



Prime Minister (2)

17

To note Chancellor's objection  
to Mr Fowler's proposals on  
employee NIC's

AF  
15/2

Treasury Chambers, Parliament Street, SW1P 3AG  
01-233 3000

14 February 1985

The Rt Hon Norman Fowler MP  
Secretary of State for Social Services  
Department of Health & Social Security  
Alexander Fleming House  
Elephant & Castle  
LONDON SE1

*Norman*

I share the  
Chancellor's concern  
MS  
attached

#### REVIEW OF SOCIAL SECURITY

I thought it might be helpful to you and our colleagues on MISC 111 if I were to comment on the proposals for employee national insurance contributions set out in Appendix 12 of MISC 111(85)1.

I do of course appreciate that the statutory responsibility for national insurance contributions lies with you, reflecting the link with benefit expenditure, particularly on pensions. But I am sure that you recognise that the implications of changes in employee NICs are absolutely crucial for our policy on personal taxation. While I would not subscribe to the theory that employee NICs are a tax, they have just as much impact on take home pay as income tax, and comparisons are frequently made of the change in the total of employee NICs and income tax combined. Moreover, employee NICs also have administrative consequences for employers and Government, and we are of course anxious to avoid placing unnecessary new burdens on either.

In the light of these wider considerations, I have to say that I find your proposals unattractive. I refer both to your proposal to lower the LEL from £35.50 to about £20 per week and convert it into a threshold, and to abolish the UEL (in both cases for employees only).

On the LEL, substantially lowering the starting point for employees' NICs would have undesirable implications both for employers' compliance costs and for administrative costs in the Inland Revenue. More employees would be brought within the scope of the NIC charge. This would add to the burdens of employers who already operate NIC and PAYE schemes, and perhaps

and for the burden  
of letting on young people



more important, oblige some employers to begin operating NIC for the first time. We are talking about very small employers indeed - someone employing a cleaner in London for 7 hours a week would in theory have to deduct and pay over NIC on the cleaner's wages. In practice of course, given that the costs of compliance would far exceed the pennies actually due in contributions, there would be widespread evasion, to which we would have to turn a blind eye. It would be a pity gratuitously to extend the frontiers of the black economy in this way.

I can understand your desire to turn the LEL into a threshold, in order to reduce the disincentive effects of the present LEL. But as you are aware, this would cost around £3 billion at its present level, and I am not convinced that, even if sums of this order were available, it would be sensible to use them in this way. The amount of damage which the theoretical distortion of the present LEL inflicts in practice seems likely to be very limited. Even 16 and 17 year olds earn well over £60 a week on average. I am convinced that money would be far better spent on our declared policy of raising tax thresholds in real terms.

Your other proposal is to phase out the employee UEL over a period. I do not think your paper brings out the full implications of such a move. Abolition of the UEL, if all other NIC rates stayed the same, would mean an extra £1,000 per year in contributions for someone earning £25,000 gross a year. The impact on take home pay, as you can see, would be very significant. If at the same time, the contracted-out employee rate disappeared with the abolition of SERPS, as you propose, then the effect would be intensified.

The effect of your proposal would, inter alia, be to increase all the higher rates of deduction from earnings by 9 per cent, with the top rate rising to 69 per cent - after all we have said about the importance of having reduced it to 60 per cent. Moreover, there is no way of compensating for these effects through the tax system. If the higher tax rates were correspondingly reduced by 9 per cent, the top rates on pensions and investment income would be reduced from 60 per cent to 51 per cent, which would confer a costly and wholly unnecessary benefit on better-off pensioners and recipients of investment income.

Furthermore, even if this were done, there would be no means of compensating those middle managers and highly skilled workers with earnings between the existing UEL and the beginning of the higher rate bands. These people would lose substantially and the effect could only be mitigated by reductions in the basic rate of tax which would be prohibitively expensive.



I have set these considerations out at some length because I think it is important that MISC 111 should be aware of the constraints on action in this area. I appreciate your desire to see a more obviously rational structure of social security contributions, but I would not wish us to make pronouncements in this very difficult area until we were clear about their implications.

I am copying this letter to the Prime Minister, to the other members of MISC 111 and to Sir Robert Armstrong.

*Nigel Lawson*  
NIGEL LAWSON

*This is a subject on which I had a great deal of work done during 1983-84, since its superficial attractions are obvious. It was always to include way of increasing the practical set out in the letter.*  
N.L.