



IFS

The Institute for Fiscal Studies

# ELECTION BRIEFING 2001

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## INTRODUCTION

# IFS Election Briefing: Overview

## Part I: The 1997–2001 Parliament

### Overall tax and spending (*EBN2*)

Between 1996–97 and 2000–01, government revenues have risen by 2.9% of GDP from 37.6% to 40.5%, while spending has decreased from 41.2% of GDP to 38.8%. As a consequence, over this four-year period, public sector net borrowing fell by a total of 5.3% of GDP, moving from large deficit to large surplus.

The table shows the movements in taxation and spending seen since 1979. During the Conservative years, the economy grew at an average of 2.1% per year, implying that both tax and public spending fell as a share of national income. In the last four years, taxes have risen as a share of national income but spending has fallen. Part of this is explained by a rapidly growing economy, which tends to boost taxation receipts and depress spending.

### Changes in taxation and spending, different periods

	Annualised average real increase (%)	
	Total taxes	Total spending
<b>Comparisons across Parliaments</b>		
This Parliament: <i>April 1997 to March 2001</i>	4.8	1.3
Last Parliament: <i>April 1992 to March 1997</i>	2.0	2.0
Conservative years: <i>April 1979 to March 1997</i>	1.8	1.7
<b>Other periods of interest</b>		
Current plans: <i>April 2001 to March 2004</i>	1.5	3.8
First two years of this Parliament: <i>April 1997 to March 1999</i>	4.5	-1.0
Five-year increase from start of first CSR: <i>April 1999 to March 2004</i>	2.9	3.8

Source: Election Briefing Note 2.

### Spending on public services (*EBN3*)

Although overall public spending has grown slowly in the last four years, spending in some areas – most notably health and education – has grown significantly more rapidly than in the 18 years of Conservative government that preceded this Parliament. This has been possible in spite of an overall reduction in spending as a share of national income because of particularly slow growth in social security spending and a reduction in debt interest payments.

Public spending grew significantly more quickly in the last year of the Parliament than in the previous three, and is planned to grow quite rapidly over the next three years.

Public sector investment spending, which had fallen in the years before the last election, has fallen further as a share of national income and in real terms, despite the government's intention to increase it.

### **Living standards under Labour (EBN4)**

Actual living standards are the result of not just changes to the tax and benefit system, but also changes to the underlying distribution of income. Data to examine this are only available for the first three years of the Labour government.

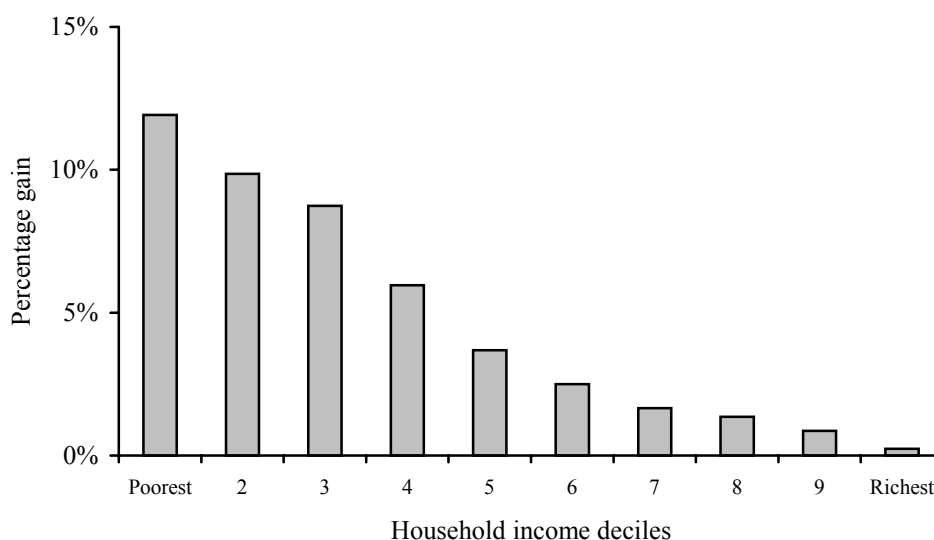
During this period, the incomes of the poorest fifth of households grew at an average annual rate of 1.4%, with subsequent fifths growing respectively at 1.5%, 1.8%, 2.4% and 2.8%. Although the direct effect of government measures was to reduce inequality, the underlying distribution of income widened by enough to more than offset the effects of tax and benefit changes in the first three years of the Parliament.

### **Fiscal reforms affecting households (EBN5)**

We have modelled the impact of changes to the tax and benefit system as it affects households. Many of the tax increases seen in recent years cannot readily be included, most notably the increased taxation on company incomes and pension fund dividends. We have assumed in these calculations that all entitlements to means-tested benefits are taken up, which they are not, which should be borne in mind in interpreting the results. The broad pattern of the results is unaffected by this.

The figure shows gains concentrated on lower incomes. The substantial gains at the bottom end are mainly a result of higher means-tested benefits, especially for pensioners and families with children. Reforms to National Insurance contributions have also helped those on lower earnings. It is important to remember that while, *on average*, families in each decile gain, some families within each decile lose from the reforms, often because of indirect taxes.

## Effect of major fiscal reforms implemented July 1997 to June 2001



Note: The first decile contains the poorest 10% of the population, while the tenth decile contains the richest 10%.

Source: Election Briefing Note 5.

### Labour and business taxes (*EBN6*)

The Labour government has cut the main corporation tax rate from 33% to 30%, abolished advance corporation tax, removed repayable dividend tax credits from pension funds, and moved to a quarterly system of tax payments for large firms. The combined effect of these changes has been to raise significant revenue during this Parliament, but in a way that is largely temporary, giving a boost to revenues during the Parliament just ending which will not be available in the longer term.

## Part II: Election 2001

### The main parties' tax and spending proposals (*EBN10*)

The Conservatives advocate spending and tax cuts of around £8bn per year relative to Labour's plans, the Liberal Democrats increases of similar size. These differences represent less than 1% of GDP, which raises the question of what the longer-term plans of all the parties are.

### The Conservatives' proposals (*EBN7*)

Tax cut proposals focus on savers, single-earner couples with children and petrol. The largest proportionate gains go to families in the middle of the income distribution. Spending cuts of £8bn are proposed to finance the tax reductions, which we analyse.

### **The Liberal Democrat proposals (*EBN8*)**

The main source of revenue to fund higher public spending for the Liberal Democrats is higher income tax, both the basic rate and a new higher rate of 50%. The new spending is targeted on education, pensioners and health. The overall package increases the average incomes of poor households and reduces those of the better-off.

### **Labour's proposals (*EBN9*)**

There is little new proposed on tax structure, but there is confirmation of some proposed welfare reforms. The new credits for pensioners, childless people on low pay and families with children would extend the means-testing approach seen in the last Parliament. Ideas for asset-based welfare are also introduced, although await further detail.

### **The structure of welfare (*EBN11*)**

If Labour were to win the election, we seem likely to see the shift to means-tested, credit-type schemes taken further. This shift has already increased the incomes of the poorest, extended joint assessment of incomes and furthered the erosion of the contributory principle. The other two main parties both challenge this approach, emphasising the problems of means testing.

### **Should we let people opt out of basic state pension? (*EBN12*)**

This briefing note examines the motivation behind the Conservative proposal to allow working-age people to opt out of basic state pension entitlement in return for lower National Insurance contributions.

### **Public spending: What are the options beyond March 2004? (*EBN13*)**

The two main parties' manifestos plan for total public expenditure only up until 2003/04. This raises the question of their longer-term plans. This note examines the longer-term trade-off available between spending on public services and tax cuts.