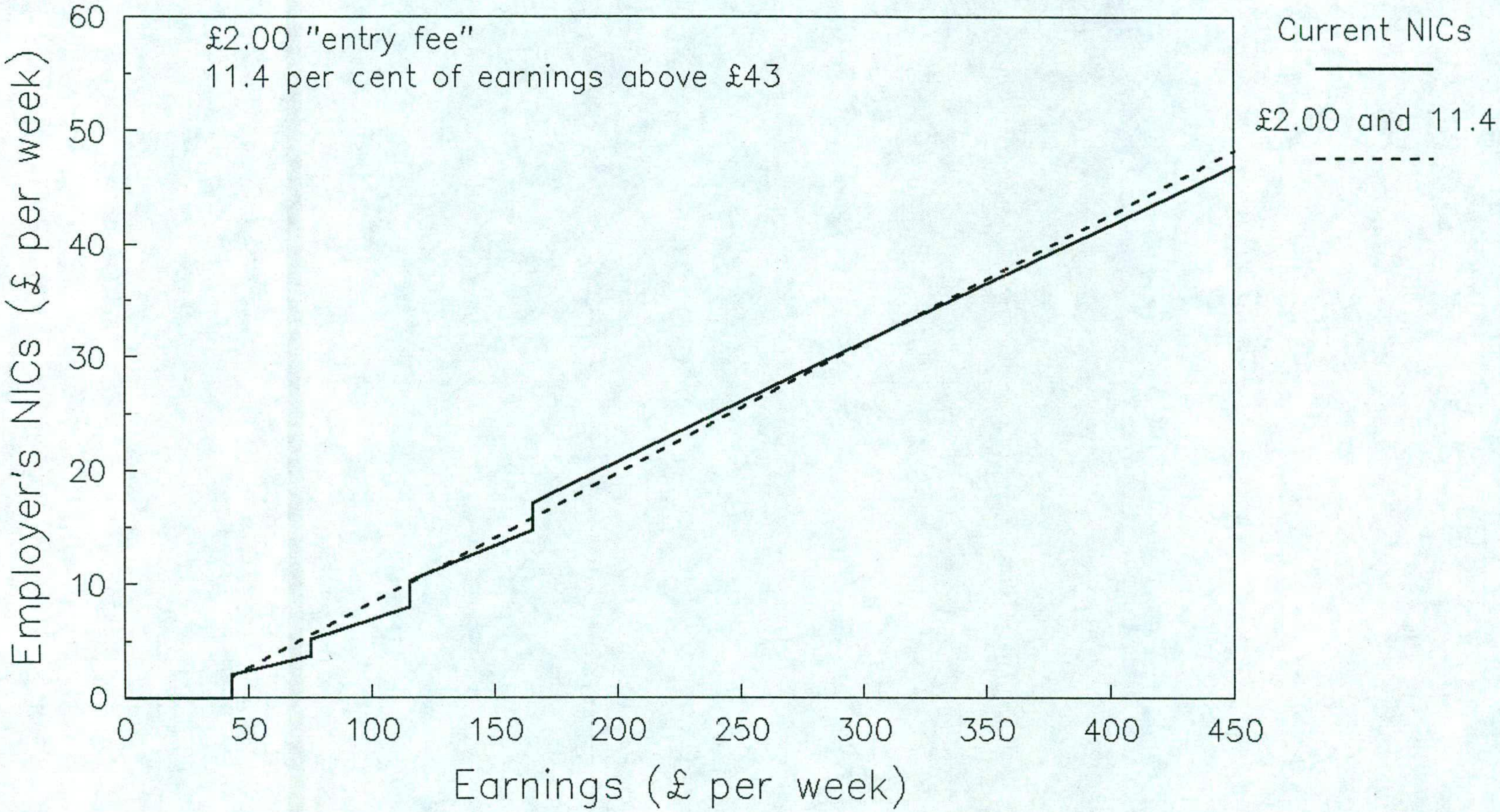


Chart 5

# Employer's NICs
## £2.00 and 11.4 per cent



FROM: A C S ALLAN
DATE: 21 February 1989

pw 16/33

**MR CULPIN**

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Riley
Mr Sedgwick
Mr A C S Allan
Mr Gilhooly
Mr McIntyre
Mr Matthews
Mr Macpherson
Miss Simpson
Miss Wallace
Mr Ford
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill IR
Mr Beighton IR
Mr Isaac IR
Mr Painter IR
Mr Mace IR

**NICs**

The Chancellor was grateful for your minute of 21 February. He is prepared to look further at options which reduce the LEL step, subject to the conditions you set out that (a) they do not cost more and (b) they do not raise the 9% marginal NIC rate. He feels it would be worth looking at entry fees of 2%, £1 and 2½%.

ACSA

A C S ALLAN

chex.rm/aa1/37 BUDGET CONFIDENTIAL

FROM: A C S ALLAN
DATE: 22 February 1989

PMG

MR MCINTYRE

cc Mr Culpin
Mr Macpherson
Mr Speedy

**NICS REFORM: DSS CONSULTATION**

The Chancellor was grateful for your minute of [22] February. He was content with the procedures you proposed.

ACSA

A C S ALLAN

BUDGET CONFIDENTIAL

FROM: J P MCINTYRE
DATE: ~~23~~ 22 February 1989 ?

CHANCELLOR

Ch
OK?
OK
AA

cc Mr Culpin
Mr Macpherson
Mr Speedy

**NICS REFORM: DSS CONSULTATION**

As agreed, I have explained Option 4 and its variants to the two nominated DSS officials. Their response was generally positive, though they have a clear preference for including employers (now, I understand, overtaken) and doing something for the £43-75 band.

2. On the handling, they saw no immediate need for any wider consultation within the Department, thought if you decided in principle that you wanted to increase the UEL as part of the package, they would need to bring in another of their colleagues to provide an authoritative view on the implications of a mid-year change for employers, DSS itself and also for occupational pension schemes, which would be affected by a change in the Guaranteed Minimum Pension. Once the shape of the measures has been agreed, they will also need to bring in one of their lawyers in order to provide instructions for Counsel.

3. At this stage, they would like only to be able to tell Counsel that he may have to do further work (unspecified) on the current Social Security Bill. At present, the draftsman concerned is under the impression that his work on the Bill has been completed, and DSS are concerned that he may get committed on other essential work when he will be needed to do the NICs clauses. Mrs Bowtell, the Deputy Secretary, would therefore, like to warn (orally) the draftsman concerned that he may have further work to do; coming from her, the warning could not be construed as having implications for any particular area of social security policy. I would be grateful if you could agree to this.

JM

J P MCINTYRE

BUDGET CONFIDENTIAL

pp

FROM: MARK CALL

DATE: 22nd February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mrs Chaplin
Mr Tyrie

**POST-PRAYERS DISCUSSION: 22 FEBRUARY**

**1. NICS**

In addition to Options 4 and 4a, the Chancellor had asked for Robert Culpin's option (£1 plus 9 per cent) to be worked up, with its "a" option. Option 4 was somewhat complex to explain and the Culpin option had the advantage that while the full gain was just under £3, this was offset by gains for the lowest paid who received no benefit from Option 4. On the other hand, the Culpin option did produce a very small band of losers, those between £72 and £75 losing a few pence. Some level of entry fee step was needed. If there was currently bunching below the LEL, this was probably more because of the hassle of entering the system than because of the high marginal rate.

**2. BUDGET SPEECH**

The Chancellor would be working on the Budget Speech over the coming weekend, and said he would welcome thoughts and possibly drafting suggestions from Ministers and Advisers. In the first instance he would be working on the section dealing with the measures, and later the economic section.

**3. MINISTERIAL ALLOCATION**

The Chancellor said he had reached a provisional view on the allocation of measures to Ministers, but would discuss this at a future meeting when all Ministers were present. The Chief Secretary would cover pensions reform, NICs reform, the earnings rule, age allowance, and private health insurance. The Economic Secretary would deal with COBO, unleaded petrol, VED, the European measures (eg VAT), and possibly confidentiality, car benefits, and stamp duty. The Financial Secretary would cover most of the remaining measures.

MC

MARK CALL

COPY NO. 16 OF 16.

FROM: A C S ALLAN
DATE: 22 February 1989

MR MACPHERSON

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Monck
Mr Scholar
Mr McIntyre
Mr Matthews
Mr Gilhooly
Mr Ford
Mrs Chaplin
Mr Tyrie
Mr Call

EMPLOYER NIC OPTIONS

The Chancellor was grateful to you for showing him Mr Macpherson's minute of 21 February. All in all, he would rather leave employers alone, as originally envisaged. He feels that we shall, of course, need a good defensive line for the asymmetric structure that emerges; but he sees much less difficulty in that than in defending the options illustrated in Mr Macpherson's note.

ACSA

A C S ALLAN

pf.dc.134 **BUDGET CONFIDENTIAL**

**FROM M C SCHOLAR**
**DATE 22 FEBRUARY 1989**

**CHANCELLOR OF THE EXCHEQUER**

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Anson
Sir Terence Burns
Dame Anne Mueller
Mr Culpin
Mr Gilhooly
Mr McIntyre
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace - IR
PS/IR

Many Thanks. This is a valid vote, & (revokes any further vote you may have cast. 2. I agree that there is much to be said for 2% on earnings below the LEL & 9% on earnings above the LEL, for all that clear the LEL. N

**NICs**

I earlier cast my vote against NIC changes. Now that things have moved on may I be allowed another vote?

2. An important part of the presentation of this will be that you have earlier removed the high marginal rates of income tax; this year you are removing them from NICs. Because, for public expenditure and other reasons you are going to stick with the contributory principle, you cannot remove all the very high marginal rates. But you are removing them as far as anyone could.

3. That seems to me a powerful argument for Robert Culpin's £1 stamp. Better still, go for a slightly lower stamp, which avoids there being any losers - a 2 per cent contribution at the LEL (ie around 86p)?

MCS

**M C SCHOLAR**

BUDGET SECRET

**Inland Revenue**

Personal Tax Division
Somerset House

FROM: B A MACE
DATE: 23 FEBRUARY 1989

FAX give to Ch.

CHANCELLOR OF THE EXCHEQUER

NICs REFORM

1. We agreed with Mr McIntyre in Treasury ST Division that we would respond to your request for information about the impact of the proposed NICs reform on cash losers from the (already announced) rise in the UEL for 1989-90 and from the proposed increase in car scales.

2. The figures in the attached tables are based on a NICs option with 2 per cent of earnings payable at the LEL (£43 per week in 1989-90) and with 9 per cent of earnings payable above the LEL up to a UEL of either £325 or £358. The results for the other options under consideration would be very similar.

---

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call
Mr McIntyre

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Calder
Mr Lewis
Mr Bush
Mr Mace
Mr Eason
Miss White
Mr Stewart
PS/IR

3. At this stage the figures should be regarded as broad-brush estimates only. They compare <u>post October 1989</u> tax and NIC liabilities with the corresponding position in 1988-89.

4. If you wished to take advantage of the NIC option to raise car benefit scales further, a very quick look suggests that a 35 per cent increase would leave around 350,000 losers* after taking account of tax and NIC changes between 1988-89 and 1989-90. (This estimate is based on the <u>average</u> gain to employees from the 1 October change to NICs (ie £1.50 per week).)

B A Mace

B A MACE

---

*ie broadly as for the previous package.

## NIC changes

| 1989-90 tax and NIC regime | Number of Cash losers 1989-90 compared with 1988-89 (millions) |
|---|---|
| i. Autumn Statement NIC changes only | $2^3/4$ |
| ii. Autumn Statement NIC changes plus indexation of tax thresholds in 1989-90 | $1^1/2 - 1^3/4$ |
| iii. New NIC option only UEL at £358 | $2^1/4$ |
| iv. New NIC option only UEL at £325 | nil |
| v. New NIC option UEL at £358 plus indexation of tax thresholds in 1989-90 | 1/2 |
| vi. New NIC option UEL at £325 plus indexation of tax thresholds in 1989-90 | nil |

## Car benefits

### Tax and NIC: analysis of losers

| Option | No of losers | Average loss £/year | No losing* over £50/year | No brought over P11D threshold |
|---|---|---|---|---|
| a. Indexation of Tax Thresholds in 1989-90<br>Autumn Statement NIC regime<br>20% on car scales | 370,000 | 49 | 160,000 | 10,000 |
| b. As a. plus<br>New NIC option UEL at £358 | 130,000 | 50 | 60,000 | 10,000 |
| c. As a. plus<br>New NIC option UEL at £325 | under 5000 | 45 | neg | 10,000 |

*excluding cases brought above P11D threshold by change in scales.

Analysis based on comparison of post October 1989 income tax and NIC liability on:

a. 1988-89 car scales, income tax rates and allowances and NIC regime.

b. Three options listed.

FROM: A C S ALLAN
DATE: 23 February 1989

MR SCHOLAR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Culpin
Mr Gilhooly
Mr McIntyre
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace - IR
PS/IR

**NICs**

The Chancellor was most grateful for your minute of 22 February. He accepts it as a valid vote, and one which revokes any earlier vote you may have cast.

2. He agrees with you that there is much to be said for 2 per cent on earnings below the LEL and 9 per cent on earnings above the LEL, for all those above the LEL.

ACSA

A C S ALLAN

FROM: A C S ALLAN
DATE: 23 February 1989

pmp

MR SCHOLAR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Culpin
Mr Gilhooly
Mr McIntyre
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace - IR
PS/IR

**NICs**

The Chancellor was most grateful for your minute of 22 February. He accepts it as a valid vote, and one which revokes any earlier vote you may have cast.

2. He agrees with you that there is much to be said for 2 per cent on earnings below the LEL and 9 per cent on earnings above the LEL, for all those above the LEL.

ACSA

A C S ALLAN

rc 1989/23.2.02

BUDGET CONFIDENTIAL

FROM: ROBERT CULPIN
DATE: 23 February 1989

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Scholar
Mr Riley
Mr Gilhooly
Mr Matthews
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

Sir Anthony Battishill )
Mr Painter ) IR
Mr Lewis )
Mr Mace )

AA / Let's speak w.

[illegible]

**NICS AND CARS**

If you decide to increase the UEL, as originally proposed, the point I am about to raise does not arise.

2. If, on the other hand, you reduce NICs but keep the UEL unchanged, most people will be about £3 a week better off, in the second half of 1989-90, than we thought they would be when you decided to raise the car scales by 20 per cent. This means that they will be about £1.50 a week better off on average over the year. There is therefore a case for considering a bigger increase in car scales.

3. It is not overwhelming. The changes in allowances and car scales will probably come through in May, backdated to April. The change in NICs will not come through until the autumn.

4. Nonetheless, your broad objective has been to raise the car scales as far as reasonably possible without creating unreasonable cash losses; and the fact is that, if you reduce NICs but keep the UEL unchanged, you could afford, if you wish, to raise the car scales a bit further.

5. I do not want to make too much of this, but it seems right to review the earlier decision explicitly, rather than letting it go by default. I have spoken to Mr Mace, and he will be ready to let you have figures <u>if</u> you decide to let the NIC reforms benefit people above the UEL and <u>if</u>, in these changed circumstances, you would like to have another look at options for the car scales.

RC

ROBERT CULPIN

fp.pk/rc 1989/24.2.02

BUDGET SECRET

pw

COPY NO 2 OF 5

FROM: ROBERT CULPIN
DATE: 24 February 1989

MR MCINTYRE

cc: (without attachment)
Mr A C S Allan
Mr Macpherson

**NICS**

I attach the National Insurance paragraphs of a BLO note I have sent the Chancellor today.

2. The entry for National Insurance in the table of Budget Measures shows a cost of £985 million in 1989-90 and £2785 million in 1990-91.

RC

ROBERT CULPIN

BUDGET SECRET

FROM: J S HIBBERD
DATE: 24 FEBRUARY 1989

Thanks

pp

CHANCELLOR

cc Sir P Middleton
Sir T Burns
Mr Wicks
Mr Scholar
Mr Riley
Mr Culpin
Mr Sedgwick
Mr Gieve
Mr Mowl
Mr O'Donnell
Mr Pickford

Ch
QIV forecast (5½%) seems OK. But monthly profile uncomfortable: 7½-8% until August then MIPs turn. (also 6½%, ULC growth)
AA

yes

[illegible] quite a squeeze on profit margins of companies.

**THE OUTLOOK FOR INFLATION IN THE IAF**

We have been reviewing the inflation forecast to 1990Q2 in the light of recent data. Our latest projections are included in the revised draft of Chapter 3 of the FSBR circulated by Peter Sedgwick today. This note provides a bit more detail, including a monthly profile for the RPI to mid-1990.

**PRODUCER PRICES AND MARGINS**

2. There was a sharp rise in manufacturers' producer output prices (excluding food, drink and tobacco) in January. The index rose to 117.5 (a 5.4 per cent increase on a year earlier) which is where we had thought the 1989Q1 average figure would be. Although we should not read too much into one month's figure, the January outturn is worrying, particularly when taken with the sharp increase in producer input price inflation (6.9 per cent) shown by DTI figures. It looks as though margins are not yet being cut as much or as quickly as we had judged.

3. The likelihood is that output inflation will average 5.4 per cent for the first quarter of this year. With some slight fall in margins through the year from then on, output price inflation would carry on at about 5½ per cent. The rate should decline to 5 per cent, possibly lower if margins continued to be squeezed in the first half of 1990.

## RETAIL PRICE INFLATION

### A health warning

4. The January RPI inflation figure was considerably higher than we were expecting, 7.5 per cent rather than 7.1 per cent. Around 0.2 points of this difference was due to a revised DOE figure for mix-adjusted house prices. Between them, DEmp and DOE are trying to improve this feature of the RPI. But it may take some while. In the meantime, we cannot rule out further uncomfortable revisions to this house price series in the future. By their nature such revisions are unpredictable.

### The outlook

**Table A: RPI and Components** per cent changes on a year earlier

| | 1989 | | | | 1990 | |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 |
| Weight | | | | | | |
| (75 ) NI | 7.3 | 6.8 | 6.0 | 5.9 | 5.6 | 4.8 |
| (163 ) Food | 4.3 | 4.4 | 4.2 | 4.2 | 4.3 | 3.9 |
| (36 ) Petrol | 3.2 | 3.8 | 3.5 | 5.3 | 3.4 | 3.5 |
| (152 ) Housing | 21.3 | 21.5 | 16.6 | 10.1 | 6.5 | 3.9 |
| (569 ) Other | 5.3 | 5.2 | 4.8 | 4.5 | 4.7 | 4.6 |
| (1000) Total | **7.7** | **7.6** | **6.6** | **5.5** | **5.0** | **4.4** |

5. Table A shows a quarterly profile to 1990Q2 for RPI inflation. Key features are:

- **Nationalised industry prices** are likely to rise more slowly (by about ½ per cent) than the all-items RPI in the year to 1989Q4, but by rather more than the RPI in the year to 1990Q2. But the outlook for the separate industries is still being reviewed and may be revised in the next few days.

- Other retail price inflation rises in 1989Q1, but abates from 1989Q2 reflecting the non-revalorisation of specific duties in the Budget. Moreover there is an assumed squeeze on margins in the second half of 1989, reflecting the slow-down in consumer demand. The 1989 budget effects drop out of the calculation in 1990Q2, to be replaced by conventional assumptions of indexation of specific duties.

- Petrol prices have risen recently and the February index is likely to rise.

- The most significant movements are in the housing component. This is dealt with in more detail below.

<u>Housing</u>

**Table B:** **HOUSING COMPONENT OF THE RPI**

| | percentage change on a year earlier | | | | | |
|---|---|---|---|---|---|---|
| | 1989 Q1 | Q2 | Q3 | Q4 | 1990 Q1 | Q2 |
| **Housing:(153)** | **21.3** | **21.5** | **16.6** | **10.1** | **6.5** | **3.9** |
| (33) rent | 8.5 | 9.3 | 9.5 | 9.2 | 9.3 | 8.5 |
| (43) rates | 8.4 | 8.4 | 8.4 | 8.4 | 8.4 | 8.0 |
| (42) MIPs | 54.8 | 57.9 | 37.4 | 14.3 | 2.5 | -4.1 |
| (35) Other | 10.9 | 9.2 | 8.1 | 7.5 | 7.5 | 6.9 |

6. Table B shows the four separate series underlying the housing component. For **domestic rates** we are assuming an increase of 8.4 per cent from April 1989. We assume no increase, in real terms, in local authority revenue in 1990/91 from Community Charge per head, compared with domestic rates a year earlier. The 'index household effect' raises the total RPI by just under ¼ per cent from April 1990. The assumption for **LA rents** is an increase of around 8½ per cent, with the RPI rent index increasing a little faster.

The MIPs profile is dominated by mortgage interest rates. The forecast currently assumes a 1 point cut in base rates in July with a 1 point cut in mortgage rates in August. There is a further 1 point fall in base rates in January 1990, with a ¾ point reduction in mortgage rates in February.

8. Another influence in the MIPs forecast is the **average value of outstanding mortgages**. This is, in effect, a lagged function of earlier house prices. Even given our forecast of virtually flat house prices, the average value of outstanding mortgages (as it feeds into the RPI), would still rise by around 1.3 per cent a month in early 1989, falling to about 1 per cent a month by the second quarter of 1990.

9. The rate of increase of **other housing costs** (water charges, repair and maintenance charges, DIY materials, dwellings insurance etc) slows through the year.

**The FSBR forecast**

10. We will, as usual, publish the inflation forecast for 1989Q4 and 1990Q2 in the FSBR in the form of Table C below. On the basis of the current forecast, and it could change in the next few days, the figures for all-items inflation are likely to round to 5½ per cent and 4½ per cent respectively.

**Table C : Retail Prices Index**

| | Weight in 1988 | Percentage changes on previous year 1988Q4 | Forecasts 1989Q4 | 1990Q2 |
|---|---|---|---|---|
| Food | 16¼ | 4 | 4¼ | 4 |
| Nationalised industries | 5½ | 7 | 6 | 5 |
| Housing | 15¼ | 16¾ | 9¼ | 4 |
| Other | 63 | 4¾ | 4½ | 4½ |
| **Total** | **100** | 6½ | 5½ | 4½ |

The monthly profile for the RPI

11. Table D shows the monthly profile for the all-items RPI inflation rate and for the RPI excluding MIPs consistent with the quarterly projections. The annual inflation rate for both series falls in April 1989 reflecting Budget measures. The all items inflation rate falls further in August as mortgage interest rates are assumed to be reduced, and again in February 1990 for the same reason. The all-items inflation rate also abates steadily in the second half of 1989 as the interest rate increases in the second half of 1988 drop out of the calculation.

12. September is the key month for social security benefit upratings. The all-items inflation rate is likely to be **6.3 per cent** in September while the figure excluding housing (the ROSSI index) is likely to be **4.6 per cent.**

**THE GDP DEFLATOR**

13. The **market price GDP deflator inflation rate** has risen from 5.3 per cent in 1987Q3 to 6.2 per cent in 1988Q3. The figure for 1988Q4 could turn out at about the same rate. Our judgements on RPI and producer output price inflation for the future feed through onto GDP deflator inflation. The extension of the VAT base increases the GDP deflator inflation rate slightly in 1989-90, by 0.1 per cent and even less in 1990/91 (because the extension of the VAT base does not occur at the beginning of 1989-90). The GDP deflator is expected to rise by **6.6 per cent** in 1988-89 and by **5.4 per cent** in 1989-90.

not 5

**EARNINGS**

14. We are still reviewing the earnings outlook. Most recent data confirms the judgement for 1988-89 in the January internal forecast of 7¼ per cent for private sector settlements plus 2 per cent drift. The January forecast for public sector settlements, however, looks on the high side given latest figures from Review bodies. We have made an approximate downward adjustment on public sector earnings, but this needs reviewing further. We also still need to consider whether the NIC package would lead to any moderation of earnings growth. Any effect on RPI inflation in 1990Q2 would be minimal.

## TABLE D: RPI Inflation: Forecast Monthly Path

Percentage increase on previous year

| | | All Items | | | All Items excl. MIPs | | |
|---|---|---|---|---|---|---|---|
| 1988 | Oct | 6.4 | | | 5.1 | | |
| | Nov | 6.4 | | | 5.1 | | |
| | Dec | 6.8 | | | 5.1 | | |
| 1989 | Jan | 7.5 | | | 5.5 | | |
| | Feb | 7.9 | 7·8 | | 5.7 | 5·6 | |
| | Mar | 7.9 | | | 5.7 | | |
| | Apr | 7.6 | | | 5.7 | | |
| | May | 7.7 | 7·7 | | 5.5 | 5·6 | |
| | June | 7.8 | | 6·9 | 5.5 | | 5·4 |
| | July | 7.6 | | | 5.2 | | |
| | Aug | 6.2 | 6·7 | | 5.2 | 5·2 | |
| | Sep | 6.3 | | | 5.2 | | |
| | Oct | 5.6 | | | 5.1 | | |
| | Nov | 5.6 | 5·6 | | 5.1 | 5·1 | |
| | Dec | 5.6 | | | 5.1 | | |
| 1990 | Jan | 5.4 | | | 5.1 | | |
| | Feb | 4.9 | 5·0 | | 5.2 | 5·1 | |
| | Mar | 4.6 | | | 5.0 | | |
| | Apr | 4.5 | | | 5.0 | | |
| | May | 4.6 | 4·4 | | 4.9 | 4·9 | |
| | June | 4.0 | | | 4.7 | | |

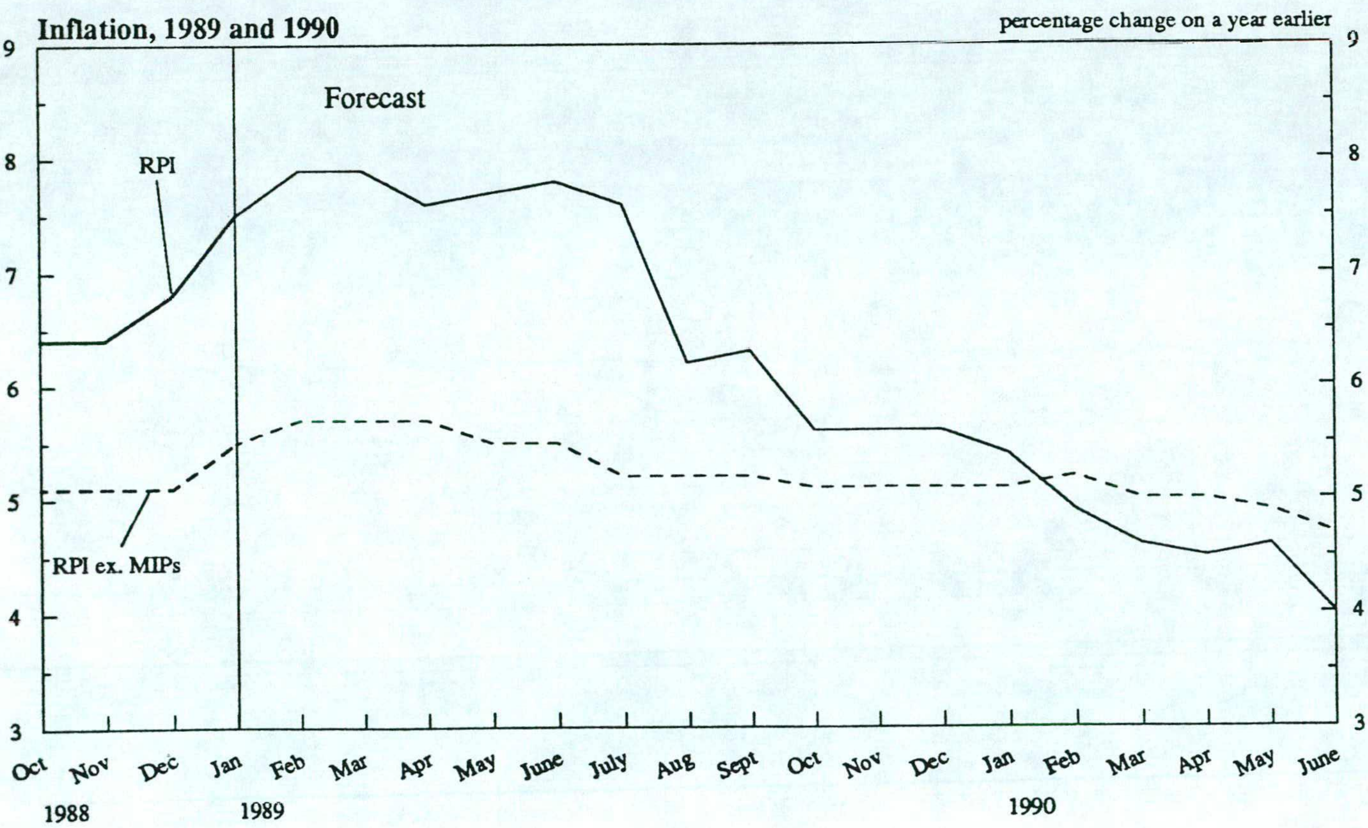


**Table E : Earnings growth**
(year to Q3)

| | Private | Public | Whole economy |
|---|---|---|---|
| 1989 | 9.0 | 8.4 | 8.8 |
| 1990 | 7.5 | 7.5 | 7.5 |

**UNIT LABOUR COSTS**

15. You suggested that we should reconsider the forecast for **unit labour costs** in 1989, because in current circumstances employers would be more likely to shake out labour than allow unit labour costs to rise by as much as we had predicted. We have looked at this again, but the forecast already had less employment than past relationships would suggest. We have increased the shake out a little further, but do not consider that an even larger shake out would be a central view. Unit labour costs are now forecast to rise by 6½ per cent in 1989.

Jim Hibberd

J S HIBBERD

JM 24/2

FROM: C SPEEDY
DATE: 24 February 1989

1. MR MCINTYRE
2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace IR
PS/IR

Thanks. 1 would not favour altering the NHS allocation, which would be more than offset by the drop in the fund in the short-term. But the rate of [illegible] from the [illegible] excessive [illegible] some time. After [illegible] the number, the problem of the balance in the NIF will be solved. 2. Inevitably, [illegible] not the [illegible] @ X:

**BUDGET CHANGES AND THE NATIONAL INSURANCE FUND**

The possible changes to national insurance contributions and the abolition of the pension earnings rule both reduce the balance in the national insurance fund. The attached crude projection assumes national insurance contributions are set at 2% of the lower earnings limit and 9% of earnings between the lower and upper earnings limit. The UEL is assumed to remain unchanged at £325 and the change takes place in October 1989. The pension earnings rule is assumed to be abolished from October 1989 but the option to defer payment of pension is retained. (Up to 1991-92 the figures are as forecast by GAD; thereafter they are based on assumptions discussed with GAD.)

2. The projection suggests that the balance of the fund as a percentage of outgoings will drop over the next few years as a consequence of the changes. The projection suggests a minimum balance as a percentage of outgoings of 19% in 1993-94. Thereafter the balance in the fund would rise if earnings rise faster than prices because contributions are linked to earnings and outgoings to prices.

The two regimes should be described as 2% on earnings below the LEL & 9% on earnings above it.

3. On the basis of these figures there is unlikely to be any problem over the next couple of years. The possible lowest balance of 19% of outgoings (in 1993-94) is just above the 17½% minimum balance recommended by the Government Actuary. The projection is however, subject to a wide margin of error (a significant cause of uncertainty is the extent to which the number of personal pensions rise) and it is possible that the balance in the fund either be somewhat higher than projected here or could drop below the recommended minimum balance.

4. The 17½% minimum balance was a recommendation made by GAD (and published) in 1983. But there is no legal bar on the balance falling below 17½%. It is a prudential consideration.

5. If in the event the balance in the fund looked like falling below the recommended minimum much would depend on how far below. One option if the fall in the balance was only slightly below the recommended minimum and this was expected to be temporary would be to do nothing and run the fund with a slightly smaller surplus than recommended. Otherwise perhaps the best option would be to restore the balance in the fund by cutting the NHS allocation. In recent years this has been increased in an effort to reduce the balance in the fund. But the legislation allows it to fall by 0.1% a year. Such a change would increase fund income by some 1% of outgoings. The NHS allocation could be cut in more than one year if necessary.

6. It therefore seems likely that the effect of the proposed changes on the national insurance fund can be absorbed without the balance in the fund going below the GAD minimum. If in the event sometime in the 1990s the fund did seem set to fall below the minimum balance adjustments in the NHS allocation offer substantial scope for dealing with the problem.

C Speedy

**C SPEEDY**

st1.speedy2

**PROJECTED NATIONAL INSURANCE FUND SURPLUS (GB) £m**

| Year | Opening balance | Base surplus projected(1) | Effect of changes(2) | Outgo(1) | End year balance | Balance as per cent of outgo |
|---|---|---|---|---|---|---|
| 1988-89 | 7,288 | 2,658 | - | 27,636 | 9,946 | 36 |
| 1989-90 | 9,946 | 1,118 | -1,091 | 29,562 | 9,973 | 34 |
| 1990-91 | 9,973 | 1,328 | -2,990 | 32,069 | 8,311 | 26 |
| 1991-92 | 8,311 | 2,201 | -3,140 | 33,920 | 7,372 | 22 |
| 1992-93 | 7,372 | 2,879 | -3,296 | 35,616 | 6,955 | 21 |
| 1993-94 | 6,955 | 3,591 | -3,461 | 37,397 | 7,085 | 19 |
| 1994-95 | 7,085 | 4,339 | -3,634 | 39,267 | 7790 | 20 |

(1) Until 1991-92 GAD forecast thereafter crude projection on assumptions discussed with GAD, main assumption is that earnings rise 2% per year faster than prices.

(2) NICs change to 2% 'stamp' at LEL, 9% on earnings above LEL, no change in UEL, plus abolition of pensions earnings rule. 1X

est.ld/james/24 Feb/PS CHX

BUDGET CONFIDENTIAL

ECONOMIC SECRETARY TO THE TREASURY

FROM: S M A JAMES
DATE: 24 February 1989

PS/CHANCELLOR

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Riley
Mr Gilhooly
Mr Matthews
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Painter - IR
Mr Lewis - IR
Mr Mace - IR

**NICS AND CARS**

The Economic Secretary has seen Mr Culpin's note of 23 February. He agrees that we should consider higher car scales if we do not raise UEL.

(I've already minuted out separately your views on this
AT)

S M A JAMES
PRIVATE SECRETARY

BUDGET SECRET

**Inland Revenue**

Personal Tax Division
Somerset House

FROM: B A MACE
DATE: 24 FEBRUARY 1989

Copy No. 1 of 35.

CHANCELLOR OF THE EXCHEQUER

Thanks. (See note on paper above).

NICs REFORM

1. At the Overview Meeting on 20 February you asked us to look at the costing of the NICs reform options using our personal income tax model.

2. The costings from our model are generally consistent with the figures which Mr McIntyre gave you earlier (and which have, of course, since been broadly confirmed by GAD). Our model gives a full year cost of about £2 .1 billion for the effect <u>on employees</u> of the Option 4 changes with the UEL increased to £358 per week. This figure is at 1989-90 income levels. It is a little lower than the corresponding figure produced by GAD. (This is probably because the personal tax model is based on annual tax returns and not weekly information, which is more accurate for assessing NIC liability.)

---

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Mr Hardcastle
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gilhooly
Mr McIntyre
Mr Mowl
Mr Macpherson
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Calder
Mr Lewis
Mr Bush
Mr Mace
Mr Eason
Miss White
Mr Stewart
PS/IR

3. You also asked if we would investigate the comparative distributional effects of the NIC reform and an equal cost increase in allowances.

4. Because the first year cost of the NICs reform is so different from the full year cost we compared the Option 4 NIC reform with two alternative allowance increases:

Option A: a 16.4 per cent increase in personal allowances (including age allowances) on 1988-89 levels. This has the same full year cost on top of indexation as Option 4.

Option B: a 12.4 per cent increase in personal allowances (including age allowances) on 1988-89 levels. This has the same first year cost on top of indexation as Option 4 (about £1 billion).

In both cases we assumed only bare indexation of the basic rate limit. In practice the conclusions which emerged from the two comparisons were very similar. So we concentrate in what follows on Option A.

5. Option A gives an increase in the basic married allowance of £400 and an increase in the single person's allowance of £250 (on top of indexation). These increases are worth £1.92 and £1.20 per week respectively to basic rate taxpayers. This compares with the £3 per week which most employees with earnings between £75 per week and £325 per week gain in a full year from the NIC Option 4.

6. Table 1 attached shows how the gains from the two alternatives are distributed at different levels for employees.

7. Of the £2.1 billion full year cost of the allowance increases about £1.7 billion goes to employees. A further £160 million goes to the self-employed and about £250 million to the elderly. Neither of these two groups benefit from NIC Option 4 (as it stands). Table 1 shows that some $2^{1}/_{2}$ million

employees with earnings under £75 per week, who do not benefit from NIC Option 4 gain about £170 million in aggregate from the Option A allowance increase. Also, employees earning from £75 up to £115 per week (the present 7 per cent NIC range) do better from the allowance increase than from the NIC option. Above this level employees do better from the NIC option, except for those with earnings above the new UEL of £358 who gain more from the allowance increase.

8. With NIC Option 4B the aggregate gains to those with earnings between the LEL and £75 per week are about £100 million in a full year (on our figuring). So this group is still better off with the allowance increase. Also, if the UEL is kept at £325 per week those with earnings above this level do better in aggregate with Option 4 or 4B than with the allowance increase. (Married men liable at the higher rate broadly break even.)

Specimen Income Tables

9. I attach two sets of the Specimen Income Tables including NICs from our traditional Budget Day Press Release. These tables are based on the Option 4B variant (with a 2 per cent charge at the LEL and 9 per cent on earnings above this level up to the UEL). The tables show the combined impact of the proposed NIC and income tax changes comparing the post October 1989 regimes with 1988-89. Set A shows the effects with the UEL at £358 per week; Set B keeps the UEL at £325. A similar set of tables for Option 4 was included in the pack of Revenue press releases submitted by Mr Denton yesterday.

Interaction with car scales

10. By way of clarification I should say that the figures in paragraph 4 of my note of 23 February were on the basis of the UEL remaining at £325 per week.

BA Mace

B A MACE

TABLE A

Equal full year cost comparison of
NIC Option and allowance increase

1989-90

| | | Option 4 | 16.4% on allowances |
|---|---|---|---|
| Range of earnings (£ p.a.) lower limit | No. employees in range (000s) | Gain £million ø | Gain £million ø |
| 2,236 (£43pw) | 2,728* | 0 | 170 |
| 3,900 (£75pw) | 1,432 | 94 | 92 |
| 5,000 | 1,367 | 65 | 96 |
| 6,000 | 1,562 | 241 | 111 |
| 7,000 | 1,516 | 234 | 114 |
| 8,000 | 1,396 | 215 | 111 |
| 9,000 | 962 | 148 | 84 |
| 10,000 | 1,270 | 196 | 113 |
| 11,000 | 1,230 | 190 | 110 |
| 12,000 | 1,122 | 173 | 101 |
| 13,000 | 1,010 | 155 | 94 |
| 14,000 | 1,522 | 235 | 142 |
| 16,000 | 1,003 | 108 | 94 |
| 18,616 (£358pw) | 2,279** | 55 | 278 |
| Total | 20,400 | 2,100 | 1,714 |

ø Full year gains on top of indexation.

* Not gainers from NIC option but about 2.4 million gain from increased tax allowances.

** Of these about 1.5 million or so contracted out employees above the UEL gain (see paragraph 8 of Mr McIntyre's submission of 23 February).

SETA UEL Z358

Budget - SECRET

# TABLE 6

## SINGLE AND MARRIED COUPLES - INCOME ALL EARNED - WEEKLY FIGURES INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS

| | Charge for 1988-89 | | | Proposed charge for 1989-90 | | | Reduction in tax and NIC after proposed change | |
|---|---|---|---|---|---|---|---|---|
| Income | Income tax | NIC[1] | Net income after tax and NIC | Income tax | NIC[1] post October 1989 | Net income after tax and NIC | Income tax and NIC | As percentage of total income |
| £ | £ | £ | £ | £ | £ | £ | £ | per cent |
| SINGLE PERSONS | | | | | | | | |
| 50.00 | 0.00 | 2.50 | 47.50 | 0.00 | 1.49 | 48.51 | 1.01 | *2.0* |
| 60.00 | 2.48 | 3.00 | 54.52 | 1.61 | 2.39 | 56.00 | 1.48 | *2.5* |
| 70.00 | 4.98 | 4.90 | 60.12 | 4.11 | 3.29 | 62.60 | 2.48 | *3.5* |
| 75.00 | 6.23 | 5.25 | 63.52 | 5.36 | 3.74 | 65.90 | 2.38 | *3.2* |
| 80.00 | 7.48 | 5.60 | 66.92 | 6.61 | 4.19 | 69.20 | 2.28 | *2.8* |
| 90.00 | 9.98 | 6.30 | 73.72 | 9.11 | 5.09 | 75.80 | 2.08 | *2.3* |
| 100.00 | 12.48 | 7.00 | 80.52 | 11.61 | 5.99 | 82.40 | 1.88 | *1.9* |
| 120.00 | 17.48 | 10.80 | 91.72 | 16.61 | 7.79 | 95.60 | 3.88 | *3.2* |
| 140.00 | 22.48 | 12.60 | 104.92 | 21.61 | 9.59 | 108.80 | 3.88 | *2.8* |
| 160.00 | 27.48 | 14.40 | 118.12 | 26.61 | 11.39 | 122.00 | 3.88 | *2.4* |
| 180.00 | 32.48 | 16.20 | 131.32 | 31.61 | 13.19 | 135.20 | 3.88 | *2.2* |
| 200.00 | 37.48 | 18.00 | 144.52 | 36.61 | 14.99 | 148.40 | 3.88 | *1.9* |
| 250.00 | 49.98 | 22.50 | 177.52 | 49.11 | 19.49 | 181.40 | 3.88 | *1.6* |
| 300.00 | 62.48 | 27.00 | 210.52 | 61.61 | 23.99 | 214.40 | 3.88 | *1.3* |
| 325.00 | 68.73 | 27.45 | 228.82 | 67.86 | 26.24 | 230.90 | 2.08 | *0.6* |
| 350.00 | 74.98 | 27.45 | 247.57 | 74.11 | 28.49 | 247.40 | -0.17 | *-0.0* |
| 375.00 | 81.23 | 27.45 | 266.32 | 80.36 | 29.21 | 265.43 | -0.89 | *-0.2* |
| 400.00 | 87.48 | 27.45 | 285.07 | 86.61 | 29.21 | 284.18 | -0.89 | *-0.2* |
| 500.00 | 124.29 | 27.45 | 348.26 | 118.87 | 29.21 | 351.92 | 3.66 | *0.7* |
| 600.00 | 164.29 | 27.45 | 408.26 | 158.87 | 29.21 | 411.92 | 3.66 | *0.6* |
| MARRIED COUPLES [2] | | | | | | | | |
| 80.00 | 0.31 | 5.60 | 74.09 | 0.00 | 4.19 | 75.81 | 1.72 | *2.2* |
| 90.00 | 2.81 | 6.30 | 80.89 | 1.47 | 5.09 | 83.44 | 2.55 | *2.8* |
| 100.00 | 5.31 | 7.00 | 87.69 | 3.97 | 5.99 | 90.04 | 2.35 | *2.4* |
| 120.00 | 10.31 | 10.80 | 98.89 | 8.97 | 7.79 | 103.24 | 4.35 | *3.6* |
| 140.00 | 15.31 | 12.60 | 112.09 | 13.97 | 9.59 | 116.44 | 4.35 | *3.1* |
| 160.00 | 20.31 | 14.40 | 125.29 | 18.97 | 11.39 | 129.64 | 4.35 | *2.7* |
| 180.00 | 25.31 | 16.20 | 138.49 | 23.97 | 13.19 | 142.84 | 4.35 | *2.4* |
| 200.00 | 30.31 | 18.00 | 151.69 | 28.97 | 14.99 | 156.04 | 4.35 | *2.2* |
| 250.00 | 42.81 | 22.50 | 184.69 | 41.47 | 19.49 | 189.04 | 4.35 | *1.7* |
| 300.00 | 55.31 | 27.00 | 217.69 | 53.97 | 23.99 | 222.04 | 4.35 | *1.4* |
| 325.00 | 61.56 | 27.45 | 235.99 | 60.22 | 26.24 | 238.54 | 2.55 | *0.8* |
| 350.00 | 67.81 | 27.45 | 254.74 | 66.47 | 28.49 | 255.04 | 0.30 | *0.0* |
| 375.00 | 74.06 | 27.45 | 273.49 | 72.72 | 29.21 | 273.07 | -0.42 | *-0.1* |
| 400.00 | 80.31 | 27.45 | 292.24 | 78.97 | 29.21 | 291.82 | -0.42 | *-0.1* |
| 500.00 | 112.83 | 27.45 | 359.72 | 106.63 | 29.21 | 364.16 | 4.44 | *0.9* |
| 600.00 | 152.83 | 27.45 | 419.72 | 146.63 | 29.21 | 424.16 | 4.44 | *0.7* |

[1] National Insurance Contributions are at the standard Class 1 rate for employees contracted-in to the State additional (earnings related) pension scheme.

[2] Calculations assume that only the husband has earned income.

Budget - SECRET SETA UEL £358

# TABLE 7

**MARRIED COUPLE WITH TWO CHILDREN - NET WEEKLY INCOME**

INCOME TAX, NATIONAL INSURANCE CONTRIBUTIONS AND CHILD BENEFIT

| Weekly income in 1988-89 | | | | | Weekly income in 1989-90 | | | | Increase in income after tax, NIC and child benefit | |
|---|---|---|---|---|---|---|---|---|---|---|
| Income[1] | Child benefit | Income tax | NIC[2] | Net income[3] | Child benefit | Income tax | NIC[2] post October 1989 | Net income[3] | Increase in income | As percentage of total income |
| £ | £ | £ | £ | £ | £ | £ | £ | £ | £ | per cent |
| **80.00** | 14.50 | 0.31 | 5.60 | 88.59 | 14.50 | 0.00 | 4.19 | 90.31 | 1.72 | *2.2* |
| **90.00** | 14.50 | 2.81 | 6.30 | 95.39 | 14.50 | 1.47 | 5.09 | 97.94 | 2.55 | *2.8* |
| **100.00** | 14.50 | 5.31 | 7.00 | 102.19 | 14.50 | 3.97 | 5.99 | 104.54 | 2.35 | *2.4* |
| **120.00** | 14.50 | 10.31 | 10.80 | 113.39 | 14.50 | 8.97 | 7.79 | 117.74 | 4.35 | *3.6* |
| **140.00** | 14.50 | 15.31 | 12.60 | 126.59 | 14.50 | 13.97 | 9.59 | 130.94 | 4.35 | *3.1* |
| **160.00** | 14.50 | 20.31 | 14.40 | 139.79 | 14.50 | 18.97 | 11.39 | 144.14 | 4.35 | *2.7* |
| **180.00** | 14.50 | 25.31 | 16.20 | 152.99 | 14.50 | 23.97 | 13.19 | 157.34 | 4.35 | *2.4* |
| **200.00** | 14.50 | 30.31 | 18.00 | 166.19 | 14.50 | 28.97 | 14.99 | 170.54 | 4.35 | *2.2* |
| **250.00** | 14.50 | 42.81 | 22.50 | 199.19 | 14.50 | 41.47 | 19.49 | 203.54 | 4.35 | *1.7* |
| **300.00** | 14.50 | 55.31 | 27.00 | 232.19 | 14.50 | 53.97 | 23.99 | 236.54 | 4.35 | *1.4* |
| **325.00** | 14.50 | 61.56 | 27.45 | 250.49 | 14.50 | 60.22 | 26.24 | 253.04 | 2.55 | *0.8* |
| **350.00** | 14.50 | 67.81 | 27.45 | 269.24 | 14.50 | 66.47 | 28.49 | 269.54 | 0.30 | *0.0* |
| **375.00** | 14.50 | 74.06 | 27.45 | 287.99 | 14.50 | 72.72 | 29.21 | 287.57 | -0.42 | *-0.1* |
| **400.00** | 14.50 | 80.31 | 27.45 | 306.74 | 14.50 | 78.97 | 29.21 | 306.32 | -0.42 | *-0.1* |
| **500.00** | 14.50 | 112.83 | 27.45 | 374.22 | 14.50 | 106.63 | 29.21 | 378.66 | 4.44 | *0.9* |
| **600.00** | 14.50 | 152.83 | 27.45 | 434.22 | 14.50 | 146.63 | 29.21 | 438.66 | 4.44 | *0.7* |

[1] Calculations assume that only the husband has earned income.

[2] National Insurance Contributions are at the standard Class 1 rate for employees contracted-in to the State additional (earnings related) pension scheme.

[3] Net income is earnings, less tax and National Insurance Contributions, plus child benefit. It does not include any income-related benefit.

Budget - SECRET SETA UEL/358 E

# TABLE 9

**SINGLE PERSONS AND MARRIED COUPLES - INCOME ALL EARNED - WEEKLY FIGURES**

COMPARISON OF INCOME AFTER INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS BETWEEN 1988-89 AND 1989-90 WHERE EARNINGS INCREASE BY 7½ PER CENT

| Charge for 1988-89 | | | | Proposed charge for 1989-90 | | | | |
|---|---|---|---|---|---|---|---|---|
| Income £ | Income tax £ | NIC[1] £ | Percent. of total income taken in tax and NIC per cent | Adjusted income[2] £ | Income tax £ | NIC[1] post October 1989 £ | Percent. of total income taken in tax and NIC per cent | Percent. change in income after tax and NIC per cent |
| SINGLE PERSONS | | | | | | | | |
| 50.00 | 0.00 | 2.50 | *5.0* | **53.75** | 0.05 | 1.82 | *3.5* | *9.2* |
| 60.00 | 2.48 | 3.00 | *9.1* | **64.50** | 2.74 | 2.79 | *8.6* | *8.2* |
| 70.00 | 4.98 | 4.90 | *14.1* | **75.25** | 5.42 | 3.76 | *12.2* | *9.9* |
| 80.00 | 7.48 | 5.60 | *16.4* | **86.00** | 8.11 | 4.73 | *14.9* | *9.3* |
| 90.00 | 9.98 | 6.30 | *18.1* | **96.75** | 10.80 | 5.69 | *17.0* | *8.9* |
| 100.00 | 12.48 | 7.00 | *19.5* | **107.50** | 13.49 | 6.66 | *18.7* | *8.5* |
| 120.00 | 17.48 | 10.80 | *23.6* | **129.00** | 18.86 | 8.60 | *21.3* | *10.7* |
| 140.00 | 22.48 | 12.60 | *25.1* | **150.50** | 24.24 | 10.53 | *23.1* | *10.3* |
| 160.00 | 27.48 | 14.40 | *26.2* | **172.00** | 29.61 | 12.47 | *24.5* | *10.0* |
| 180.00 | 32.48 | 16.20 | *27.0* | **193.50** | 34.99 | 14.40 | *25.5* | *9.7* |
| 200.00 | 37.48 | 18.00 | *27.7* | **215.00** | 40.36 | 16.34 | *26.4* | *9.5* |
| 250.00 | 49.98 | 22.50 | *29.0* | **268.75** | 53.80 | 21.17 | *27.9* | *9.2* |
| 300.00 | 62.48 | 27.00 | *29.8* | **322.50** | 67.24 | 26.01 | *28.9* | *8.9* |
| 325.00 | 68.73 | 27.45 | *29.6* | **349.38** | 73.96 | 28.43 | *29.3* | *7.9* |
| 350.00 | 74.98 | 27.45 | *29.3* | **376.25** | 80.67 | 29.21 | *29.2* | *7.6* |
| 375.00 | 81.23 | 27.45 | *29.0* | **403.12** | 87.39 | 29.21 | *28.9* | *7.6* |
| 400.00 | 87.48 | 27.45 | *28.7* | **430.00** | 94.11 | 29.21 | *28.7* | *7.6* |
| 500.00 | 124.29 | 27.45 | *30.3* | **537.50** | 133.87 | 29.21 | *30.3* | *7.5* |
| 600.00 | 164.29 | 27.45 | *32.0* | **645.00** | 176.87 | 29.21 | *32.0* | *7.5* |
| MARRIED COUPLES[3] | | | | | | | | |
| 80.00 | 0.31 | 5.60 | *7.4* | **86.00** | 0.47 | 4.73 | *6.0* | *9.1* |
| 90.00 | 2.81 | 6.30 | *10.1* | **96.75** | 3.15 | 5.69 | *9.1* | *8.7* |
| 100.00 | 5.31 | 7.00 | *12.3* | **107.50** | 5.84 | 6.66 | *11.6* | *8.3* |
| 120.00 | 10.31 | 10.80 | *17.6* | **129.00** | 11.22 | 8.60 | *15.4* | *10.4* |
| 140.00 | 15.31 | 12.60 | *19.9* | **150.50** | 16.59 | 10.53 | *18.0* | *10.1* |
| 160.00 | 20.31 | 14.40 | *21.7* | **172.00** | 21.97 | 12.47 | *20.0* | *9.8* |
| 180.00 | 25.31 | 16.20 | *23.1* | **193.50** | 27.34 | 14.40 | *21.6* | *9.6* |
| 200.00 | 30.31 | 18.00 | *24.2* | **215.00** | 32.72 | 16.34 | *22.8* | *9.4* |
| 250.00 | 42.81 | 22.50 | *26.1* | **268.75** | 46.15 | 21.17 | *25.0* | *9.1* |
| 300.00 | 55.31 | 27.00 | *27.4* | **322.50** | 59.59 | 26.01 | *26.5* | *8.8* |
| 325.00 | 61.56 | 27.45 | *27.4* | **349.38** | 66.31 | 28.43 | *27.1* | *7.9* |
| 350.00 | 67.81 | 27.45 | *27.2* | **376.25** | 73.03 | 29.21 | *27.2* | *7.6* |
| 375.00 | 74.06 | 27.45 | *27.1* | **403.12** | 79.75 | 29.21 | *27.0* | *7.6* |
| 400.00 | 80.31 | 27.45 | *26.9* | **430.00** | 86.47 | 29.21 | *26.9* | *7.6* |
| 500.00 | 112.83 | 27.45 | *28.1* | **537.50** | 121.63 | 29.21 | *28.1* | *7.5* |
| 600.00 | 152.83 | 27.45 | *30.0* | **645.00** | 164.63 | 29.21 | *30.1* | *7.5* |

[1] National Insurance Contributions are at the standard Class 1 rate for employees contracted-in to the State additional (earnings related) pension scheme.

[2] The adjusted incomes shown for 1989-90 are for illustration. They have been obtained by increasing the corresponding incomes in 1988-89 by 7½ per cent.

[3] Calculations assume that only the husband has earned income.

Budget - SECRET SETA UEL Z358

# TABLE 10

**MARRIED COUPLE WITH TWO CHILDREN - INCOME ALL EARNED - WEEKLY FIGURES**

COMPARISON OF INCOME AFTER INCOME TAX, NATIONAL INSURANCE CONTRIBUTIONS AND CHILD BENEFIT BETWEEN 1988-89 AND 1989-90 WHERE EARNINGS INCREASE BY 7½ PER CENT

| 1988-89 | | | | | 1989-90 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Income[1] £ | Child Benefit £ | Income tax £ | NIC[2] £ | Net income[3] £ | Adjusted income[4] £ | Child benefit £ | Income tax £ | NIC[2] Post October 1989 £ | Net income[3] £ | Percentage change in net income per cent |
| **70.00** | 14.50 | 0.00 | 4.90 | 79.60 | **75.25** | 14.50 | 0.00 | 3.76 | 85.99 | *8.0* |
| **80.00** | 14.50 | 0.31 | 5.60 | 88.59 | **86.00** | 14.50 | 0.47 | 4.73 | 95.30 | *7.6* |
| **90.00** | 14.50 | 2.81 | 6.30 | 95.39 | **96.75** | 14.50 | 3.15 | 5.69 | 102.41 | *7.4* |
| **100.00** | 14.50 | 5.31 | 7.00 | 102.19 | **107.50** | 14.50 | 5.84 | 6.66 | 109.50 | *7.2* |
| **120.00** | 14.50 | 10.31 | 10.80 | 113.39 | **129.00** | 14.50 | 11.22 | 8.60 | 123.68 | *9.1* |
| **140.00** | 14.50 | 15.31 | 12.60 | 126.59 | **150.50** | 14.50 | 16.59 | 10.53 | 137.88 | *8.9* |
| **160.00** | 14.50 | 20.31 | 14.40 | 139.79 | **172.00** | 14.50 | 21.97 | 12.47 | 152.06 | *8.8* |
| **180.00** | 14.50 | 25.31 | 16.20 | 152.99 | **193.50** | 14.50 | 27.34 | 14.40 | 166.26 | *8.7* |
| **200.00** | 14.50 | 30.31 | 18.00 | 166.19 | **215.00** | 14.50 | 32.72 | 16.34 | 180.44 | *8.6* |
| **250.00** | 14.50 | 42.81 | 22.50 | 199.19 | **268.75** | 14.50 | 46.15 | 21.17 | 215.93 | *8.4* |
| **300.00** | 14.50 | 55.31 | 27.00 | 232.19 | **322.50** | 14.50 | 59.59 | 26.01 | 251.40 | *8.3* |
| **325.00** | 14.50 | 61.56 | 27.45 | 250.49 | **349.38** | 14.50 | 66.31 | 28.43 | 269.14 | *7.4* |
| **350.00** | 14.50 | 67.81 | 27.45 | 269.24 | **376.25** | 14.50 | 73.03 | 29.21 | 288.51 | *7.2* |
| **375.00** | 14.50 | 74.06 | 27.45 | 287.99 | **403.12** | 14.50 | 79.75 | 29.21 | 308.66 | *7.2* |
| **400.00** | 14.50 | 80.31 | 27.45 | 306.74 | **430.00** | 14.50 | 86.47 | 29.21 | 328.82 | *7.2* |
| **500.00** | 14.50 | 112.83 | 27.45 | 374.22 | **537.50** | 14.50 | 121.63 | 29.21 | 401.16 | *7.2* |
| **600.00** | 14.50 | 152.83 | 27.45 | 434.22 | **645.00** | 14.50 | 164.63 | 29.21 | 465.66 | *7.2* |

[1] Calculations assume that only the husband has earned income.

[2] National Insurance Contributions are at the standard Class 1 rate for employees contracted-in to the State additional (earnings related) pension scheme.

[3] Net income is earnings, less tax and National Insurance Contributions, plus child benefit. It does not include any income-related benefit.

[4] The adjusted incomes shown for 1989-90 are for illustration. They have been obtained by increasing the corresponding incomes in 1988-89 by 7½ per cent.

Budget - SECRET

SET B UEL £325

# TABLE 6

**SINGLE AND MARRIED COUPLES - INCOME ALL EARNED - WEEKLY FIGURES**
**INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS**

| | Charge for 1988-89 | | | Proposed charge for 1989-90 | | | Reduction in tax and NIC after proposed change | |
|---|---|---|---|---|---|---|---|---|
| Income | Income tax | NIC[1] | Net income after tax and NIC | Income tax | NIC[1] post October 1989 | Net income after tax and NIC | Income tax and NIC | As percentage of total income |
| £ | £ | £ | £ | £ | £ | £ | £ | per cent |
| SINGLE PERSONS | | | | | | | | |
| 50.00 | 0.00 | 2.50 | 47.50 | 0.00 | 1.49 | 48.51 | 1.01 | *2.0* |
| 60.00 | 2.48 | 3.00 | 54.52 | 1.61 | 2.39 | 56.00 | 1.48 | *2.5* |
| 70.00 | 4.98 | 4.90 | 60.12 | 4.11 | 3.29 | 62.60 | 2.48 | *3.5* |
| 75.00 | 6.23 | 5.25 | 63.52 | 5.36 | 3.74 | 65.90 | 2.38 | *3.2* |
| 80.00 | 7.48 | 5.60 | 66.92 | 6.61 | 4.19 | 69.20 | 2.28 | *2.8* |
| 90.00 | 9.98 | 6.30 | 73.72 | 9.11 | 5.09 | 75.80 | 2.08 | *2.3* |
| 100.00 | 12.48 | 7.00 | 80.52 | 11.61 | 5.99 | 82.40 | 1.88 | *1.9* |
| 120.00 | 17.48 | 10.80 | 91.72 | 16.61 | 7.79 | 95.60 | 3.88 | *3.2* |
| 140.00 | 22.48 | 12.60 | 104.92 | 21.61 | 9.59 | 108.80 | 3.88 | *2.8* |
| 160.00 | 27.48 | 14.40 | 118.12 | 26.61 | 11.39 | 122.00 | 3.88 | *2.4* |
| 180.00 | 32.48 | 16.20 | 131.32 | 31.61 | 13.19 | 135.20 | 3.88 | *2.2* |
| 200.00 | 37.48 | 18.00 | 144.52 | 36.61 | 14.99 | 148.40 | 3.88 | *1.9* |
| 250.00 | 49.98 | 22.50 | 177.52 | 49.11 | 19.49 | 181.40 | 3.88 | *1.6* |
| 300.00 | 62.48 | 27.00 | 210.52 | 61.61 | 23.99 | 214.40 | 3.88 | *1.3* |
| 325.00 | 68.73 | 27.45 | 228.82 | 67.86 | 26.24 | 230.90 | 2.08 | *0.6* |
| 350.00 | 74.98 | 27.45 | 247.57 | 74.11 | 26.24 | 249.65 | 2.08 | *0.6* |
| 375.00 | 81.23 | 27.45 | 266.32 | 80.36 | 26.24 | 268.40 | 2.08 | *0.6* |
| 400.00 | 87.48 | 27.45 | 285.07 | 86.61 | 26.24 | 287.15 | 2.08 | *0.5* |
| 500.00 | 124.29 | 27.45 | 348.26 | 118.87 | 26.24 | 354.89 | 6.63 | *1.3* |
| 600.00 | 164.29 | 27.45 | 408.26 | 158.87 | 26.24 | 414.89 | 6.63 | *1.1* |
| MARRIED COUPLES[2] | | | | | | | | |
| 80.00 | 0.31 | 5.60 | 74.09 | 0.00 | 4.19 | 75.81 | 1.72 | *2.2* |
| 90.00 | 2.81 | 6.30 | 80.89 | 1.47 | 5.09 | 83.44 | 2.55 | *2.8* |
| 100.00 | 5.31 | 7.00 | 87.69 | 3.97 | 5.99 | 90.04 | 2.35 | *2.4* |
| 120.00 | 10.31 | 10.80 | 98.89 | 8.97 | 7.79 | 103.24 | 4.35 | *3.6* |
| 140.00 | 15.31 | 12.60 | 112.09 | 13.97 | 9.59 | 116.44 | 4.35 | *3.1* |
| 160.00 | 20.31 | 14.40 | 125.29 | 18.97 | 11.39 | 129.64 | 4.35 | *2.7* |
| 180.00 | 25.31 | 16.20 | 138.49 | 23.97 | 13.19 | 142.84 | 4.35 | *2.4* |
| 200.00 | 30.31 | 18.00 | 151.69 | 28.97 | 14.99 | 156.04 | 4.35 | *2.2* |
| 250.00 | 42.81 | 22.50 | 184.69 | 41.47 | 19.49 | 189.04 | 4.35 | *1.7* |
| 300.00 | 55.31 | 27.00 | 217.69 | 53.97 | 23.99 | 222.04 | 4.35 | *1.4* |
| 325.00 | 61.56 | 27.45 | 235.99 | 60.22 | 26.24 | 238.54 | 2.55 | *0.8* |
| 350.00 | 67.81 | 27.45 | 254.74 | 66.47 | 26.24 | 257.29 | 2.55 | *0.7* |
| 375.00 | 74.06 | 27.45 | 273.49 | 72.72 | 26.24 | 276.04 | 2.55 | *0.7* |
| 400.00 | 80.31 | 27.45 | 292.24 | 78.97 | 26.24 | 294.79 | 2.55 | *0.6* |
| 500.00 | 112.83 | 27.45 | 359.72 | 106.63 | 26.24 | 367.13 | 7.41 | *1.5* |
| 600.00 | 152.83 | 27.45 | 419.72 | 146.63 | 26.24 | 427.13 | 7.41 | *1.2* |

[1] National Insurance Contributions are at the standard Class 1 rate for employees contracted-in to the State additional (earnings related) pension scheme.

[2] Calculations assume that only the husband has earned income.

Budget - SECRET SET B UEL £325

## TABLE 7

**MARRIED COUPLE WITH TWO CHILDREN - NET WEEKLY INCOME**

INCOME TAX, NATIONAL INSURANCE CONTRIBUTIONS AND CHILD BENEFIT

| Weekly income in 1988-89 | | | | | Weekly income in 1989-90 | | | | Increase in income after tax, NIC and child benefit | |
|---|---|---|---|---|---|---|---|---|---|---|
| Income[1] | Child benefit | Income tax | NIC[2] | Net income[3] | Child benefit | Income tax | NIC[2] post October 1989 | Net income[3] | Increase in income | As percentage of total income |
| £ | £ | £ | £ | £ | £ | £ | £ | £ | £ | per cent |
| 80.00 | 14.50 | 0.31 | 5.60 | 88.59 | 14.50 | 0.00 | 4.19 | 90.31 | 1.72 | *2.2* |
| 90.00 | 14.50 | 2.81 | 6.30 | 95.39 | 14.50 | 1.47 | 5.09 | 97.94 | 2.55 | *2.8* |
| 100.00 | 14.50 | 5.31 | 7.00 | 102.19 | 14.50 | 3.97 | 5.99 | 104.54 | 2.35 | *2.4* |
| 120.00 | 14.50 | 10.31 | 10.80 | 113.39 | 14.50 | 8.97 | 7.79 | 117.74 | 4.35 | *3.6* |
| 140.00 | 14.50 | 15.31 | 12.60 | 126.59 | 14.50 | 13.97 | 9.59 | 130.94 | 4.35 | *3.1* |
| 160.00 | 14.50 | 20.31 | 14.40 | 139.79 | 14.50 | 18.97 | 11.39 | 144.14 | 4.35 | *2.7* |
| 180.00 | 14.50 | 25.31 | 16.20 | 152.99 | 14.50 | 23.97 | 13.19 | 157.34 | 4.35 | *2.4* |
| 200.00 | 14.50 | 30.31 | 18.00 | 166.19 | 14.50 | 28.97 | 14.99 | 170.54 | 4.35 | *2.2* |
| 250.00 | 14.50 | 42.81 | 22.50 | 199.19 | 14.50 | 41.47 | 19.49 | 203.54 | 4.35 | *1.7* |
| 300.00 | 14.50 | 55.31 | 27.00 | 232.19 | 14.50 | 53.97 | 23.99 | 236.54 | 4.35 | *1.4* |
| 325.00 | 14.50 | 61.56 | 27.45 | 250.49 | 14.50 | 60.22 | 26.24 | 253.04 | 2.55 | *0.8* |
| 350.00 | 14.50 | 67.81 | 27.45 | 269.24 | 14.50 | 66.47 | 26.24 | 271.79 | 2.55 | *0.7* |
| 375.00 | 14.50 | 74.06 | 27.45 | 287.99 | 14.50 | 72.72 | 26.24 | 290.54 | 2.55 | *0.7* |
| 400.00 | 14.50 | 80.31 | 27.45 | 306.74 | 14.50 | 78.97 | 26.24 | 309.29 | 2.55 | *0.6* |
| 500.00 | 14.50 | 112.83 | 27.45 | 374.22 | 14.50 | 106.63 | 26.24 | 381.63 | 7.41 | *1.5* |
| 600.00 | 14.50 | 152.83 | 27.45 | 434.22 | 14.50 | 146.63 | 26.24 | 441.63 | 7.41 | *1.2* |

[1] Calculations assume that only the husband has earned income.

[2] National Insurance Contributions are at the standard Class 1 rate for employees contracted-in to the State additional (earnings related) pension scheme.

[3] Net income is earnings, less tax and National Insurance Contributions, plus child benefit. It does not include any income-related benefit.

Budget - SECRET SET B UEL £325

# TABLE 9

**SINGLE PERSONS AND MARRIED COUPLES - INCOME ALL EARNED - WEEKLY FIGURES**

COMPARISON OF INCOME AFTER INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS BETWEEN 1988-89 AND 1989-90 WHERE EARNINGS INCREASE BY 7½ PER CENT

| Charge for 1988-89 | | | | Proposed charge for 1989-90 | | | | |
|---|---|---|---|---|---|---|---|---|
| Income £ | Income tax £ | NIC[1] £ | Percent. of total income taken in tax and NIC per cent | Adjusted income[2] £ | Income tax £ | NIC[1] post October 1989 £ | Percent. of total income taken in tax and NIC per cent | Percent. change in income after tax and NIC per cent |
| SINGLE PERSONS | | | | | | | | |
| **50.00** | 0.00 | 2.50 | *5.0* | **53.75** | 0.05 | 1.82 | *3.5* | *9.2* |
| **60.00** | 2.48 | 3.00 | *9.1* | **64.50** | 2.74 | 2.79 | *8.6* | *8.2* |
| **70.00** | 4.98 | 4.90 | *14.1* | **75.25** | 5.42 | 3.76 | *12.2* | *9.9* |
| **80.00** | 7.48 | 5.60 | *16.4* | **86.00** | 8.11 | 4.73 | *14.9* | *9.3* |
| **90.00** | 9.98 | 6.30 | *18.1* | **96.75** | 10.80 | 5.69 | *17.0* | *8.9* |
| **100.00** | 12.48 | 7.00 | *19.5* | **107.50** | 13.49 | 6.66 | *18.7* | *8.5* |
| **120.00** | 17.48 | 10.80 | *23.6* | **129.00** | 18.86 | 8.60 | *21.3* | *10.7* |
| **140.00** | 22.48 | 12.60 | *25.1* | **150.50** | 24.24 | 10.53 | *23.1* | *10.3* |
| **160.00** | 27.48 | 14.40 | *26.2* | **172.00** | 29.61 | 12.47 | *24.5* | *10.0* |
| **180.00** | 32.48 | 16.20 | *27.0* | **193.50** | 34.99 | 14.40 | *25.5* | *9.7* |
| **200.00** | 37.48 | 18.00 | *27.7* | **215.00** | 40.36 | 16.34 | *26.4* | *9.5* |
| **250.00** | 49.98 | 22.50 | *29.0* | **268.75** | 53.80 | 21.17 | *27.9* | *9.2* |
| **300.00** | 62.48 | 27.00 | *29.8* | **322.50** | 67.24 | 26.01 | *28.9* | *8.9* |
| **325.00** | 68.73 | 27.45 | *29.6* | **349.38** | 73.96 | 26.24 | *28.7* | *8.9* |
| **350.00** | 74.98 | 27.45 | *29.3* | **376.25** | 80.67 | 26.24 | *28.4* | *8.8* |
| **375.00** | 81.23 | 27.45 | *29.0* | **403.12** | 87.39 | 26.24 | *28.2* | *8.7* |
| **400.00** | 87.48 | 27.45 | *28.7* | **430.00** | 94.11 | 26.24 | *28.0* | *8.6* |
| **500.00** | 124.29 | 27.45 | *30.3* | **537.50** | 133.87 | 26.24 | *29.8* | *8.4* |
| **600.00** | 164.29 | 27.45 | *32.0* | **645.00** | 176.87 | 26.24 | *31.5* | *8.2* |
| MARRIED COUPLES[3] | | | | | | | | |
| **80.00** | 0.31 | 5.60 | *7.4* | **86.00** | 0.47 | 4.73 | *6.0* | *9.1* |
| **90.00** | 2.81 | 6.30 | *10.1* | **96.75** | 3.15 | 5.69 | *9.1* | *8.7* |
| **100.00** | 5.31 | 7.00 | *12.3* | **107.50** | 5.84 | 6.66 | *11.6* | *8.3* |
| **120.00** | 10.31 | 10.80 | *17.6* | **129.00** | 11.22 | 8.60 | *15.4* | *10.4* |
| **140.00** | 15.31 | 12.60 | *19.9* | **150.50** | 16.59 | 10.53 | *18.0* | *10.1* |
| **160.00** | 20.31 | 14.40 | *21.7* | **172.00** | 21.97 | 12.47 | *20.0* | *9.8* |
| **180.00** | 25.31 | 16.20 | *23.1* | **193.50** | 27.34 | 14.40 | *21.6* | *9.6* |
| **200.00** | 30.31 | 18.00 | *24.2* | **215.00** | 32.72 | 16.34 | *22.8* | *9.4* |
| **250.00** | 42.81 | 22.50 | *26.1* | **268.75** | 46.15 | 21.17 | *25.0* | *9.1* |
| **300.00** | 55.31 | 27.00 | *27.4* | **322.50** | 59.59 | 26.01 | *26.5* | *8.8* |
| **325.00** | 61.56 | 27.45 | *27.4* | **349.38** | 66.31 | 26.24 | *26.5* | *8.8* |
| **350.00** | 67.81 | 27.45 | *27.2* | **376.25** | 73.03 | 26.24 | *26.4* | *8.7* |
| **375.00** | 74.06 | 27.45 | *27.1* | **403.12** | 79.75 | 26.24 | *26.3* | *8.6* |
| **400.00** | 80.31 | 27.45 | *26.9* | **430.00** | 86.47 | 26.24 | *26.2* | *8.6* |
| **500.00** | 112.83 | 27.45 | *28.1* | **537.50** | 121.63 | 26.24 | *27.5* | *8.3* |
| **600.00** | 152.83 | 27.45 | *30.0* | **645.00** | 164.63 | 26.24 | *29.6* | *8.2* |

[1] National Insurance Contributions are at the standard Class 1 rate for employees contracted-in to the State additional (earnings related) pension scheme.

[2] The adjusted incomes shown for 1989-90 are for illustration. They have been obtained by increasing the corresponding incomes in 1988-89 by 7½ per cent.

[3] Calculations assume that only the husband has earned income.

Budget - SECRET

SET B VEL £325.

## TABLE 10

**MARRIED COUPLE WITH TWO CHILDREN - INCOME ALL EARNED - WEEKLY FIGURES**

COMPARISON OF INCOME AFTER INCOME TAX, NATIONAL INSURANCE CONTRIBUTIONS AND CHILD BENEFIT BETWEEN 1988-89 AND 1989-90 WHERE EARNINGS INCREASE BY 7½ PER CENT

| 1988-89 | | | | | 1989-90 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Income[1] £ | Child Benefit £ | Income tax £ | NIC[2] £ | Net income[3] £ | Adjusted income[4] £ | Child benefit £ | Income tax £ | NIC[2] post October 1989. £ | Net income[3] £ | Percentage change in net income per cent |
| **70.00** | 14.50 | 0.00 | 4.90 | 79.60 | **75.25** | 14.50 | 0.00 | 3.76 | 85.99 | *8.0* |
| **80.00** | 14.50 | 0.31 | 5.60 | 88.59 | **86.00** | 14.50 | 0.47 | 4.73 | 95.30 | *7.6* |
| **90.00** | 14.50 | 2.81 | 6.30 | 95.39 | **96.75** | 14.50 | 3.15 | 5.69 | 102.41 | *7.4* |
| **100.00** | 14.50 | 5.31 | 7.00 | 102.19 | **107.50** | 14.50 | 5.84 | 6.66 | 109.50 | *7.2* |
| **120.00** | 14.50 | 10.31 | 10.80 | 113.39 | **129.00** | 14.50 | 11.22 | 8.60 | 123.68 | *9.1* |
| **140.00** | 14.50 | 15.31 | 12.60 | 126.59 | **150.50** | 14.50 | 16.59 | 10.53 | 137.88 | *8.9* |
| **160.00** | 14.50 | 20.31 | 14.40 | 139.79 | **172.00** | 14.50 | 21.97 | 12.47 | 152.06 | *8.8* |
| **180.00** | 14.50 | 25.31 | 16.20 | 152.99 | **193.50** | 14.50 | 27.34 | 14.40 | 166.26 | *8.7* |
| **200.00** | 14.50 | 30.31 | 18.00 | 166.19 | **215.00** | 14.50 | 32.72 | 16.34 | 180.44 | *8.6* |
| **250.00** | 14.50 | 42.81 | 22.50 | 199.19 | **268.75** | 14.50 | 46.15 | 21.17 | 215.93 | *8.4* |
| **300.00** | 14.50 | 55.31 | 27.00 | 232.19 | **322.50** | 14.50 | 59.59 | 26.01 | 251.40 | *8.3* |
| **325.00** | 14.50 | 61.56 | 27.45 | 250.49 | **349.38** | 14.50 | 66.31 | 26.24 | 271.33 | *8.3* |
| **350.00** | 14.50 | 67.81 | 27.45 | 269.24 | **376.25** | 14.50 | 73.03 | 26.24 | 291.48 | *8.3* |
| **375.00** | 14.50 | 74.06 | 27.45 | 287.99 | **403.12** | 14.50 | 79.75 | 26.24 | 311.63 | *8.2* |
| **400.00** | 14.50 | 80.31 | 27.45 | 306.74 | **430.00** | 14.50 | 86.47 | 26.24 | 331.79 | *8.2* |
| **500.00** | 14.50 | 112.83 | 27.45 | 374.22 | **537.50** | 14.50 | 121.63 | 26.24 | 404.13 | *8.0* |
| **600.00** | 14.50 | 152.83 | 27.45 | 434.22 | **645.00** | 14.50 | 164.63 | 26.24 | 468.63 | *7.9* |

[1] Calculations assume that only the husband has earned income.

[2] National Insurance Contributions are at the standard Class 1 rate for employees contracted-in to the State additional (earnings related) pension scheme.

[3] Net income is earnings, less tax and National Insurance Contributions, plus child benefit. It does not include any income-related benefit.

[4] The adjusted incomes shown for 1989-90 are for illustration. They have been obtained by increasing the corresponding incomes in 1988-89 by 7½ per cent.

BUDGET CONFIDENTIAL

**Inland Revenue**

Central Division
Somerset House

cl
Clearly must see report. AA

yes now

FROM : G H BUSH
DATE : 24 February 1989

FINANCIAL SECRETARY

**NATIONAL INSURANCE CONTRIBUTIONS FOR THE SELF-EMPLOYED : CLASS 2 AND CLASS 4**

You will recall that, since last year, we have been working with DSS officials on the scope for streamlining National Insurance contributions paid by the self-employed. DTI Ministers pressed the case for joint work by officials on this because they considered there could be deregulation benefits.

2. When the report on this work is finally signed off by DSS officials - we are awaiting their final comments - we shall be sending you a copy with a covering analysis and recommendations. But I thought you should be aware now of where the exercise stands in view of:

- the current Budget discussions about changes to employee NICs (and possible changes to the self-employed NICs - Mr McIntyre's note to the Chancellor of 23 February, para.10 et seq);

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cc Chancellor
Paymaster General
Chief Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Byatt
Mr Scholar
Mr Culpin
Mr McIntyre
Mr Gilhooly
Mrs Chaplain
Mr Tyrie
Mr Call

Sir A Battishill
Mr Isaac
Mr Rogers
Mr Painter
Mr Beighton
Mr Lewis
Mr Cherry
Mr Calder
Mr Willis
Mr Mace
Mr Keelty
Mr Yard
Mr Carr
PS/IR
Mr Bush

- the possibility that the topic is mentioned in any further discussions with Mr Moore.

3. We do not think that the conclusions in the report change the options for NICs for this year's Budget. The report is principally about options for the longer term for the self-employed. Nor do we think the options for this year's Budget change the main conclusions of the report.

4. However, if you would like to see the report before it is formally completed, I will send you a copy straight away. It will be coming to you in any event within the next week or two.

G H BUSH

COPY NO. 25 OF 25.

FROM: J M G TAYLOR
DATE: 27 February 1989

MR SPEEDY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr McIntyre
Mr Mowl
Mr Macpherson
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Mace - IR
PS/IR

**BUDGET CHANGES AND THE NATIONAL INSURANCE FUND**

The Chancellor was grateful for your note of 24 February.

2. He has commented that he would not favour cutting the NHS allocation, since a drop in the fund will be short-lived. But that is in any event some way off. For the moment, the key point is that the problem of the excessive balance in the NIF has been well and truly solved.

3. He has noted, incidentally, the description of the new regime in footnote (ii) of the table annexed to your minute. He has commented that the new regime should be described as: "2 per cent on earnings below the LEL, and 9 per cent on earnings above it".

J M G TAYLOR

FROM: J P MCINTYRE
DATE: 28 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Monck
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gilhooly
Mr Mowl
Mr Gieve
Mr Macpherson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

Thanks. I don't see how the self-employed can complain about this. N

**NICS: SELF EMPLOYED**

Following yesterday's decisions on the UEL and the self employed, you may be interested to see the attached table setting out the NIC payments for employers/employees and the self employed following the October changes.

2. We have now had the self employed change costed by GAD. The first year (1988-89) effect is a little smaller than we estimated: £35 million instead of £50 million. In 1989-90, the GAD estimate is £151 million, including £7 million for the consequential adjustment to Class 3, the voluntary contributions. (This assumes that Class 2 is uprated in the usual way next April from £2.95 to £3.15.) We had estimated about £150 million.

3. The reason for the large difference between the first and second year cost is in terms of accruals and receipts. Although Class 2 is a weekly liability, many self employed give DSS cheques for several months' or even whole year's contributions in arrears.

J P MCINTYRE

ANNEX A

NICS FROM OCTOBER 1989

| Weekly Earnings/ Profits (£) | Contracted-in Employee only | Contracted-in Total Employer/ Employee | Self Employed Class 2 + Class 4 (after tax relief) | Contracted -out Total Employer/ Employee | Contracted -out Employee only |
|---|---|---|---|---|---|
| 43 | 0.86 | 3.01 | 0 | 3.01 | 0.86 |
| 45.19(SEE)* | 1.11 | 3.37 | 2.95 | 3.19 | 1.01 |
| 75 | 3.74 | 8.99 | 2.95 | 7.13 | 3.10 |
| 96.74(LPL) | 5.70 | 12.47 | 2.95 | 9.34 | 4.62 |
| 100 | 5.99 | 12.99 | 3.13 | 9.68 | 4.85 |
| 150 | 10.49 | 23.99 | 5.89 | 17.78 | 8.35 |
| 200 | 14.99 | 35.89 | 8.64 | 26.78 | 11.85 |
| 250 | 19.49 | 45.62 | 11.40 | 33.61 | 15.35 |
| 300 | 23.99 | 55.34 | 14.15 | 40.43 | 18.85 |
| 325 (UEL/UPL) | 26.24 | 60.02 | 15.53 | 43.85 | 20.60 |
| 500 | 26.24 | 89.49 | 15.53 | 62.14 | 20.60 |

Notes
* Small Earnings Exception. At this level of profits, self employed are required to pay Class 2.

Assumptions

1. Employees pay 2 per cent on earnings below the LEL, plus 9 per cent on earnings between LEL and UEL.

2. UEL and UPL unchanged at £325.

3. Class 2 NIC for self employed reduced from £4.25 a week to £2.95.

rc 1989/28.2.01

BUDGET CONFIDENTIAL

FROM: ROBERT CULPIN
DATE: 28 February 1989

CHANCELLOR

OK: use 2nd chart, but it must be smaller...

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Scholar
Mr Riley
Mr Gieve
Mr Gilhooly
Mr McIntyre
Mr Matthews
Mr Pickford
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

**PRESENTING THE NATIONAL INSURANCE REFORM**

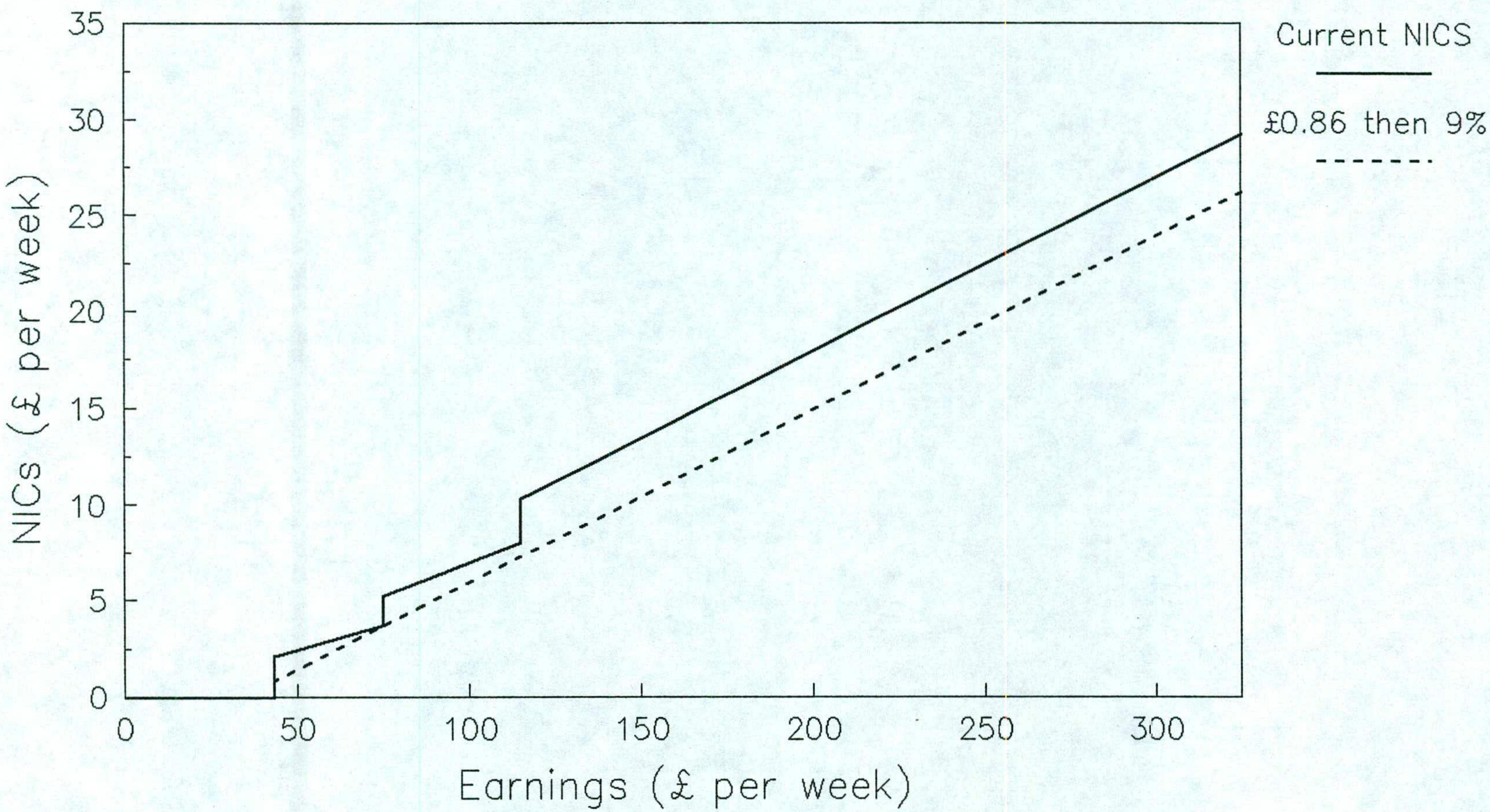
It is not custom and practice to have charts in Chapter 4 of the red book; but in the case of the NIC reform, I think it could help. Would you be content in principle for us to include a picture?

2. I attach two possible versions, one extending above the UEL, the other not. We would of course need to change the heading and descriptions for the FSBR.

RC

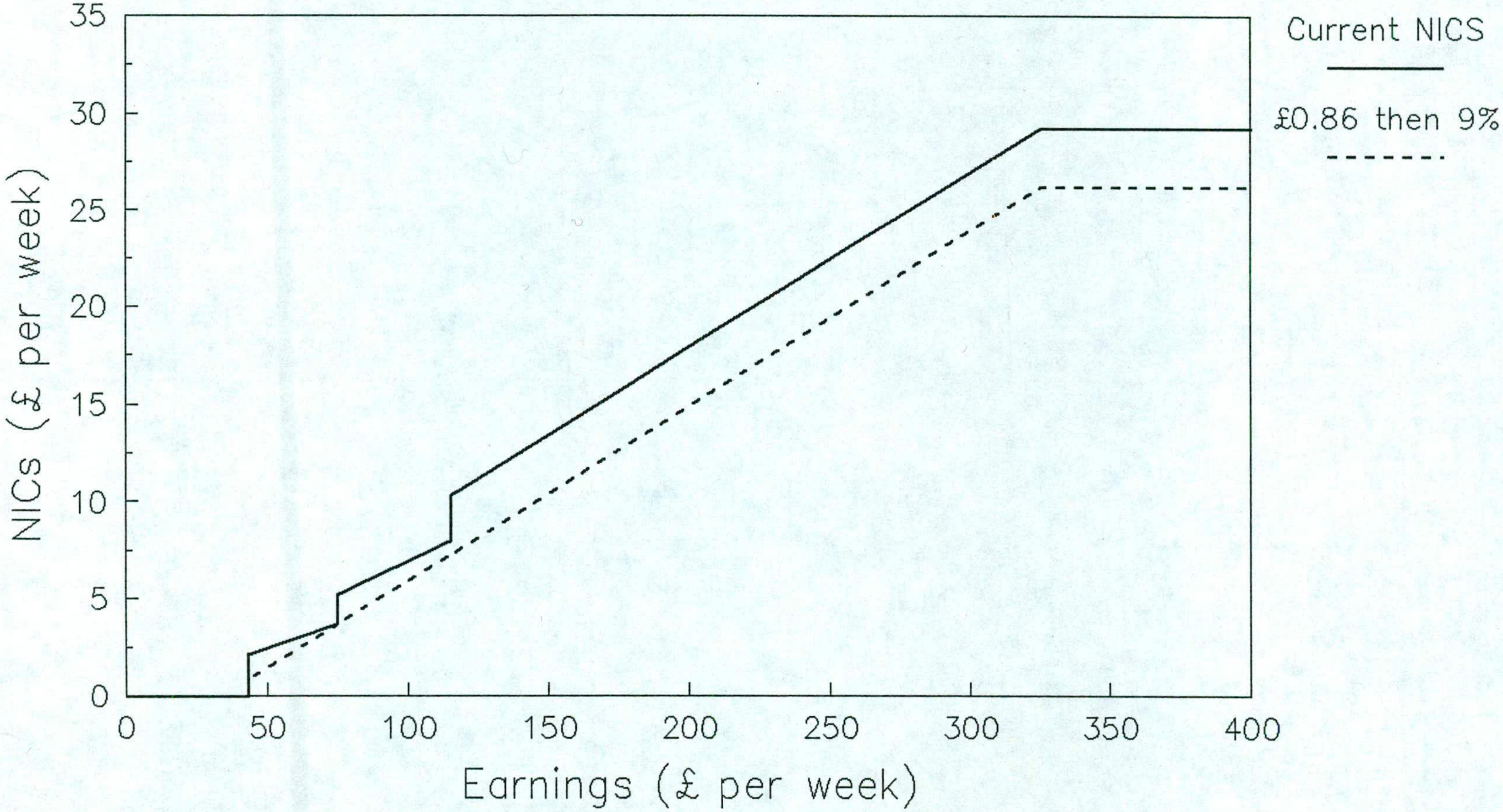
ROBERT CULPIN

# 2% of £43 then 9 per cent rate




£0.86 "entry fee"
9% on earnings between £43 and £358

# 2% of £43 then 9 per cent rate




£0.86 "entry fee"
9% on earnings between £43 and £358

FINANCIAL SECRETARY TO THE TREASURY

Pup

**FROM:** **R C M SATCHWELL**
**DATE:** **28 February 1989**

**MR BUSH - IR**

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Byatt
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr McIntrye
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

**NICs FOR THE SELF-EMPLOYED: CLASS 2 AND 4**

The Financial Secretary was most grateful for your minute of 24 February. He notes that this work will not impinge on the NICs package in this year's Budget. He is therefore content to wait for the report to arrive in due course.

R.C.M.S.

**R C M SATCHWLELL**
**Private Secretary**

fim2.cr/Sharples/m.051

BUDGET CONFIDENTIAL

FROM: A J SHARPLES
DATE: 1 March 1989

1. MR ILETT
2. PRINCIPAL PRIVATE SECRETARY

cc PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Wicks
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Ilett
Miss O'Mara
Mr Neilson
Miss Wallace
Mrs Chaplin

It is annoying that we cannot use a Finance Bill to repeal COBO's parent legislation; we went into this in detail in 1987, and the basic problem is that there is no precedent for amending this legislation in Finance Bills (as there was for the Exchange Control Act) and so no way round the difficulty that it is not a "finance" measure. M. 1/iii

**CONTROL OF BORROWING ORDER 1958 (COBO)**

Your minute of 27 February records that the Chancellor would like to repeal COBO's parent legislation (the 1946 Borrowing (Control and Guarantees) Act) in the 1990 Finance Bill.

2. In fact we shall need to find an alternative legislative vehicle for repeal of the 46 Act. Parliamentary Counsel has advised that we cannot use a Finance Bill as this is not strictly a finance measure. (Mr Ilett's minute to the Financial Secretary 31 January 1989).

3. We are discussing with Treasury Solicitors what form the repeal legislation would take and to which Bill it might be attached.

Adam Sharples

A J SHARPLES

chex.rm/jmt1/78 **BUDGET CONFIDENTIAL**

FROM: J M G TAYLOR
DATE: 1 March 1989

**MR MCINTYRE**

cc **Chief Secretary**
**Financial Secretary**
**Paymaster General**
**Economic Secretary**
**Sir P Middleton**
**Mr Anson**
**Sir T Burns**
**Mr Monck**
**Mr Culpin**
**Mr Riley**
**Mr Sedgwick**
**Mr Gilhooly**
**Mr Mowl**
**Mr Gieve**
**Mr Macpherson**
**Mr Speedy**
**Mrs Chaplin**
**Mr Tyrie**
**Mr Call**

**PS/IR**

**NICS: SELF EMPLOYED**

The Chancellor was grateful for your note of 28 February, enclosing a table setting out the NIC payments for employers/employees and the self employed following the October changes.

2. He has commented that he does not see how the self employed can complain, with this.

J M G TAYLOR

chex.rm/jmtl/75 **BUDGET CONFIDENTIAL**

FROM: J M G TAYLOR
DATE: 1 March 1989

**MR CULPIN**

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Riley
Mr Gieve
Mr Gilhooly
Mr McIntyre
Mr Matthews
Mr Pickford
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

**PRESENTING THE NATIONAL INSURANCE REFORM**

The Chancellor has seen your note of 28 February.

2. He is content for a picture to be included in the Red Book. He would prefer the version which does <u>not</u> extend above the UEL; and the chart must be small.

J M G TAYLOR

FROM: J P MCINTYRE
DATE: 1 March 1989

CHANCELLOR

Chr Content re 'x' ?
AF 1/3

cc Mr Anson
Mr Culpin
Mr Michie
Mr Speedy

**NICS REFORM: DSS CONSULTATION**

As we get nearer Budget day, the nominated officials in DSS who have already been consulted about NICs reform are becoming increasingly concerned to bring in some of their colleagues. They would like to bring in a further seven people, bringing the total number of officials involved to ten.

2. The list of proposed new names is attached. I have been through it with one of the officials already involved, and it has been reduced in size as a result. I think that most of the remaining names on the list are justified, though I think we could reasonably turn down the Press Officer, at least for the present. You will see that not all of the officials would need to be brought in at once.

3. I would be grateful for your agreement to bring these additional DSS officials into the consultation, at the time and on the basis described in the Annex, except for the Press Officer who would have to wait till later.

x

JM

J P MCINTYRE

OK, I suppose, with the exception of the Press Officer.

NB I am thinking of cutting back the package somewhat.

N.

# PROPOSED LIST OF DSS OFFICIALS FOR CONSULTATION ON NICs

**Already involved:**

Michael Partridge (Perm. Sec)
Ann Bowtell (Dep. Sec, Social Security policy)
Michael Lloyd (Principal, NICs).

| **Proposed** | | **Timing** |
|---|---|---|
| **Stuart Lord** | (PS/Secretary of State)<br>Essential for SoS involvement | Immediate |
| **Joan Firth** | (Under Secretary; NICs, Pensions etc)<br>Responsible for both NICs and Earnings Rule. Needs to ensure that October implementation feasible for both. | Immediate |
| **Katherine Blunt** | (Ass. Secretary, Unemployment benefit)<br>Urgent advice needed on whether reduction in NICs payable on earnings upto LEL has implications for UB qualifying conditions. If effect is to ease qualifying conditions, may need to be rectified in current Bill. | Immediate |
| **Guy Fiegehen** | (Sen. Econ. Adviser)<br><br>To agree (with Treasury & IR) estimates for impact of NIC reductions on benefits and numbers in poverty/unemployment traps. To advise SoS generally on distributional effects. | Monday 6 March |
| **Rosemary Lester** | (Legal adviser)<br>To prepare Instructions for Counsel. Also to advise on whether GAD report necessary when NICs clauses tabled. | Immediate |

| | | |
|---|---|---|
| **Steve Reardon** | (Press Office)<br>To help prepare DSS press notice for Budget Day and advise SoS on presentation generally. (DSS Press notice will be part of Budget press notices and will of course have to be agreed with us.) | Monday 6 March |
| **Mrs Ivy Jones** | (Secretary to Mrs Firth)<br>Would do all necessary typing within DSS. | Monday 6 March |

FROM: J M G TAYLOR
DATE: 1 March 1989

**MR MCINTYRE**

cc **Chief Secretary**
**Financial Secretary**
**Paymaster General**
**Economic Secretary**
**Sir P Middleton**
**Mr Anson**
**Sir T Burns**
**Mr Monck**
**Mr Culpin**
**Mr Riley**
**Mr Sedgwick**
**Mr Gilhooly**
**Mr Mowl**
**Mr Gieve**
**Mr Macpherson**
**Mr Speedy**
**Mrs Chaplin**
**Mr Tyrie**
**Mr Call**

**PS/IR**

**NICS: SELF EMPLOYED**

The Chancellor was grateful for your note of 28 February, enclosing a table setting out the NIC payments for employers/employees and the self employed following the October changes.

2. He has commented that he does not see how the self employed can complain, with this.

J M G TAYLOR

stlmar.1

BUDGET SECRET

Copy No 1 of 24

I agree. The main outstanding issue is married women optants, for whom some concession is probably necessary. JM.

FROM: C SPEEDY
DATE: 2 March 1989

1. MR MCINTYRE
2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Monck Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gilhooly
Mr Mowl
Mr Gieve
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

Thanks. This has been somewhat overtaken by my decision to leave the Class 2 rate unchanged. 2/3. Thus, for example, the revalorisation argument @ X does not apply. Thus (a) no change for married women optants (b) reduce Class 3 as proposed (tho' formula which need not be expressed in terms of Class 1) (c) no change for share fishermen (d) change armed forces rule as proposed. N

**NICS REFORM: CONSEQUENTIAL CHANGES**

This submission seeks your consent to changes in the NICs paid by married women optants, voluntary contributors, share fishermen and the armed forces.

**Married women optants**

2. Married women optants pay a reduced rate of NICs but do not acquire any rights to benefits except Statutory Sick Pay and Statutory Maternity Pay. They rely instead on their husbands contributions to obtain access to contributory benefits. Their present contribution rate of 3.85% has remained the same since 1983-84. There is no particular rationale to this rate other than that they should make some contribution to the fund and it should be at a reduced rate to reflect the lack of entitlement to contributory benefits. Women have not been allowed to elect to be treated in this way since 1977. The number of optants is therefore declining as the existing optants retire. However,

there are still about a million optants of whom 800,000 earn above the LEL.

3. One option would be to make **no change in the married women optants rate**. In this case optants earning up to £58.45 a week would have lower NICs if they paid ordinary class 1. Very roughly 150,000 optants might be in this position. Many would presumably switch to class 1 and thus acquire some rights to benefits. Others might continue as optants in the expectation that their earnings would rise above the break even point (once they have ceased to be an optant they cannot revert to optant status). There are no losers from this option and it is likely to reduce the number of optants hastening the disappearance of this anomalous group.

4. One argument against this option is that those who remain optants earning below £58.45 will pay more than those on class 1 but not acquire benefit rights. An obvious solution for women in this position would be to switch to class 1 and so pay lower contributions. They would still have their pension entitlement from their husbands' earnings. But this choice may not be straightforward, particularly for those whose earnings fluctuate, bearing in mind that the break-even point against class 1 may vary from year to year. Perhaps a more telling argument against this option is that it would be criticised on the grounds that the optants would be being treated differently from everybody else whose NICs were being cut.

5. A second option would be to change the married women optants rate to **1% of earnings up to the lower earnings limit (LEL) and 3.85% on earnings between the LEL and upper earnings limit (UEL).** This gives all married women earning above the LEL a reduction in NICs of £1.23 a week. This compares with the reduction in class 1 contributions of £3.01 a week for those earning above the reduced rate bands. At the LEL, optants would pay 43p (a 74 per cent cut), compared with employees' NIC of 86p (a 78 per cent cut). At the UEL, optants would pay £11.29 (a 10 per cent cut) versus £26.24 for employees (just over 10 per cent cut). The cost would be £19 million in 1989-90 and £51 million in a full year.

6. A cheaper third option would be to set the optants rate at **2% of earnings up to the LEL and 3.85% on earnings between the LEL and UEL**. Married optants would thus pay the same "entry fee" as those on class 1 but thereafter would have a lower rate. This option gives all optants earning above the LEL a gain of 80p a week. At the LEL optants would pay 86p (a 48 per cent cut) the same as the employees NIC of 86p (a 78 per cent cut). At the UEL optants would pay £11.72 (a 6 per cent cut) versus £26.24 for employees (just over a 10 per cent cut). The cost would be £12 million in 1989-90 and £33 million in a full year.

7. We recommend this third option because it gives all optants earning above the LEL a gain at moderate cost to the fund. It would also mean that all employees, including optants, would pay the initial 2 per cent (subject to para 10 below).

**Voluntary contributions**

8. Voluntary contributions (class 3) are usually set at class 2 (self-employed flat rate) less 10 pence. We therefore recommend that the class 3 rate should be £2.85 a week, a reduction of £1.30. This would cost £4 million in 1989-90 and £11 million in a full year.

or, equivalently, at employee's + employer's Class I NICs @ LEL - 15p

**Share Fishermen**

overtaken

9. Share fishermen pay a special rate which is the class 2 self-employed rate plus an additional £1.55 to take account of their entitlement to unemployment benefit. We therefore recommend that the share fishermen rate fall in line with class 2 to £4.50 a reduction of £1.30 a week. The cost is less than three-quarters of a million in a full year.

**Armed Forces**

10. The armed forces pay NICs at contracted out rates but the rate they pay is rebated by an additional 0.65% because they are not entitled to some benefits. And unlike the contracted out,

this rebate applies to NICs on earnings below as well as above the LEL. Thus at present they pay 8.35% (9%-0.65%) on earnings up to the LEL and 6.35% (7%-0.65%) on earnings between the LEL and UEL. In the new system the rebate of 0.65% would be a considerable proportion of the 2% on earnings up to the LEL. We do not think this would be justified so we recommend that the armed forces rebate should only apply between the LEL and UEL. The effect would be to reduce the gains of armed forces earning above the reduced rate bands from £3.01 a week to £2.73. The cost of the main package applied to the armed forces is about £50 million in a full year but this is included in the costing of the package already provided by the GAD. Applying the armed forces rebate only between the LEL and UEL would bring in revenue of £5 million in a full year.

## Conclusion

11. You are asked to agree which option should be adopted for married women optants and to the proposals for voluntary contributions share fishermen and the armed forces.

12. Please note that the costs set out above would be additional to the costings for the package so far provided by GAD (except for the armed forces). The full year cost of our recommended options would be £35 million. If you were to go for the most generous (second) option for married women optants, this would rise to £53 million.

Chris Speedy

**C SPEEDY**

BUDGET CONFIDENTIAL

fst.jf/SUSAN/2.3.4

FINANCIAL SECRETARY TO THE TREASURY

Pmg

PS/CHANCELLOR

FROM: MISS S J FEEST
DATE: 2 MARCH 1989

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gilhooly
Mr Mowl
Mr Gieve
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

NICS REFORM: CONSEQUENTIAL CHANGES

The Financial Secretary has seen Mr Speedy's minute of 2 March to the Chancellor and is in favour of Option 3 for married women optants.

Susan

MISS S J FEEST
(ASSISTANT PRIVATE SECRETARY)

FROM: J M G TAYLOR
DATE: 2 March 1989

**MR MCINTYRE**

cc **Mr Anson**
**Mr Culpin**
**Mr Michie**
**Mr Speedy**

**NICS REFORM: DSS CONSULTATION**

The Chancellor has seen your note of 1 March. He is content to go along with your conclusion that the additional DSS officials should be brought into the consultation at the time and on the basis described in the Annex to your note, except for the Press Officer who must wait until later.

J M G TAYLOR

chex.rm/jmt1/91 **BUDGET CONFIDENTIAL**

CHANCELLOR OF THE EXCHEQUER

FROM: J M G TAYLOR
DATE: 2 March 1989

PMP

**MR MCINTYRE**

cc **Mr Anson**
**Mr Culpin**
**Mr Michie**
**Mr Speedy**

**NICS REFORM: DSS CONSULTATION**

The Chancellor has seen your note of 1 March. He is content to go along with your conclusion that the additional DSS officials should be brought into the consultation at the time and on the basis described in the Annex to your note, except for the Press Officer who must wait until later.

J M G TAYLOR

st1mar.2

BUDGET SECRET

Agreed with CST: go for option 2, unless Mr Moore vehemently objects; in which case option 3.

Copy of 1 of 23

FROM: C SPEEDY

DATE: 3 March 1989

1. MR ~~MCINTYRE~~

2. CHANCELLOR

None of this affects the Budget arithmetic. But the medium term outlook for the NIF is more difficult than GAD's earlier figures suggested. There is a good case for adjusting the NHS allocation, as in Mr Speedy's para 6, as part of the package to avoid speculation that contributions may have to rise in the mid-90s to finance benefits.

JM
3/3.

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gilhooly
Mr Mowl
Mr Gieve
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

**BUDGET CHANGES AND THE NATIONAL INSURANCE FUND**

We and the GAD have been looking again at the figures for the effect of the national insurance changes and abolition of the pension earnings rule on the balance in the national insurance fund in the medium term. The position is rather less comfortable in the medium term than we previously advised (my minute of 24 February), though there is no problem in the short term. The new figures reflect the following changes:

i. the effect of reduced interest on the lower balance in the Fund (this was not taken account of in the earlier calculations).

ii. allowance for an expected reduction in the contracted out rebate to 5% in April 1993 (the rebate, now 5.8 per cent, is adjusted every 5 years; other things being equal the rebate falls as people given enhanced accrual at the start of SERPS

Ch
V awkward to present a 'cut' in NHS allocations. CST's views?

AA

Yes - tho' not all that awkward - we never made any big public presentation of the NHS allocation - and I'm not sure you need to make it. I am attracted to the reasoning for option 2.

retire and are replaced by new workers without enhanced accrual).

iii. FSBR forecast assumptions rather than those made in December, including a higher projection for the number of personal pensions in line with experience in 1988-89.

iv. The higher DSS estimates for the cost of abolishing the pensioners' earnings rule.

2. Table 1 at Annex A shows the revised projections.

3. Some of these changes tend to increase the balance in the Fund, others to reduce it. But the net impact is to reduce the balance to some £4½ billion at the end of 1993-94, compared with £7 billion in the earlier projections. This would be only 12% of outgo and still be falling. It would be thus well below the GAD recommended minimum of 17½% and could not be sustained. Although the projection is clearly subject to a large degree of uncertainty especially on the number of future personal pensions and extent of real earnings growth, it means that we need to consider again whether action should be taken to avoid the balance falling too far.

4. One option in view of the uncertainty would be to wait to see whether the balance actually does fall below 17½ per cent. The risk with this option is that if the balance did fall too far, a major change in the NHS allocation might be needed or else re-invention of the Treasury Supplement.

5. More immediately, although there is no legal requirement for GAD to produce a report on the Fund to accompany the DSS legislation, the Department are bound to be asked soon after the Budget Statement, for example in proceedings on the Bill, to give estimates for the medium and long term impact on the Fund. (As it happens, the Social Services Committee has already asked them to update the long term projections in the 1985 Green Paper for NI benefits and contributions. A response is due by Easter). If no action were underway to prevent the balance in the Fund falling

below 17½ per cent, this would show up in the DSS response, in terms of higher required contribution rates. GAD say that a total contribution rate (employers and employees) of 19.85 per cent, 0.4 per cent higher than now, would be needed in 1995-96 to leave a reasonable balance in the Fund. This could be embarrassing, so soon after your announcement of NIC reductions. For these reasons, a do-nothing approach has distinct disadvantages. We have therefore considered two other options.

6. So far we have assumed that all the cost of the NICs changes would fall on the Fund. There is however, a case for some reduction in the NHS allocation. In particular, it is perhaps unreasonable that more than half employees NICs on earnings below the LEL (ie 1.05% out of 2%) should be diverted to finance the NHS, with the result that only 41p of the 86p "entry ticket" would finance benefits. So a second option would be to have **a zero employees' NHS allocation on earnings up to the LEL** (the employers' NHS allocation would be unchanged). With this change, the balance in the Fund as a proportion of outgo is projected to bottom out at 19% in 1993-94 (see Table 2 at Annex A). This would need primary legislation, which could be included in the current Bill along with the rest of the package.

7. A third option would be to **reduce the rate of the NHS allocation**. If the NHS allocation were reduced by 0.1% for both employees and employers in 1990-91 and 1991-92 the balance in the fund by 1993-94 would bottom out at 22% of outgoings (see Table 3 at Annex A). A decision to begin these reductions would not be required until the Autumn 1989 review of national insurance contributions. Reductions of upto 0.1% a year could be achieved by regulations.

8. This option would not prevent the new GAD/DSS projections pointing to higher contribution rates in the mid-90s, because they would assume no change in the NHS allocation. DSS would therefore have to announce, in presenting the projections, that contributions would not necessarily rise in the medium term and that adjustments in the NHS allocation could be made to maintain a reasonable balance in the Fund. (Such a statement ought to be

able to avoid giving the false impression that the government was thinking of cutting NHS expenditure to finance benefits, but this would be one of the risks in this option).

9. The second and third options are not mutually exclusive. It would be possible to take the second option now and if the balance in the fund became too low to reduce the NHS allocation on a year by year basis, as necessary.

**Recommendation**

10. It seems likely that DSS will have to produce new medium and long term projections for the NIF soon after the Budget. Without action (or at least a statement of intent) on the NHS allocation, these projections would point to the need for an increase in contribution rates of about 0.4 per cent by 1993-94 in order to finance benefits (uprated by prices). To avoid this, we think there is a good case for considering the second option and using the current Bill to eliminate the NHS allocation from the 2 per cent NIC payable on earnings upto the LEL. This could be presented as a reasonable step to take on its merits, in order to avoid over half the minimum contributions going to finance the NHS rather than contributory benefits. It would not appear primarily a means of protecting the NIF balance in the longer term.

11. We would be grateful for your views. If you would like this option considered further, we will consult DSS officials. If we are to do it, there might well be advantage in having it announced as part of the Budget Day detail, rather than separately later on, when it might attract more attention.

Chris Speedy

C SPEEDY

Annex A

**Table 1**

**NIF Projected with Budget Changes**

£m

| Year | Outgo | Fund balance at end of year | Balance as per cent of outgo |
|---|---|---|---|
| 1988-89 | 27,636 | 9,946 | 36 |
| 1989-90 | 29,562 | 10,693 | 36 |
| 1990-91 | 32,069 | 9,124 | 28 |
| 1991-92 | 33,920 | 7,352 | 22 |
| 1992-93 | 35,616 | 5,533 | 16 |
| 1993-94 | 37,397 | 4,431 | 12 |
| 1994-95 | 39,267 | 4,262 | 11 |
| 1995-96 | 41,230 | 4,086 | 10 |

**Table 2**

**NIF Projected with Budget Changes and no employees' NHS allocation below LEL**

£m

| Year | Outgo | Fund balance at end of year | Balance as per cent of outgo |
|---|---|---|---|
| 1988-89 | 27,636 | 9,946 | 36 |
| 1989-90 | 29,562 | 10,862 | 37 |
| 1990-91 | 32,069 | 9,800 | 31 |
| 1991-92 | 33,920 | 8,595 | 25 |
| 1992-93 | 35,616 | 7,414 | 21 |
| 1993-94 | 37,397 | 7,028 | 19 |
| 1994-95 | 39,267 | 7,661 | 20 |
| 1995-96 | 41,230 | 8,381 | 20 |

**Table 3**

**NIF Projected with Budget Changes and cuts in employers' and employees NHS allocation of 0.1% in 1990-91 and 1991-92**

£m

| Year | Outgo | Fund balance at end of year | Balance as per cent of outgo |
|---|---|---|---|
| 1988-89 | 27,636 | 9,946 | 36 |
| 1989-90 | 29,562 | 10,693 | 36 |
| 1990-91 | 32,069 | 9,542 | 30 |
| 1991-92 | 33,920 | 8,749 | 26 |
| 1992-93 | 35,616 | 8,102 | 23 |
| 1993-94 | 37,397 | 8,335 | 22 |
| 1994-95 | 39,267 | 9,682 | 25 |
| 1995-96 | 41,230 | 11,222 | 27 |

Main assumptions used in projections:

i. Based on GAD forecast using Treasury FSBR assumptions until 1991-92.

ii. Thereafter contributions assumed to grow at 7% per annum (in line with earnings) and outgo to grow at 5% (in line with prices).

iii. Interest rate assumed to fall from present levels to 8% by end of projection.

iv. Contracted out rebate falls by 0.8% in April 1993.

v. Budget changes are NICs package without the self-employed and with pensions earnings rule abolition.

COPY NO. 24 OF 25.

FROM: A C S ALLAN

DATE: 3 March 1989

pap

MR SPEEDY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Gilhooly
Mr McIntyre
Mr Mowl
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

**NICs REFORM: CONSEQUENTIAL CHANGES**

The Chancellor was grateful for your minute of 2 March. The recommendations have been somewhat overtaken by the Chancellor's decision to leave the Class II rate unchanged. It would thus no longer be possible to criticise not changing the married women optants' rate on the grounds that everybody else's NICs were being cut. The Chancellor thus feels that:

(i) there should be no change for married women optants;

(ii) the Class III rate should be reduced as proposed (though the formula will need to be expressed in terms of Class I not Class II);

(iii) no change for share fishermen;

(iv) the Armed Forces rebate should be changed as you propose.

ACSA

A C S ALLAN

rc 1989/3.3.02

BUDGET SECRET

COPY NO 1 OF 18

FROM: ROBERT CULPIN
DATE: 3 March 1989

CHANCELLOR

cc: Chief Secetary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Scholar
Mr Riley
Mr Gieve
Mr Gilhooly
Mr McIntyre
Mr Matthews
Mr Pickford
Mr Macpherson
Mr Ford

Thanks. While we sh[oul]d certainly make use of X, we sh[oul]d not make use of the main point, because of our Achilles' heel, the taxpayer pensioners,* who are v. vocal & for whom this is clearly the worst option. (It also shows that the comparison is slightly spurious, in that what ought to be compared is this v. options w. the same exclusion of the one category of ~~pensioners~~ pensioners.) So NO COMPARISONS. This must be presented on its own merits.

## WHO GAINS FROM THE NATIONAL INSURANCE REFORM?

You might like to glance at these two pictures. They compare the gains from the Budget NIC reform with a roughly equal-cost increase in tax allowances or reduction in the basic rate.

2. The main message is that for people between about half and about average earnings, the NIC reform is much the best option. This is the shaded area on the charts.

3. Two caveats:

- pensioners cannot gain on NICs, because they do not pay them;

- savers cannot gain on their investment income, because it does not suffer NICs.

* not to mention the self employed

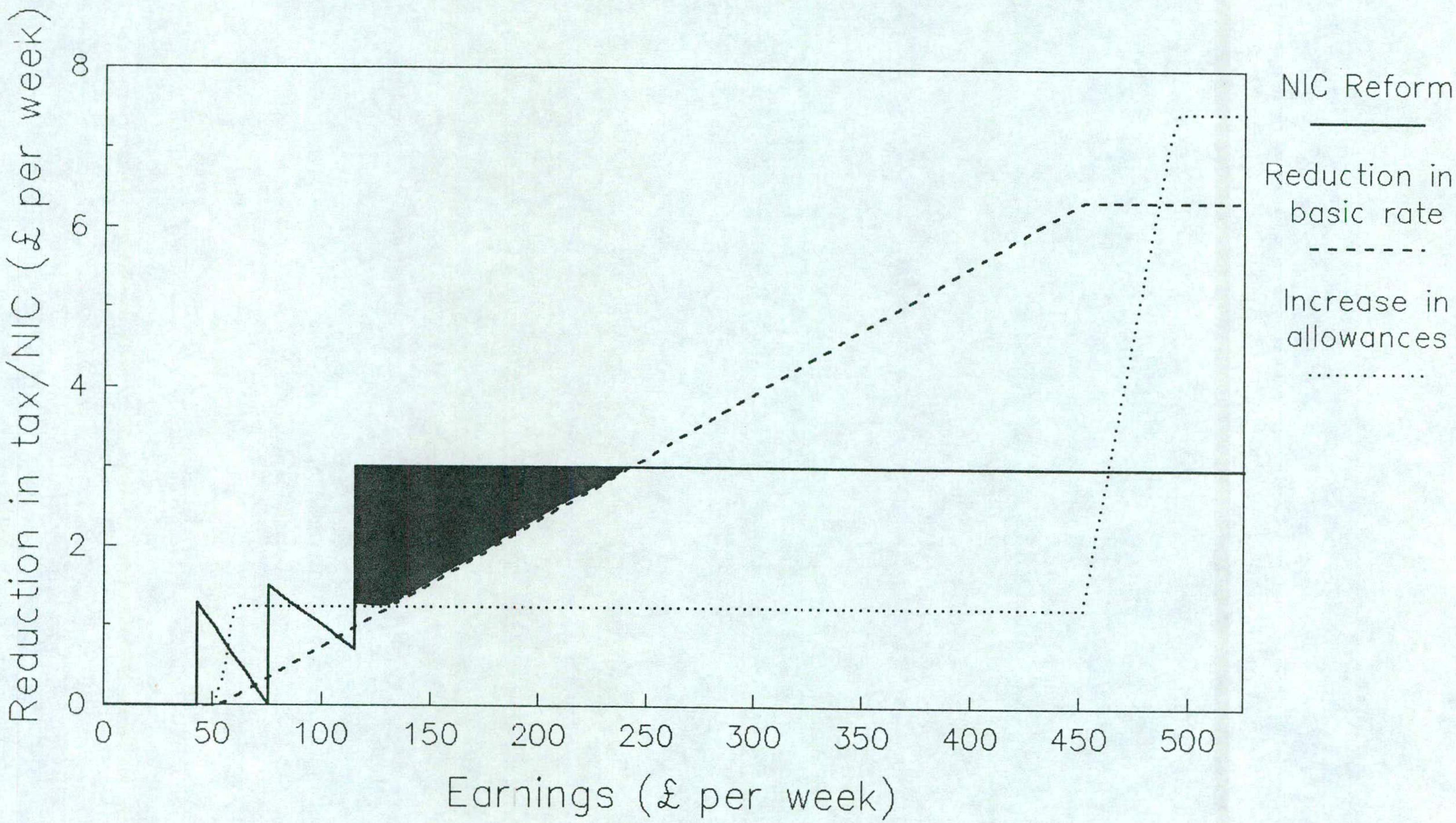
4. Below half average earnings, the gains from the NIC reform are necessarily jagged. That is because of the steps in the present system.

5. 70 per cent of the benefit of the NIC reform goes to those earning less than average male full-time earnings.

Rc

ROBERT CULPIN

## Comparison of tax/NIC packages
### Single person – gain in pounds per week

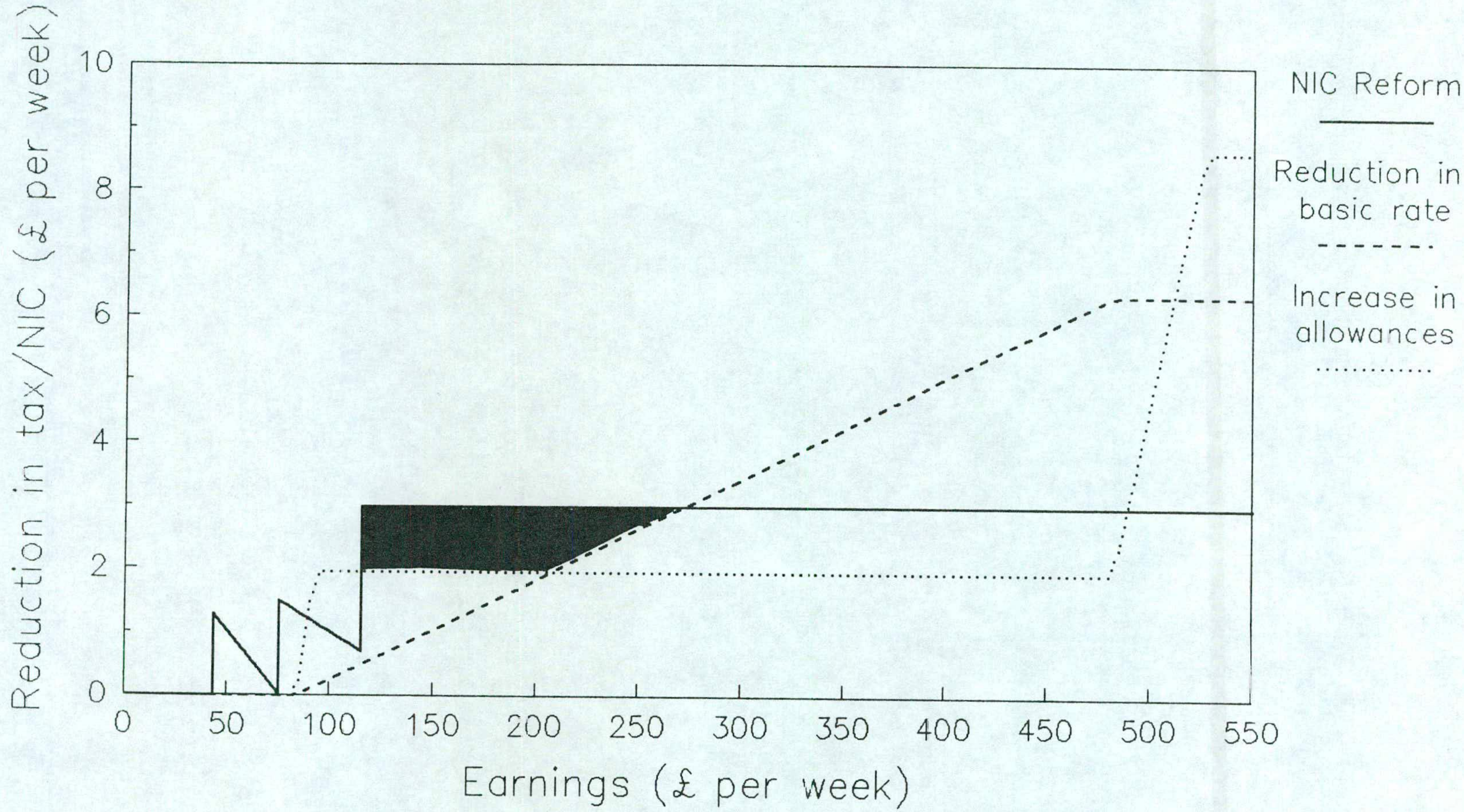



NICs system as in scorecard
Reduction of 1.6 per cent in basic rate
Real increase of 10 per cent in allowances

Options all have approximate cost of £2.8 billion in 1990–91

## Comparison of tax/NIC packages

### Married man – gain in pounds per week




NICs system as in scorecard
Reduction of 1.6 per cent in basic rate
Real increase of 10 per cent in allowances

Options all have approximate cost of £2.8 billion in 1990–91
(Figures assume non–working wife)

rc 1989/3.3.03

BUDGET CONFIDENTIAL

Py

FROM: ROBERT CULPIN
DATE: 3 March 1989

MR MCINTYRE

cc: Mr Riley
Mr A C S Allen
Mr Gilhooly
Mr Matthews
Miss Simpson
Mr Macpherson

**THE GAD ON NICS**

Will there be a GAD White Paper on the forthcoming National Insurance changes? If so, do we know when it will be published?

2. I only ask because we need to keep track of all the bits and pieces which will be appearing at and around the time of the Budget.

RC

ROBERT CULPIN

BUDGET CONFIDENTIAL

FROM: J P MCINTYRE
DATE: 6 March 1989

MR CULPIN

cc Mr Riley
Mr A C S Allan
Mr Gilhooly
Mr Matthews
Mr Macpherson
Miss Simpson
Mr Speedy

**GAD ON NICS**

Your minute of 3 March.

2. The DSS solicitor has advised that there is no legal requirement for a GAD White Paper on the forthcoming NIC changes. And DSS say there was no White Paper at the time of the 1985 changes. However, they are putting the point to their Secretary of State to see whether, as a matter of policy, he would want a White Paper published.

3. If there were to be a White Paper, it would be published on 12 April, along with the relevant New Clauses to the Bill at Report Stage.

4. However, it is quite likely that DSS will be asked on Budget day, or very soon afterwards, what the impact of the various changes, including abolition of the pensioners' earnings rule, will be on the NIF. A line to take on this will be in the briefing.

JM

J P MCINTYRE

chex.rm/aa1/63 **BUDGET SECRET**

COPY NO 17 OF 19 COPIES

FROM: A C S ALLAN
DATE: 6 March 1989

Pay

MR CULPIN

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Riley
Mr Gieve
Mr Gilhooly
Mr McIntyre
Mr Matthews
Mr Pickford
Mr Macpherson
Mr Ford

**WHO GAINS FROM THE NATIONAL INSURANCE REFORM?**

The Chancellor was grateful for your minute of 3 March. He feels that, while we should certainly make use of the point that 70 per cent of the benefit of the NIC reform goes to those earning less than average male full time earnings, we should not make use of ~~the~~ your main point (that for people between about half and average earnings the NIC reform is much better than an equal cost increase in tax allowances or reduction in the basic rate) because of our Achilles' heel, the tax paying pensioners (not to mention the self-employed), who are very vocal and for whom this is clearly the worst option. (This also shows that the comparison is slightly spurious, in that what ought to be compared is the NIC relief versus options which cost the same excluding the cost of relief to pensioners). So no comparisons. This reform must be presented on its own merits.

ACSA

A C S ALLAN

COPY NO. 26 OF 26 .

FROM: A C S ALLAN
DATE: 6 March 1989

MR SPEEDY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Gilhooly
Mr McIntyre
Mr Mowl
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

**BUDGET CHANGES AND THE NATIONAL INSURANCE FUND**

The Chancellor was grateful for your minute of 3 March. He would be grateful for the Chief Secretary's views. His initial comments were that it need not be all that awkward to present a "cut" in the NHS allocation, given that we have never made anything of the increases in the NHS allocation in recent years, nor did anyone else. He is attracted to the ingenious option 2 (a zero employee's NHS allocation on earnings up to the LEL).

A C S ALLAN

I agree: we should leave Class 3 unchanged. JM 6/3

FROM: C SPEEDY

DATE: 6 March 1989

Grateful for views of CST

1. MR MCINTYRE
2. CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Gilhooly
Mr Mowl
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

PS/IR

Ch
Robert is not convinced. With no change in Class 3, how would we justify big difference in entry ticket for employed (86p + £2.15 employer) and unemployed wishing to pay Class 3 (£4.15)
AA

**NICS REFORM: CONSEQUENTIAL CHANGES**

Mr Allan's minute of 3 March recorded your decisions on my submission of 2 March. Unfortunately, in one respect, the advice in this submission was somewhat overtaken by the decision to leave class 2 NICS paid by the self employed unchanged. A cut in Class 3 (voluntary contributions) could make it more difficult to defend no change in Class 2, and this submission advises you to reconsider your decision on Class 3.

**The Link Between Class 2 and Class 3 Contributions**

2. There is no statutory requirement for Class 2 and 3 contributions to be linked, but it is logical, and more easily defensible, that these two flat rate contributions should be fixed consistently.

<u>Class 2</u> Contributions (£4.25 a week) entitle a person to

* Flat rate retirement pension, and widows benefits; and

* Sickness and invalidity benefits.

<u>Class 3</u> Contributions (£4.15 a week) entitle a person to flat rate retirement pension only.

3. Since 1985, Class 2 contributions have been fixed as the combined (employees and employers) Class 1 contribution at the LEL (ie. 10 per cent) less 5 pence to reflect the fact that the self-employed are not entitled to unemployment benefit. Class 3 contributions are calculated by subtracting a further 10 pence to reflect non-entitlement to sickness benefit.

4. A cut in the Class 3 rate from £4.15 to £2.85 whilst keeping the Class 2 rate at £4.25 would therefore introduce an inconsistency. The only way of defending the difference of £1.40 between the Class 2 and Class 3 rates would be that the cost of sickness benefit had increased substantially. This would be impossible to sustain. In short, the rates must hang together or they will hang separately.

**Recommendation**

5. We recommend that, now it has been decided to leave Class 2 unchanged, Class 3 should also be left unchanged. This would cut the cost of the package by £4 million in 1989-90 and £11 million in 1990-91.

pp **C SPEEDY**

cst.ps/7ce8..,..ins

BUDGET SECRET

COPY NO 2 OF 23 COPIES

JM/89/9.

0463

FROM: MISS C EVANS
DATE: 8 March 1989

pmp

MR SPEEDY

cc: PS/Chancellor
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Scholar
Mr McIntyre
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Gilhooly
Mr Mowl
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

**NICS REFORM: CONSEQUENTIAL CHANGES**

The Chief Secretary and the Chancellor have discussed the recommendation on the Class 3 rate put forward in your submission of 6 March. In addition to the option of cutting the Class 3 rate to £2.85, the Chief Secretary discussed with Mr McIntyre yesterday the case for a cut to 86p, which would align Class 3 with Class 1.

2. Ministers have concluded that we should leave Class 3 contributions unchanged in the Budget. They fear that a reduction in Class 3 would carry a strong risk of worsening the reaction of the self-employed to the unchanged Class 2 rates. If there is pressure to cut Class 3, we could do this in the Committee stage of the Social Security Bill or in the Autumn Statement.

CE

MISS C EVANS
Private Secretary

Graph of this cost costing ASAP. Is £3bn Fy an conv?

FINANCIAL TIMES

SHADOW BUDGET

# Labour calls for package for poor

12 3

By Michael Cassell, Political Correspondent

A BUDGET package designed to help the less well-off and costing around £3bn was last night presented to the shadow Cabinet by Mr John Smith, the shadow Chancellor.

With the Budget only six days away, Labour is maintaining its call for Mr Nigel Lawson, the Chancellor, to concentrate on proposals intended to help the lower-paid.

The Opposition has been heartened by opinion poll evidence that Mr Lawson – and in particular his Budget last year – is being held responsible for the present economic difficulties. There remains concern, however, that the party has some way to go in convincing voters that it can provide a more equitable and effective stewardship of the economy.

With Labour's policy review in its final stages, the party is assembling its own economic proposals, which are expected to incorporate graduated tax bands beginning at around 15 per cent and rising to around 50 per cent.

In a statement to the last shadow Cabinet meeting before the Budget, Mr Smith accused the Chancellor of "showering largesse" on the rich in 1988 and said that he should be ready this year to do elementary justice to the less well-off.

He unveiled a package of measures which would meant that a family with two children on 75 per cent of average earnings (£190.57 a week) would gain more than £6 a week.

Mr Smith said a priority was the restoration of the real value of child benefit, which should rise from £7.25 to £8.35 in order to restore the level it would have reached if it had not been frozen.

He also called for a generous uprating of personal allowances, emphasising that even if they rose by 8.75 per cent there would be no change in the taxpayers' tax burden.

Mr Smith claimed that, to help taxpayers having difficulty in making ends meet, personal allowances would have to rise by substantially more than the rise in earnings and the increases should be concentrated on the benefits available at the bottom end of the scale.

Labour also wants to see radical reforms in the national insurance system, which it claims has become unfair because it is not progressive. Mr Smith suggested that the Chancellor should change the lower earnings limit into an allowance, so that national insurance contributions are paid only on the excess of income over £43 – the lower earnings limit from this April.

The Chancellor, Mr Smith suggested, should help pay for the reform by removing the upper limit on contributions. In this way, he claimed, national insurance would be made a much fairer system and a serious poverty trap for lower wage earners could be removed.

Mr Smith said that the £3bn cost of his proposals would not be much different from the fiscal drag total of £2bn-£3bn which accrues to the Chancellor in bigger-than-expected tax revenues

John Smith: 'largesse showered on rich in 1988'

THE TIMES

## Fun evening

27

Some of most incisive comment on Tuesday's Budget could come at a dinner to be held the following Thursday in Westminster. Up to 40 ex-Treasury economists will be attending the thrash at the St Ermyn's Hotel which, if successful, could turn into an annual event. Those invited must have worked as an economist under Chancellors Healey, Howe or Lawson and be bona fide private sector workers now. Joint organizer, Penelope Rowlatt, now with National Economic Research Associates, says that the occasion will be informal but that contributions from the floor on the Budget or related matters will be welcomed.

The Guardian

## Shadow budget gives lower paid £6.50 extra per week

6 1

Patrick Wintour

A PACKAGE aimed at giving nearly half Britain's wage earners an extra £6.50 a week was proposed yesterday by the shadow chancellor, Mr John Smith, as part of his strategy of opposition to Mr Nigel Lawson's Budget next Tuesday.

He told a meeting of the shadow Cabinet: "In 1988, Mr Lawson showered largesse on the rich. In 1989, he ought to do elementary justice to the less well-off."

Mr Smith said the Government could target help on the low paid by a £3 billion package made up of increases in personal tax allowances, child benefit and a major reform of the National Insurance system.

Mr Smith proposed that the Chancellor increase child benefit to £8.35 a week, the level it would have reached had it not been frozen last year.

He also called for an increase in personal allowances for those at the bottom of the income scale of well above 8.75 per cent — the current increase in average earnings.

Mr Smith's chief demand is for the upper limit on National Insurance contributions to be removed so that people with an income above that limit — currently £15,800 — be liable for contributions on their higher earnings. The money would be used to help the lower paid.

2/1

Ch Ex 14/2

RT. HON. JOHN SMITH QC MP

HOUSE OF COMMONS LONDON SW1A 0AA

Telephone: 01- 219 6441
Fax: 01- 219 5792

# Press Notice

EMBARGOED NOON
THURSDAY 9 MARCH 1989

## SHADOW CHANCELLOR WARNS AGAINST FURTHER CUT IN TAX RATES

In an article published in 'Tribune' today the Shadow Chancellor of the Exchequer, the Rt Hon John Smith QC MP, warns against further cuts in tax rates in next week's budget.

Last year's tax giveaway, argues the Shadow Chancellor, "fuelled the Tory consumer credit boom sending Britain massively into the red. The record trade deficit in 1988 of over £14,000 million is the awful legacy of Mr Lawson's foolhardy and unfair budget".

"The same mistakes must not be made again. What Britain needs this year is a budget designed to restore balance to the economy and fairness in society. We must return to a progressive tax system with contributions based upon ability to pay. And we must tackle the supply-side constraints that limit the potential for economic growth."

"In the present tax structure, a further cut in the basic rate would compound the errors of the 1988 budget. Last year the Chancellor showered tax cuts on the richest members of our society. This year he should change the habits of a lifetime and help the low paid. He should generously uprate personal allowances, radically reform the structure of our national insurance system, and increase child benefit."

ENDS

NOTE: Copies of Tribune are available in the Press Gallery - or ring 278 0911

# "OUT WRITE"

THE Labour Party prides itself on its achievements at local government level. Housing, education and the social services have all been the subject of intense Labour activity and provision, that provision providing excellent examples of service to the community.

All the more surprising then that many party members should ignore a whole tier of local government. "What?" I hear you say, "a whole tier?" Yes, a whole tier. I refer to parish councils.

This lack of interest is based on a false assumption: parish councils have little or no powers to exercise, and are therefore merely talking shops. This assumption needs to be discarded and replaced by a more realistic understanding of their work.

To begin with, parish councils only exist in England (outside London) and Wales (where they are called community councils). They do not exist in Scotland or Northern Ireland. In total there are about 8,600, and they are specifically civil parishes and not to be confused with ecclesiastical parishes centred on the Anglican church.

## Winning at the parish pump

They exist as small local authorities and councillors are elected every four years, similar to other councils; the next elections will take place in 1991. However, much of this is detail. Party members will be much more interested in what parish councils can do. The answer is plenty.

For a start, parish councils issue their own rate precepts, and that power cannot be restrained. They are free to set a rate appropriate to their needs – common sense will usually dictate a ceiling. That freedom, and the support of the local community, has allowed a number of councils to set up and provide a wide range of community services.

Leisure and recreation facilities are a very popular form of provision. My own parish council has a leisure complex that provides squash courts, football pitches, allotments, a bowling green and social club. In the expanding field of leisure and recreation, this local provision is always well-used and usually provided at modest rates, with concessionary rates for the unwaged and youngsters.

# Lawson pile mistakes on

**Last year's budget fu to high interest rate trade deficit. Labour' JOHN SMITH dema budget should tackle t economi**

NIGEL LAWSON described the 1988 budget as a "milestone", but for the majority of people in Britain, the Chancellor's milestone has become a millstone round their necks. Higher and higher interest rates are hurting industry, and have sharply increased the cost of living – more than wiping out the effect of last year's tax cuts.

The tax give-away fuelled the Tory consumer credit boom sending Britain massively into the red. The record trade deficit in 1988 of over £14,000 million is the awful legacy of Mr Lawson's foolhardy and unfair budget.

But the Chancellor's fiscal errors of 1988 are being compounded by his monetary mistakes in 1989. His reliance on interest rates alone as the universal panacea for the nation's economic ills harms Britain's export performance and makes the deficit worse.

The Chancellor hopes that the unbalanced credit boom will be slowed to a so-called 'soft landing'. Mr Lawson wants high interest rates to effect a sharp decrease in

**'As Tory Britain lives beyond its means, Lawson fills the gap by holding interest rates high to**

The Government argues that high interest rates are needed to control inflation. But high interest rates are also needed to help pay for the deficit. As Tory Britain continues to live beyond its means, unable to pay its way in the world, Mr Lawson is filing the hole in the balance of payments by holding interest rates high enough to attract capital from abroad.

But as a result Britain is becoming dangerously dependent on a mountain of "hot money" placed short term in London. Mr Lawson is at the mercy of the money markets of the world. Market sentiment could turn against sterling at any time. And if such a loss of confidence were to occur, then the pound would inevitably decline – unless the Chancellor raised interest rates even higher.

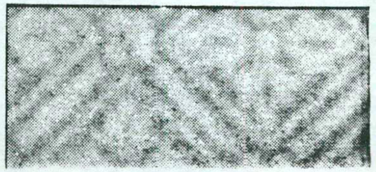
The Government's high interest rates are the "risk premium" that must be paid to finance the deficit. Mr Lawson is prepared to pay this price because it buys time for the Government to bring about the so-called "soft landing". But the price is really paid by industry, and by the British people, as the cost of living soars.

It is a risky strategy. The interest rate weapon is a double-edged sword. It makes its impact both on demand and the exchange rate. Nobody knows how long a balance of payments deficit of over £14,000 million can be financed, and what level of interest rates will be necessary to maintain the stability of the

pushed by rising prices. This government has managed to create both cost–push and demand–pull inflation at the same time.

The Tory credit boom has allowed demand to surge ahead of our industry's ability to supply. The recession of the early eighties has seriously weakened the British economy with the result that skill shortages and capacity constraints quickly fuel inflation. Meanwhile the Government has pushed up the price of water, electricity, transport, and, of course, borrowing.

High interest rates actually make inflation worse, forcing up mortgage rates which, in turn, raise the retail price index. The Chancellor would like to fiddle the figures and take



# n piles monetary es on fiscal error

**Last year's budget fuelled inflation and led to high interest rates to fund the Tories' trade deficit. Labour's Shadow Chancellor JOHN SMITH demands that this year's budget should tackle the real constraints on economic growth**

pushed by rising prices. This government has managed to create both cost–push and demand–pull inflation at the same time.

The Tory credit boom has allowed demand to surge ahead of our industry's ability to supply. The recession of the early eighties has seriously weakened the British economy with the result that skill shortages and capacity constraints quickly fuel inflation. Meanwhile the Government has pushed up the price of water, electricity, transport, and, of course, borrowing.

High interest rates actually make inflation worse, forcing up mortgage rates which, in turn, raise the retail price index. The Chancellor would like to fiddle the figures and take mortgage cost out of the RPI. But rising mortgage bills consume personal income just like any other price rise.

The Government makes spurious comparisons with other industrialised countries that do not include mortgage costs in their calculation of retail prices. But the pattern of home ownership in many other comparable countries is very different, and other forms of housing cost – such as rents – are included in price measures.

It is invidious of Mr Lawson to disclaim the inflationary effect of increased mortgage payments; and offers precious little comfort for the millions of homeowners who are facing increased mortgage bills.

Last March the Government's handling of the economy was grossly irresponsible. The budget gave the green light to borrow and spend as never before. The Chancellor chose tax cuts for the rich rather than prudent investment in the supply-side of the British economy.

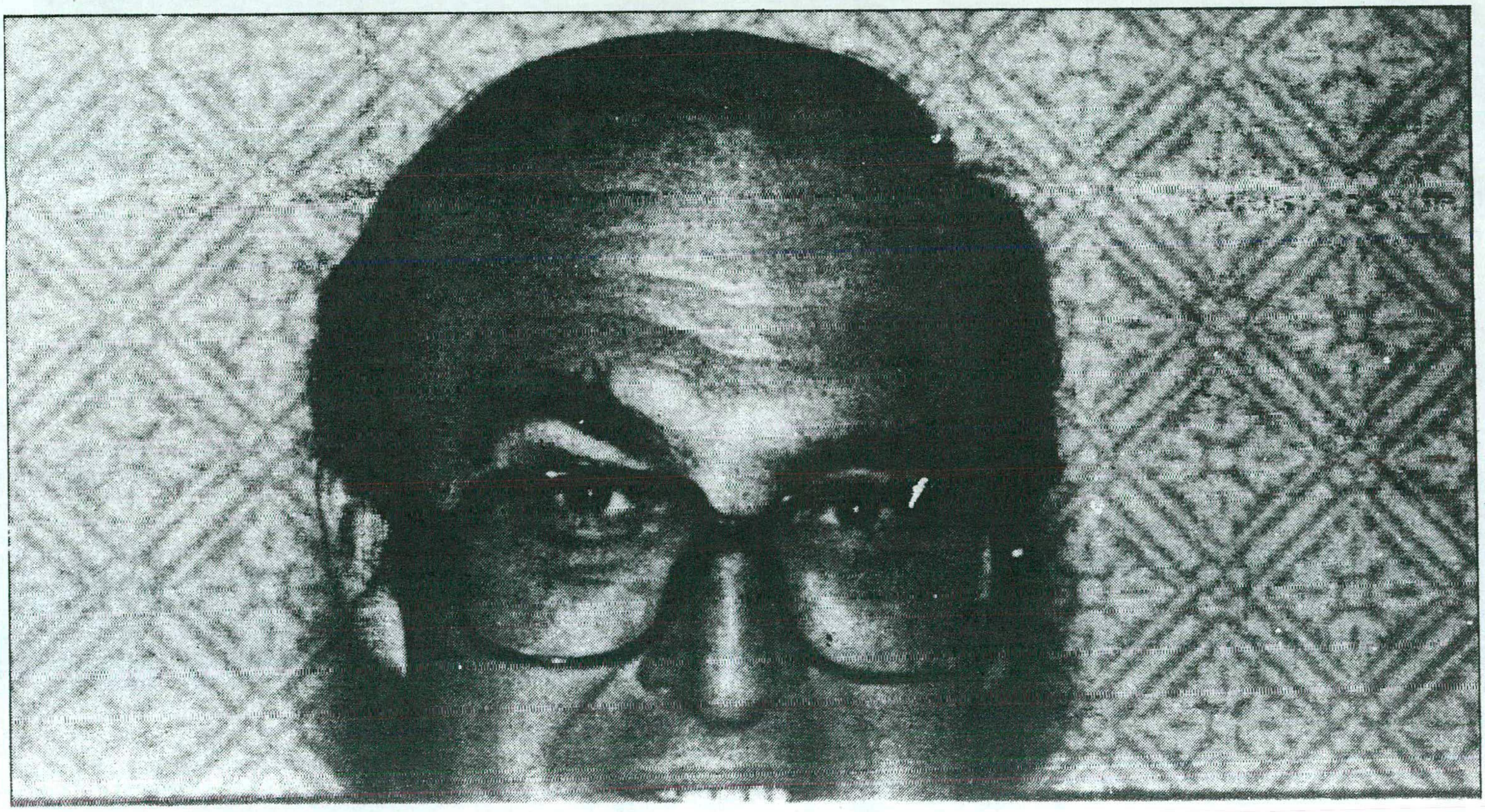
**'Britain needs a budget to restore balance to the economy and fairness in society. We must return to a progressive tax system'**

The billions that Mr Lawson gave away should have been invested in the regions, in education and training, and in research and development – laying the foundations for sustained economic growth.

The same mistakes must not be made again. What Britain needs this year is a budget designed to restore balance to the economy and fairness in society. We must return to a progressive tax system with contributions based upon ability to pay. And we must tackle the supply-side constraints that limit the potential for economic growth.

In the present tax structure, a further cut in the basic rate would compound the errors of the 1988 budget. Last year the Chancellor showered tax cuts on the richest members of our society. This year he should change the habits of a lifetime and help the low paid. He should generously uprate personal allowances, radically reform the structure of our national insurance system, and increase child benefit.

The record trade deficit must be reduced. The Chancellor should lessen his dependence on high interest rates. Fiscal, monetary and supply-side policies are needed to rebalance the economy, away from consumption in favour of investment. If the nation is to sustain economic and social progress in the 1990s, we cannot afford to waste the seedcorn from which genuine industrial miracles will grow.



A POWER that parish councils exercise, which has nothing to do with spending money, is the right to be consulted over planning applications. Although district and county councils are the planning authorities and therefore responsible for land development, parish councils have a right to be notified of any planning application affecting their area and are entitled to make comments which the planning authority must take into account. With the current emphasis on protecting the environment, this power is a valuable ally in the constant battle against those who would abuse the environment for personal gain.

A very useful general power the parish councils have is commonly called "the free 2p". This allows them to spend every year up to the product of a 2p rate on anything which in the opinion of the parish council is of benefit to its area or its residents. This is often used as a means of providing grants to organisations. The council I work for has given grants to numerous local organisations including pensioners' groups, the local youth and community centre, citizens' advice bureaux and football clubs.

PARISH councils can be innovative too. One council in our local area has taken to providing free milk to infant schools, thus restoring the situation that existed for many years until Thatcher "the milk snatcher" did away with free school milk when she was Secretary of State for Education in the Heath Government. Another council provides a warning light and alarm system for disabled residents, so enabling them to raise the alarm should they need any help.

In this short sketch I've only touched on some of the powers parish councils can exercise. To give you a flavour of their full powers, they can provide personally or have an input into: allotments, arts and crafts, baths, cemeteries, church yards, clocks, common land, entertainments, footpaths, halls, footway lighting, litter collection, mortuaries, open spaces, parking places, parks, planning, playing fields, ponds, post and telephone, public lavatories, roadside verges, seats, shelters, signs, swimming, tourism and village greens. Enough!

Alongside this provision there is something else they provide that will attract all socialists. It is their immediacy and accessibility for local residents. Being a truly local council they are far removed from the perceived distant bureaucracies of county and district councils. Local residents find in their parish councils something comfortable and reassuring. As socialists we need to "rediscover" them and take advantage of the opportunities they offer.

**JOHN KIMBERLEY**

## attract capital from abroad'

the growth of economic demand which will bring about a marked reduction in imports. The strategy rests on the highly questionable assumption that as domestic demand falls British industry will effortlessly switch its production to the export market.

Last November, in the Autumn Statement, the Treasury forecast import growth this year of only 5 per cent and an export surge of 7 per cent. But last week's trade figures for January already show that the Treasury's optimism is completely unjustified.

Non-oil exports are running 3 per cent below forecast and non-oil imports are running 2.5 per cent above forecast. The January deficit amounted to £1,700 million – the third highest monthly figure ever recorded. If the monthly deficits remain at this level all year we will end up with a trade gap in 1989 of over £20,000 million!

The Chancellor is determined to use interest rates as the sole means of controlling the unbalanced consumer boom. As a result the country faces the risk of repeating the recessionary mismanagement that occurred in the first term of Margaret Thatcher's Government.

Most extraordinary of all, the Government is being forced to slow down economic growth when "overheating" is confined only to the South East, and when the real level unemployment is still well above two million. High interest rates will worsen job prospects and widen the growing North–South divide.

How can our export industries be expected to dramatically improve their performance if high interest rates force up the value of the pound? The rise in the real exchange rate of over 20 per cent since the end of 1986 will damage the competitiveness of British industry. The Government's high pound, high interest rate strategy makes imports more attractive, not less.

The Government may be caught in scissors of their own making. The Chancellor may wish to relax the restraint on demand, but still need to protect the pound. Domestic indicators may suggest interest rate cuts, whilst external pressures move the other way. These self-inflicted policy dilemmas are the result of last year's economically inept and morally deficient budget.

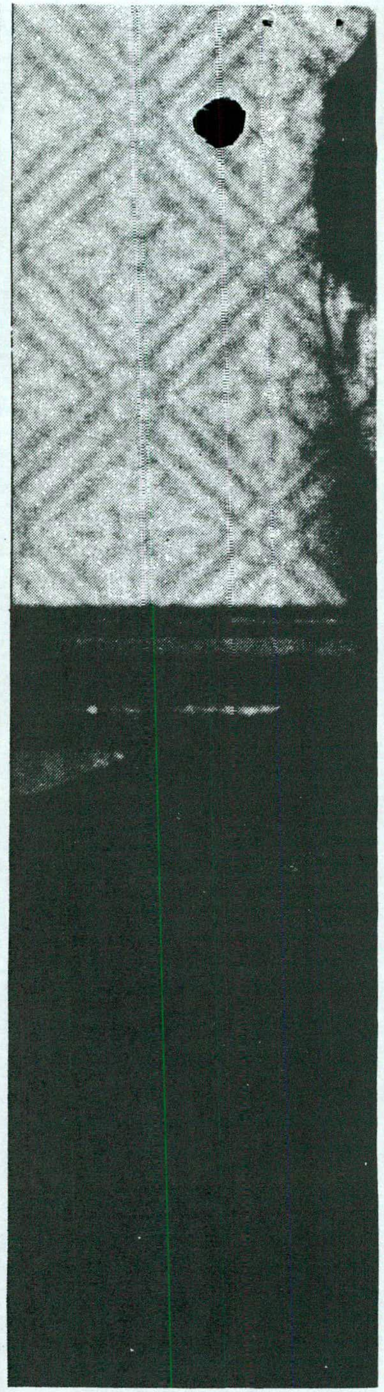
The credibility of Tory economic policy is being further undermined by the resurgence of inflation. After a decade of Tory rule Mrs Thatcher's claim to be the slayer of inflationary dragons is misplaced; her amibiton for zero inflation is being thwarted; and her Government provokes – not prevents – a spiral of rising prices.

The inflation rate is heading for 8 per cent, twice as high as last year's budget forecast, and the highest level of the seven leading industrial economies. Mr Lawson's "temporary blip" is maturing into a fully-blown prices spiral – an inflationary surge

**'The credibility of Tory economic policy is undermined by the resurgence of inflation. Mrs Thatcher has provoked a price spiral'**

which has been nurtured in this Tory government's own backyard.

The Chancellor is a disillusioned monetarist struggling unconvincingly to manage demand with interest rates alone. But Mr Lawson displays no real understanding of the causes of inflation. The word inflation is much abused in our language. It is single term used to describe a variety of circumstances. Inflation can be demand-led, or



chex.md/jmt/7 RESTRICTED

FROM: J M G TAYLOR
DATE: 9 March 1989

bf. 13/3

MR MATTHEWS (ETS)

cc Mr Scholar
Mr Culpin
Mr Pickford
Miss Simpson

Mr Calder IR

LABOUR'S 'SHADOW BUDGET'

... The Chancellor has seen the enclosed piece in today's FT.

2. He would be grateful for a costing, as soon as possible, of Mr Smith's alternative package. In particular, he has asked whether the £3 billion figure for the cost of Mr Smith's proposals is correct.

J M G TAYLOR

Thursday, March 9, 1989

Graph of this costing ASAP. Is £35 … Eg on conv…

FINANCIAL TIMES

SHADOW BUDGET

# Labour calls for package for poor

12¾

By Michael Cassell, Political Correspondent

A BUDGET package designed to help the less well-off and costing around £3bn was last night presented to the shadow Cabinet by Mr John Smith, the shadow Chancellor.

With the Budget only six days away, Labour is maintaining its call for Mr Nigel Lawson, the Chancellor, to concentrate on proposals intended to help the lower-paid.

The Opposition has been heartened by opinion poll evidence that Mr Lawson – and in particular his Budget last year – is being held responsible for the present economic difficulties. There remains concern, however, that the party has some way to go in convincing voters that it can provide a more equitable and effective stewardship of the economy.

With Labour's policy review in its final stages, the party is assembling its own economic proposals, which are expected to incorporate graduated tax bands beginning at around 15 per cent and rising to around 50 per cent.

In a statement to the last shadow Cabinet meeting before the Budget, Mr Smith accused the Chancellor of "showering largesse" on the rich in 1988 and said that he should be ready this year to do elementary justice to the less well off.

He unveiled a package of measures which would meant that a family with two children on 75 per cent of average earnings (£190.57 a week) would gain more than £6 a week.

Mr Smith said a priority was the restoration of the real value of child benefit, which should rise from £7.25 to £8.35 in order to restore the level it would have reached if it had not been frozen.

He also called for a generous uprating of personal allowances, emphasising that even if they rose by 8.75 per cent there would be no change in the taxpayers' tax burden.

Mr Smith claimed that, to help taxpayers having difficulty in making ends meet, personal allowances would have to rise by substantially more than the rise in earnings and the increases should be concentrated on the benefits available at the bottom end of the scale.

Labour also wants to see radical reforms in the national insurance system, which it claims has become unfair because it is not progressive. Mr Smith suggested that the Chancellor should change the lower earnings limit into an allowance, so that national insurance contributions are paid only on the excess of income over £43 – the lower earnings limit from this April.

The Chancellor, Mr Smith suggested, should help pay for the reform by removing the upper limit on contributions. In this way, he claimed, national insurance would be made a much fairer system and a serious poverty trap for lower wage earners could be removed.

Mr Smith said that the £3bn cost of his proposals would not be much different from the fiscal drag total of £2bn-£3b… which accrues to the Chanc… lor in bigger-than-expected … revenues

John Smith: 'largesse showered on rich in 1988 swm1.10.3

BUDGET CONFIDENTIAL

FROM: S W MATTHEWS
DATE: 10 March 1989

CHANCELLOR

Many thanks.
AA: Did you confirm re £720 & the NICs pt we spoke abt?
N.

cc PS/Chief Secretary
PS/Financial Secretary
Mr Scholar
Mr Culpin
Mr Pickford
Miss Simpson
Mr Wilson
Mr Tyrie

Mr Calder IR

**LABOUR'S "SHADOW BUDGET"**

A copy of Mr Smith's press release on his "Shadow Budget" is attached. It is rather thin on detail, and we have had to guess at some of the component parts in producing the following costings.

2 Child benefit Mr Smith proposes an increase in child benefit from £7.25 a week to £8.35 a week. This would cost about £690 million. This estimate excludes any flow backs from reduced payments of income support or family credit, as presumably Mr Smith would want poorer families to benefit from the increase in child benefit.

3. Personal allowances The cost of indexing the personal allowances in 1989-90 is some £1465 million. Each 1 per cent increase in personal allowances and the basic rate limit above this costs £205 million. Mr Smith calls for an increase in allowances of more than 8¾ per cent, to offset fiscal drag from the growth of earnings. An increase of 10 per cent in allowances would cost some £655 million more than the cost of indexation; a 15 per cent increase, some £1650 million more.

4 These figures are based on the Autumn Statement ready reckoners. If you wish to pursue the matter, the Inland Revenue statisticians would be able to update them so that they are fully consistent with the FSBR. (The changes would, though, probably be small).

5. Employees' NIC Mr Smith proposes turning the LEL into an allowance. The press release does not specify what he would do about the £75 p.w. and £115 p.w steps, but implies that he would either leave them intact or apply a 9 per cent marginal rate to all earnings above £43 p.w. If the latter were his intention, the main difference (at the lower end) from your Budget measures would be that Mr Smith would not keep the 86 pence a week "entry fee". This would cost some £845 million in a full year, above the £2.8 billion of your own package.

6. Mr Smith also proposes abolishing the UEL. This would bring in about £1.6 billion, ignoring any implications for additional future payments of SERPs.

The overall package

7. The total cost of Mr Smith's reform of employee NICs might thus be around £2 billion in a full year (£2.8 billion plus £0.8 billion for abolishing the entry fee, less £1.6 billion for abolishing the UEL).

8. When the £0.7 billion cost of the increase in child benefit is added in, this would leave only £0.3 billion for over-indexation of allowances if he is to keep within a £3 billion limit - not quite enough to finance even an 8¾% increase in allowances (assuming that he envisages the reform of NICs being implemented at the start of 1989-90).

9. Mr Smith's package presumably includes revalorising the specific duties.

SM.

S W MATTHEWS

RT. HON. JOHN SMITH QC MP

HOUSE OF COMMONS LONDON SW1A 0AA
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# Press Notice

PRESS RELEASE

EMBARGOED UNTIL 5 PM

WEDNESDAY 8 MARCH

## SHADOW CHANCELLOR CALLS FOR JUSTICE FOR THE LESS WELL OFF

"The Shadow Chancellor, Rt Hon John Smith QC MP, today outlined options that should be considered in the budget next week to help the low paid. In a statement to the Shadow Cabinet this evening Mr Smith proposed measures by which a family with two children on 75% of average earnings (£190.57 per week) would gain over £6 per week.

The Shadow Chancellor's statement proposes

* Restoration of the cuts in Child Benefit
* Generous uprating of personal tax allowances
* Radical reform of the system of National Insurance

A copy of the Shadow Chancellor's statement to the Shadow Cabinet is attached."

ENDS

FOR FURTHER INFORMATION PLEASE CONTACT DAVID WARD
219 6441 - 4263

SHADOW CHANCELLOR'S STATEMENT TO THE SHADOW CABINET
WEDNESDAY 8 MARCH 1989

## JUSTICE FOR THE LOW PAID

In 1988 Mr Lawson showered largesse on the rich. In 1989 he ought to do elementary justice to the less well off. He could - and should - increase child benefit, increase personal tax allowances for the low income taxpayers, and make a major reform of the unjust national insurance system.

Child benefit has been frozen at £7.25 per week. It should - as a minimum - be increased to £8.35 per week, the level it would have reached if it had been updated. That would bring direct - if modest - practical help to many poorer families. After all, child benefit replaced a child tax allowance which would have automatically been updated in line with inflation.

Mr Lawson is obliged to increase personal allowances by the rate of inflation in December 1988 which was 6.8%. We know it is higher now - it is heading for 8%. If he were to increase allowances by the increase in average earnings (8.75%) he would make no change in the taxpayers' tax burden - they would be paying the same proportion of income in personal taxation. So - if he wants to help those taxpayers who have difficulty in making ends meet - he needs to make an increase in personal allowances substantially higher than the increase in earnings. He should do so - and he should concentrate the benefits on those at the bottom of the scale.

National Insurance has become a favourite Tory tax raiser. At a stroke they increased the basic rate from 6½ to 9% some years ago. Now National Insurance contributions (employees and employers) raise three quarters as much as the total of all income tax.

The system has become very unfair because it is not progressive. There is a lower earnings limit which will be £43 per week as from April 1989. Below that amount, national insurance is not paid. But as soon as an employee gets above the limit, he or she has to pay a contribution on the whole of their earnings. If he or she earns £44, the liability is immediately over £2 per week. At the top end, people earning over £15,800 per year, pay no national insurance on their earnings above that sum.

The Chancellor should make a major reform of the national insurance system by changing the lower earnings limit into an allowance so that national insurance contributions were paid only on the excess of income over £43. He should help to pay for this reform by removing the upper limit on contributions.

In this way national insurance could be made a much fairer system. It would end the temptation to "bunch" wages at just below £43 to avoid national insurance contributions (by employers even more than employees) and remove a serious poverty trap for lower wage earners.

To show how changes of this kind could help people on modest incomes, take the example of a family with two children whose earnings are equivalent to 75% of the average for all full-time male workers - £190.57 per week. Nearly half the wage earners in Britain are below this figures. The family would gain over £6 per week from national insurance reform and child benefit alone. They would pay £3.87 less in national insurance and gain £2.20 in child benefit.

In addition they would pay less income tax depending on how the personal allowances were increased. If the increase were in line with earnings (the very minimum the Chancellor should do) that would be an extra 41p weekly.

The total cost of these changes - depending to some extent on how they were introduced - would be in the region of £3 billion, not much different from the "fiscal drag" amount of £2 - £3 billion by which the Chancellor gets in more taxes than was originally calculated. But it could bring much needed help to many struggling families.

chex.md/aa/31 **BUDGET CONFIDENTIAL**

**FROM: A C S ALLAN**
**DATE: 10 March 1989**

**MR S W MATTHEWS**

cc PS/Chief Secretary
PS/Financial Secretary
Mr Scholar
Mr Culpin
Mr Pickford
Miss Simpson
Mr Wilson
Mr Tyrie

Mr Calder IR

**LABOUR'S "SHADOW BUDGET"**

The Chancellor was most grateful for your minute of 10 March.

ACSA

**A C S ALLAN**

FROM: J P MCINTYRE
DATE: 10 March 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Mowl
Mr Gilhooly
Mr Matthews
Mr Pickford
Miss Simpson
Mr Wilson
Mrs Chaplin
Mr Tyrie
Mr Call
PS/IR

Thanks. We can certainly [illegible] Mr Smith package [illegible] £3-7¼ billion, depending on [illegible] + presentation. [illegible]

Ch: Alex has separately sought advice on the NIC point you asked about.
[initials] 10/3

## NICS: LABOUR PROPOSALS

The NIC features of Mr Smith's proposals are:

i. Conversion of LEL into threshold
ii. UEL abolition

2. The GAD costing of (i) is relatively straightforward. For employees only, the full year cost (1989-90, receipts basis and assuming retention of reduced rate bands) would be £3.2 billion. The same change for employers would add a further £3.7 billion.

3. (ii) is more difficult. I gather from DSS and GAD that the way they normally cost this (in PQ Answers etc) is to assume a shadow UEL for the purposes of SERPS entitlements and contracted-out rebates. Thus employees earning over £325, the current UEL, would find themselves paying more NICs. But the contracted-in would not earn any extra SERPS, and the contracted-out would not get any extra rebate - they would pay the full 9 per cent on earnings above the current UEL.

4. GAD and DSS justify this by reference to the existing shadow UEL for <u>employers</u>. This is fixed at the UEL for employees and avoids giving contracted-out rebates to employers on the earnings of their employees above the employees' UEL. GAD and DSS assume that, if we abolished the employees' UEL, we would do the same. On this basis, abolishing the UEL brings in about £1.6 billion; this is the number given in Mr Matthews minute of earlier today (not copied to all).

5. However, it is not clear whether Mr Smith is contemplating a shadow UEL for employees. If not, two things would follow. First, contracted-out rebates would ~~to~~ apply on <u>all</u> earnings above the LEL. Abolition would then bring in only £0.8 billion. Second, the long term cost of SERPS would increase, because there would be no upper limit on relevant earnings for SERPS purposes. GAD say the extra public expenditure cost would be about £12 million after 5 years and £2 billion after 30 years (today's prices). The current estimated cost of SERPS in 30 years time is £14 billion. So the increase would be about 14 per cent.

6. There are therefore 2 possible lines of attack on the Opposition proposals:

a. <u>Assume a shadow UEL</u>: this would mean higher contributions for employees on over £368 (assuming the LEL is converted into a threshold) with nothing in return. Contrary to contributory principle.

b. <u>Assume no shadow UEL:</u> this would bring in only £0.8 billion in extra contributions and add substantially to long term SERPS cost.

7. In practice, abolition without a shadow UEL would mean the state offering an earnings-related pension on virtually the whole earnings of people with very high incomes - and a rebate on the same basis to pay for contracted-out pensions. This seems a bit unlikely. Without checking, GAD knew of no other countries which do this, except possibly the Italians.

JM

J P MCINTYRE

FROM: J P MCINTYRE
DATE: 13 March 1989

CHANCELLOR

cc Chief Secretary
Mr Scholar
Mr Culpin
Mr Gieve
Mr Pickford
Mr Macpherson
Mrs Chaplin

Thanks

Please (minute understood)

NICS REFORM

Mr Allan's minute of 10 March asked about the comparison with NICs under Labour and the burden of employer NICs in the UK compared with other countries.

**NICs under Labour**

2. You are correct in that anyone who is contracted in and earns £120 a week or less will pay less NICs under the Budget package than he would if the Labour regime of 6.5 per cent employee NICs had been carried forward.

3. However, the contracted-out employee will still pay more under the Budget package than under Labour at £120; £6.25 against £5.88. At £107 or less, contracted-out employees will be paying less NICs than under the Labour regime. (The contracted-out rebate was 2.5 per cent under Labour compared with 2 per cent now.)

? 4. A more serious difficulty in using this point is that, whereas £120 is less than half average earnings now, it was 1.3 times average earnings in 1978-79. The employee on half average earnings paid £3.08 in 1978-79 (ie 6.5 per cent of all earnings). From October this year, he will pay £9.28 (ie an average rate of 6.8 per cent).

5. One other way of comparing the reformed system with the position under Labour would be to take the combined employer/employee rate. From October 1978, the total NIC rate for all employees was:

| | |
|---|---|
| employers | 10% |
| employers' NI surcharge | 3.5% |
| employees | 6.5% |
| | 20% |

6. The standard rate is already lower at 19.45 per cent. From October, the total rate for employees at average earnings will be 18.4 per cent (10.45 per cent for employers, 7.9 per cent average rate for employees) and at ½ average earnings 15.8 per cent (9 per cent for employers, 6.8 per cent average rate for employees).

**Employer NICs**

7. DSS confirm that the burden of employer NICs tends to be greater in other countries. The table below is taken from Economic Trends, December 1987:

**Employers' Social Security Contributions: As proportion of GNP at factor cost:**

| | |
|---|---|
| UK | 4 per cent |
| USA | 4 per cent |
| Japan | 4.5 per cent |
| Germany | 8.4 per cent |
| Netherlands | 9.6 per cent |
| Sweden | 14.0 per cent |
| France | 14.7 per cent |

These figures relate to 1985.

8. This point has also now been included in the briefing.

JM

J P MCINTYRE

chex.rm/aal/73 **BUDGET SECRET**

1/ 11

COPY NO OF COPIES

FROM: A C S ALLAN
DATE: 10 March 1989

**MR MCINTYRE**

cc PS/Chief Secretary
Mr Scholar
Mr Culpin
Mr Gieve
Mr Pickford
Mr Macpherson
Mrs Chaplin

**NICs REFORM**

The Chancellor calculates that anyone earning £120 a week or less (to the nearest £1) will pay less in NICs under the Budget package than he would if the Labour regime of 6½ per cent employee NICs on all earnings (if above the LEL) had been carried forward. Can you check and confirm this please. It is potentially one of the components of the answer to the question 'even now higher NIC burden than under Labour'.

2. The Chancellor would also be grateful to know if it is true that the burden of employer NICs in the UK is lower than that in other countries. If so, that is a useful addition to the points to counter the question 'nothing for employers' - together with the points that the 1985 reform still stands etc.

ACSA

A C S ALLAN

chex.rm/aa1/76 **BUDGET CONFIDENTIAL**

5

FROM: A C S ALLAN
DATE: 13 March 1989

**MR MCINTYRE**

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Gilhooly
Mr Matthews
Mr Mowl
Mr Pickford
Miss Simpson
Mr Wilson
Mrs Chaplin
Mr Tyrie
Mr Call
PS/IR

**NICS: LABOUR PROPOSALS**

The Chancellor was grateful for your minute of 10 March, on Mr Smith's proposals. He feels we can certainly say that his package would cost £3-4 billion, depending on the assumptions, and probably £4 billion.

ACSA

A C S ALLAN