

Post PBR and CSR Briefing

Institute for Fiscal Studies

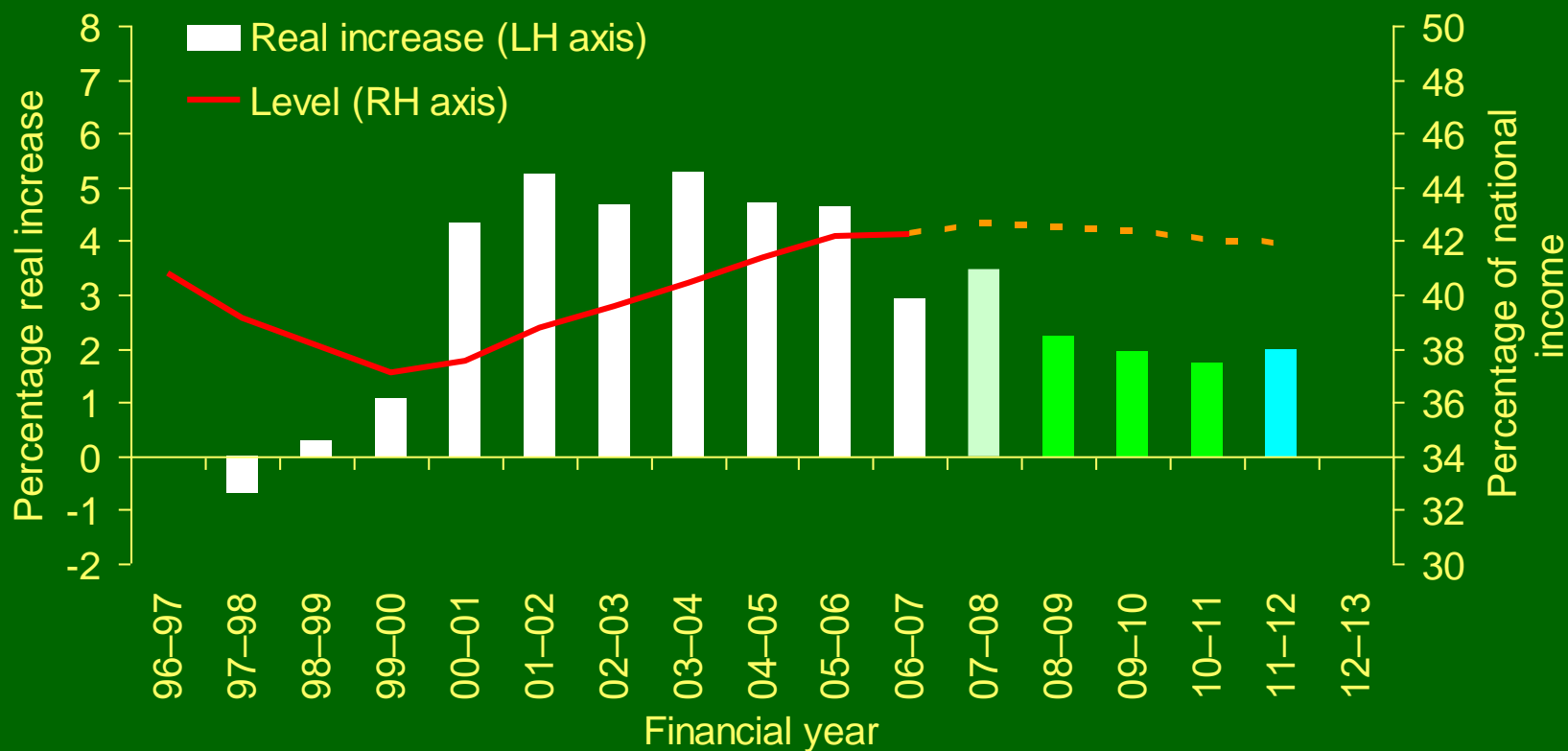
10th October 2007

www.ifs.org.uk/budgets/pbr2007/index.php

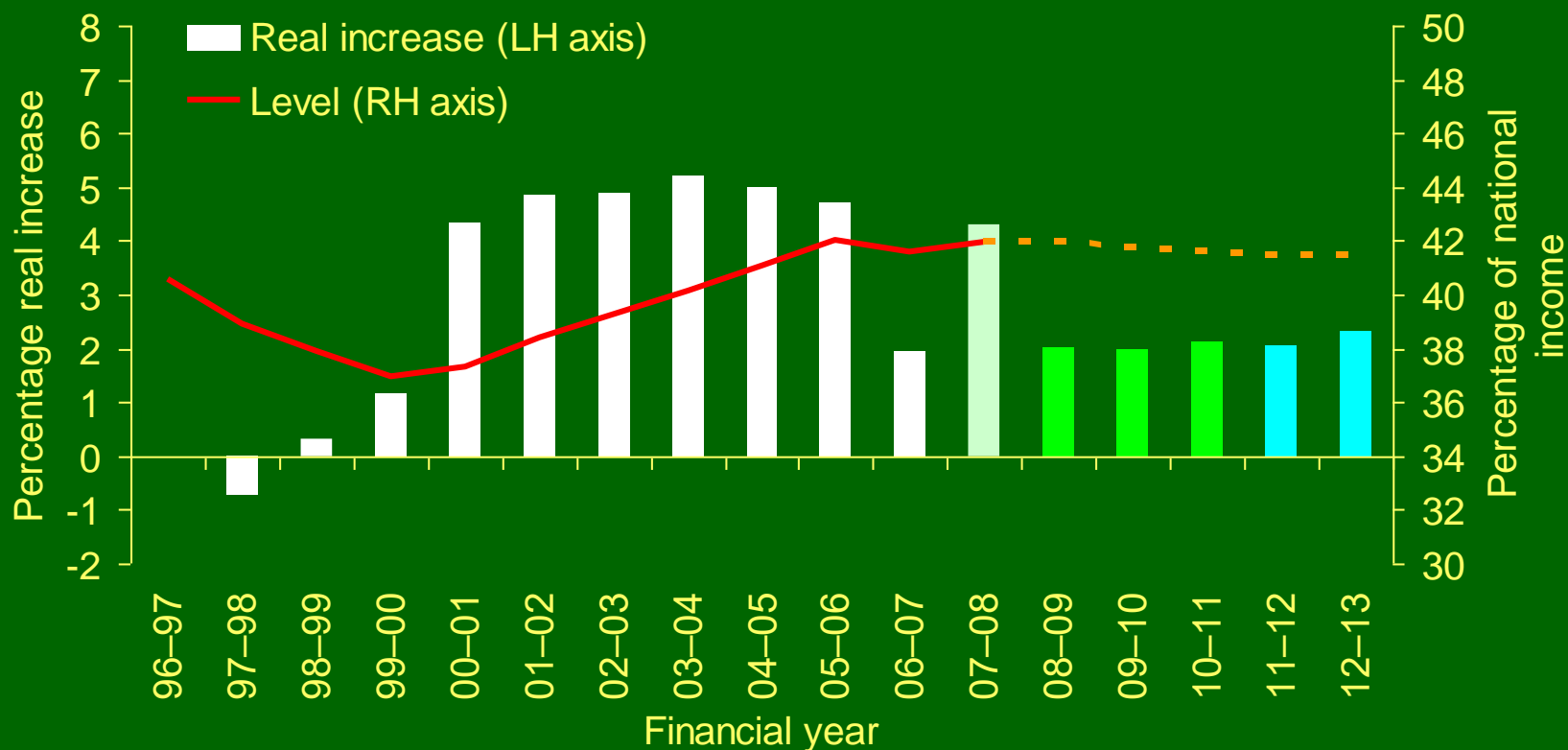
The CSR settlement

Carl Emmerson

Total spending – Budget 2007



Total spending – PBR 2007



A challenging spending review

Av. annual increase (%)	Current	Capital	Total
2007 CSR	+1.9	+4.4	+2.1
<i>Labour</i>			
April 1999 to March 2008	+3.6	+15.7	+4.0
April 1997 to March 1999	-0.3	+6.8	-0.2
<i>Conservatives</i>			
April 1979 to March 1997	+1.7	-5.0	+1.5

Sharing the proceeds of growth



What is a spending cut?



What is a spending cut?



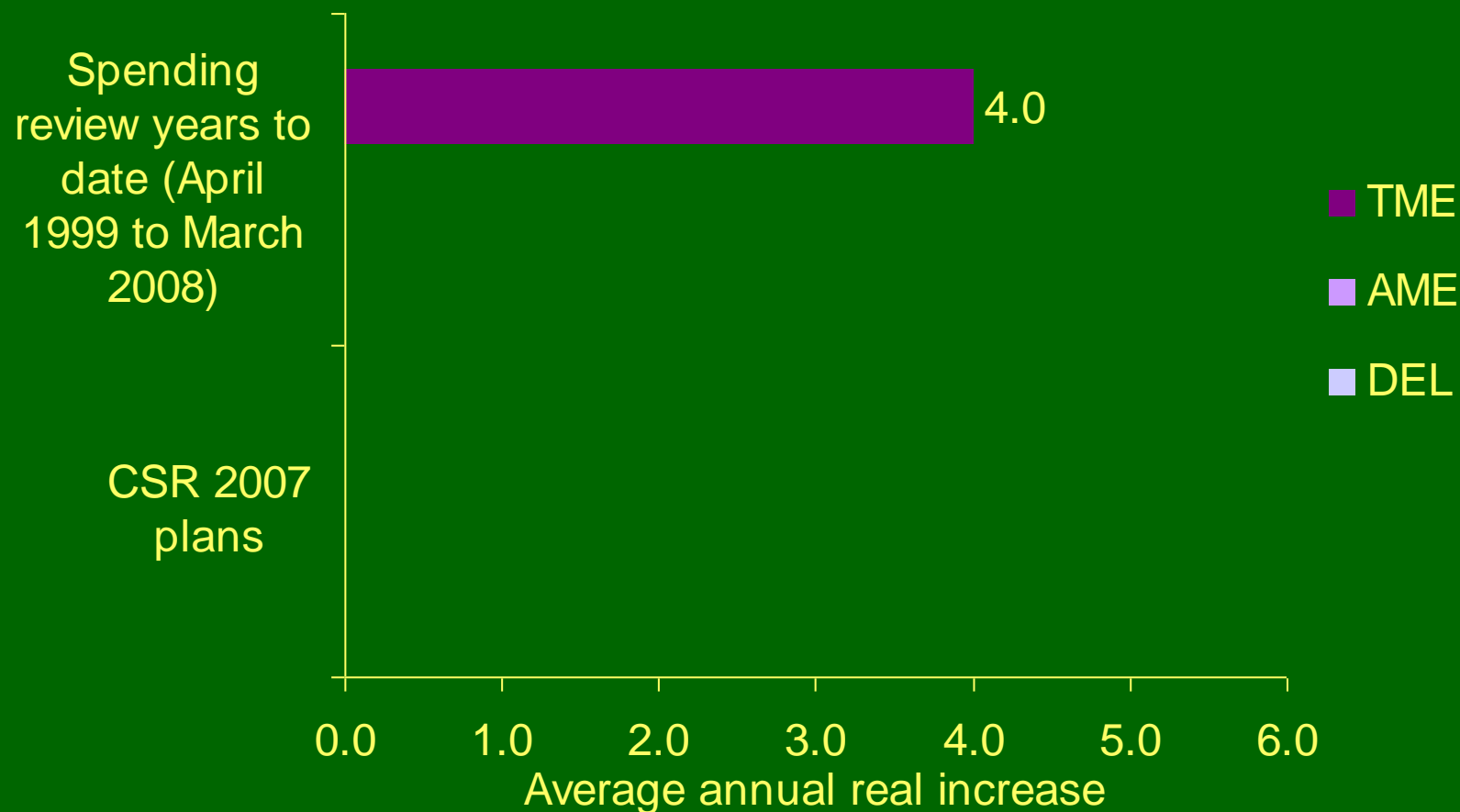
“The Conservative Party is committed to making cash cuts of £35 billion from Labour's public spending plans – cuts so large they could only be found from cutting deep into front-line public services, including schools, hospitals and the police.”

(Alistair Darling, 17 March 2005)

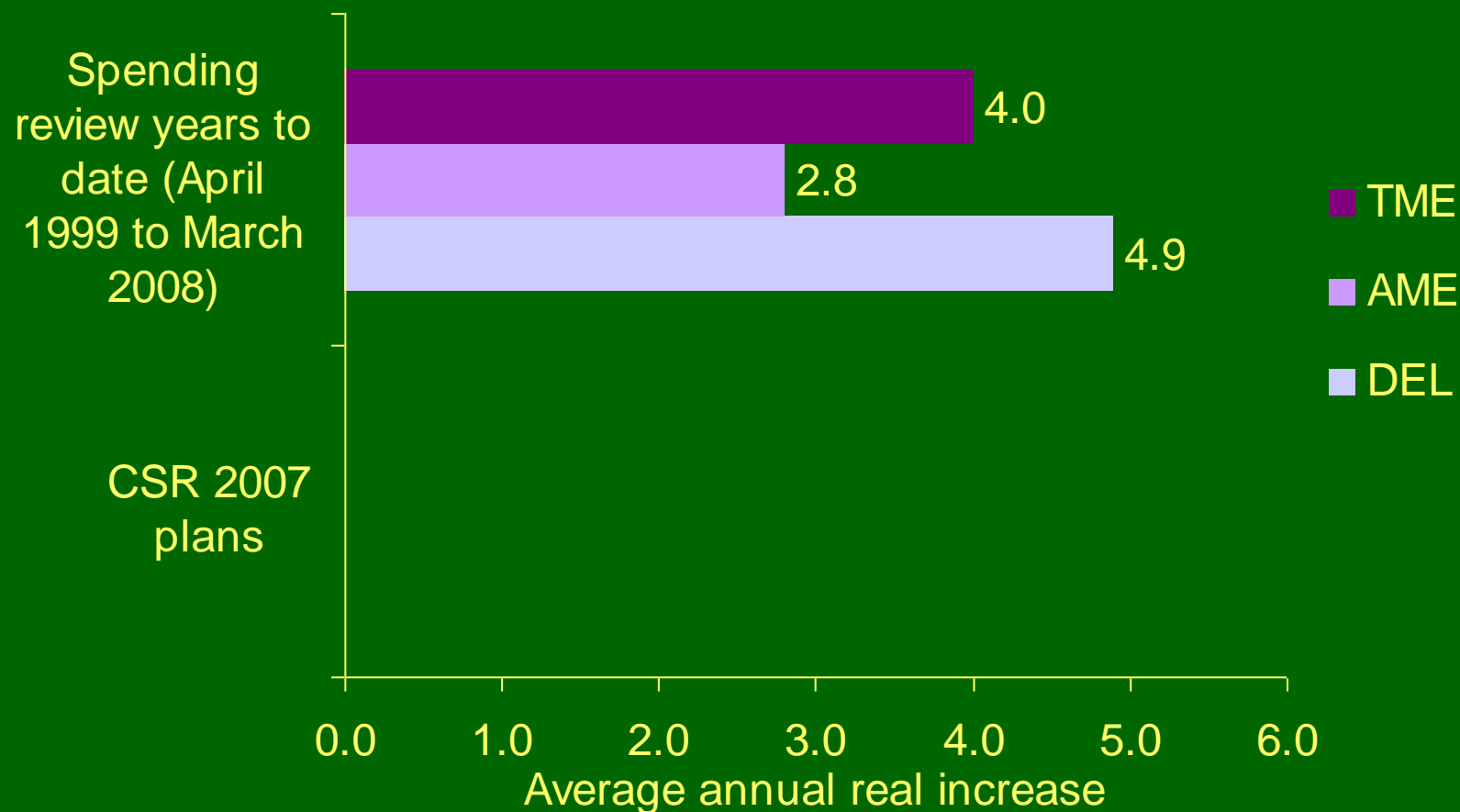
Labour's spending cut

- Using Labour's campaign methodology, spending to be cut by:
 - £6bn over the three CSR years
(0.4% of national income in 2010–11 terms)
 - £9bn over the three CSR years plus next two
(0.5% of national income in 2012–13 terms)
- Placing in 2007–08 terms
 - £5bn over the three CSR years
 - £7bn over the three CSR years plus two

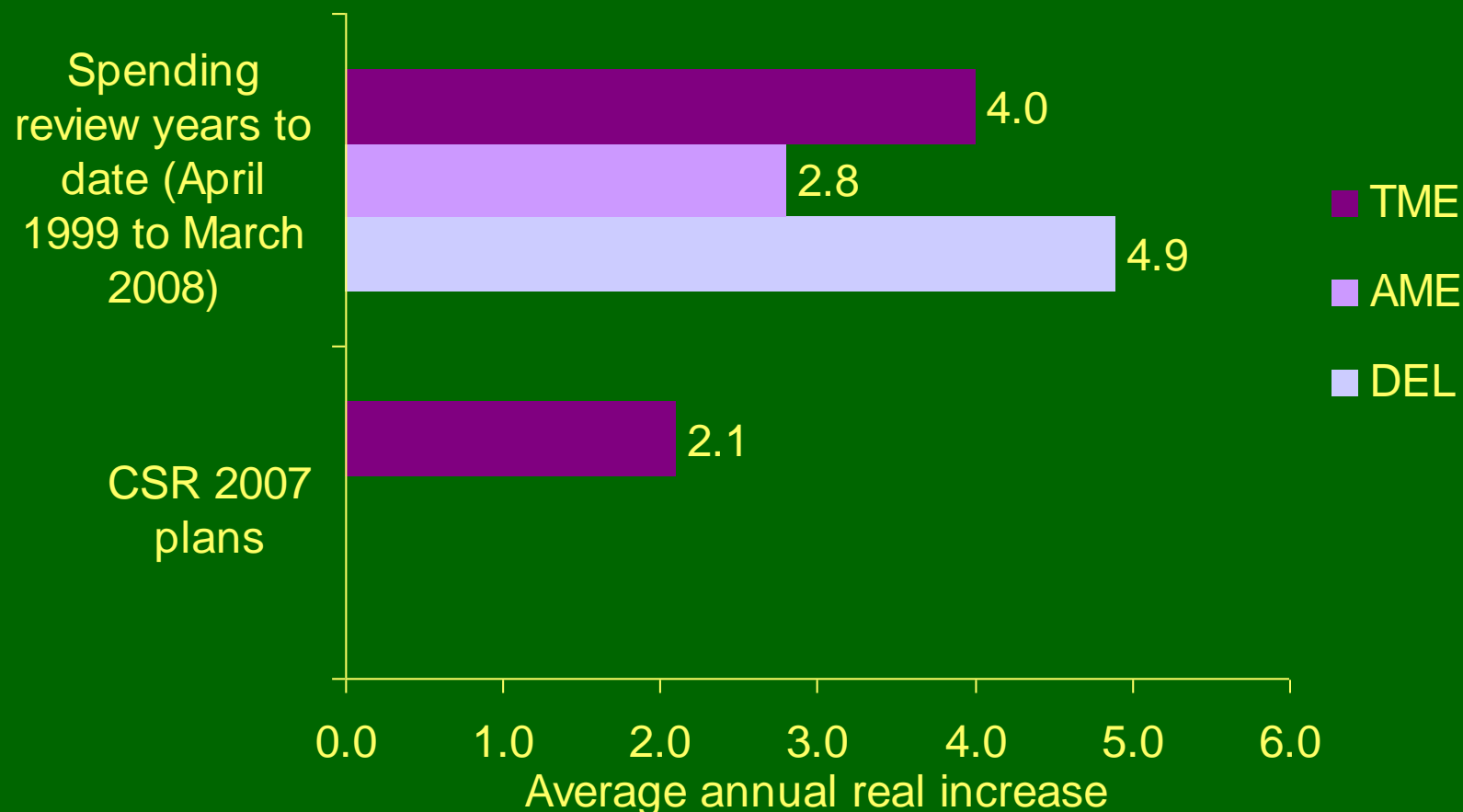
Breakdown of spending growth



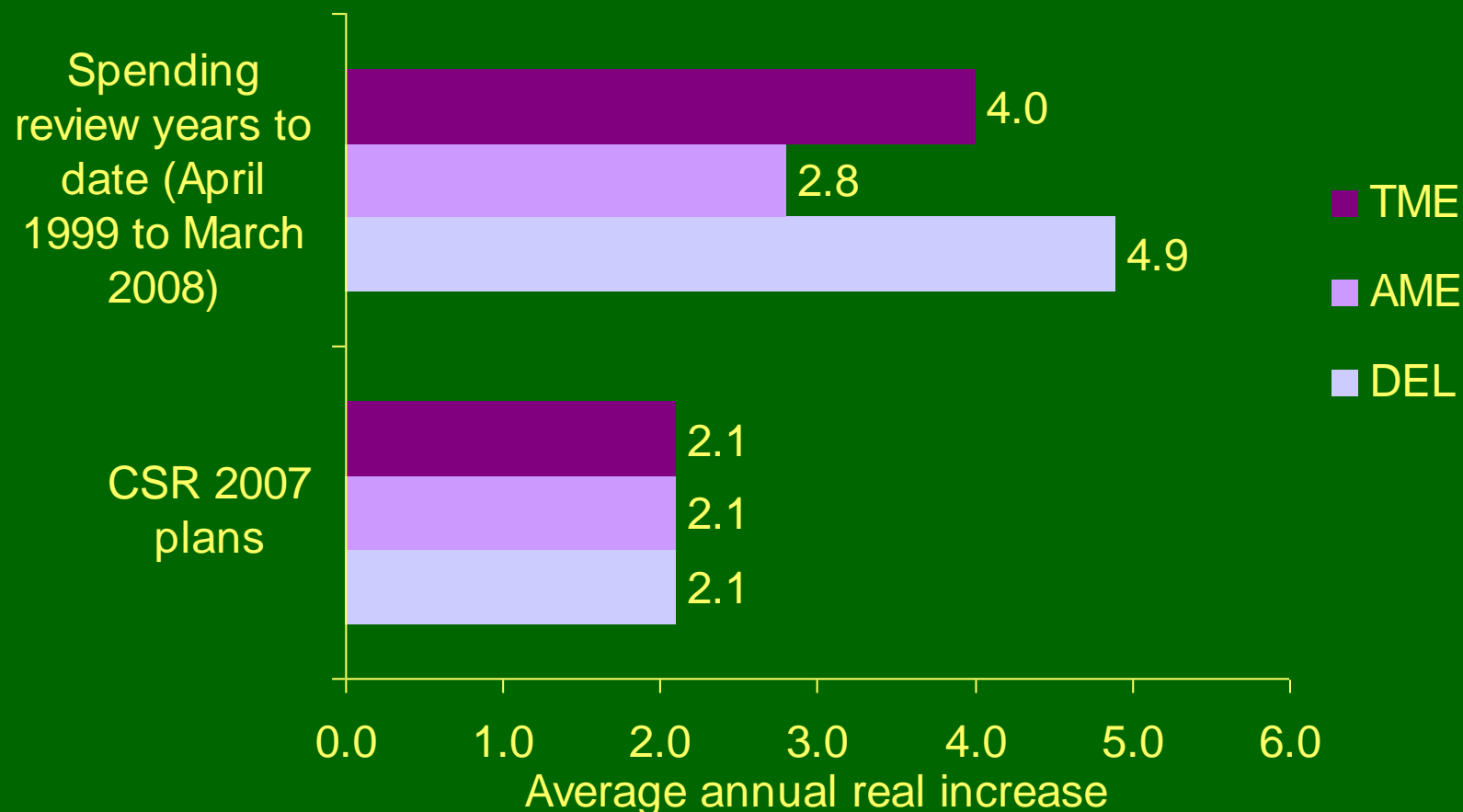
Breakdown of spending growth



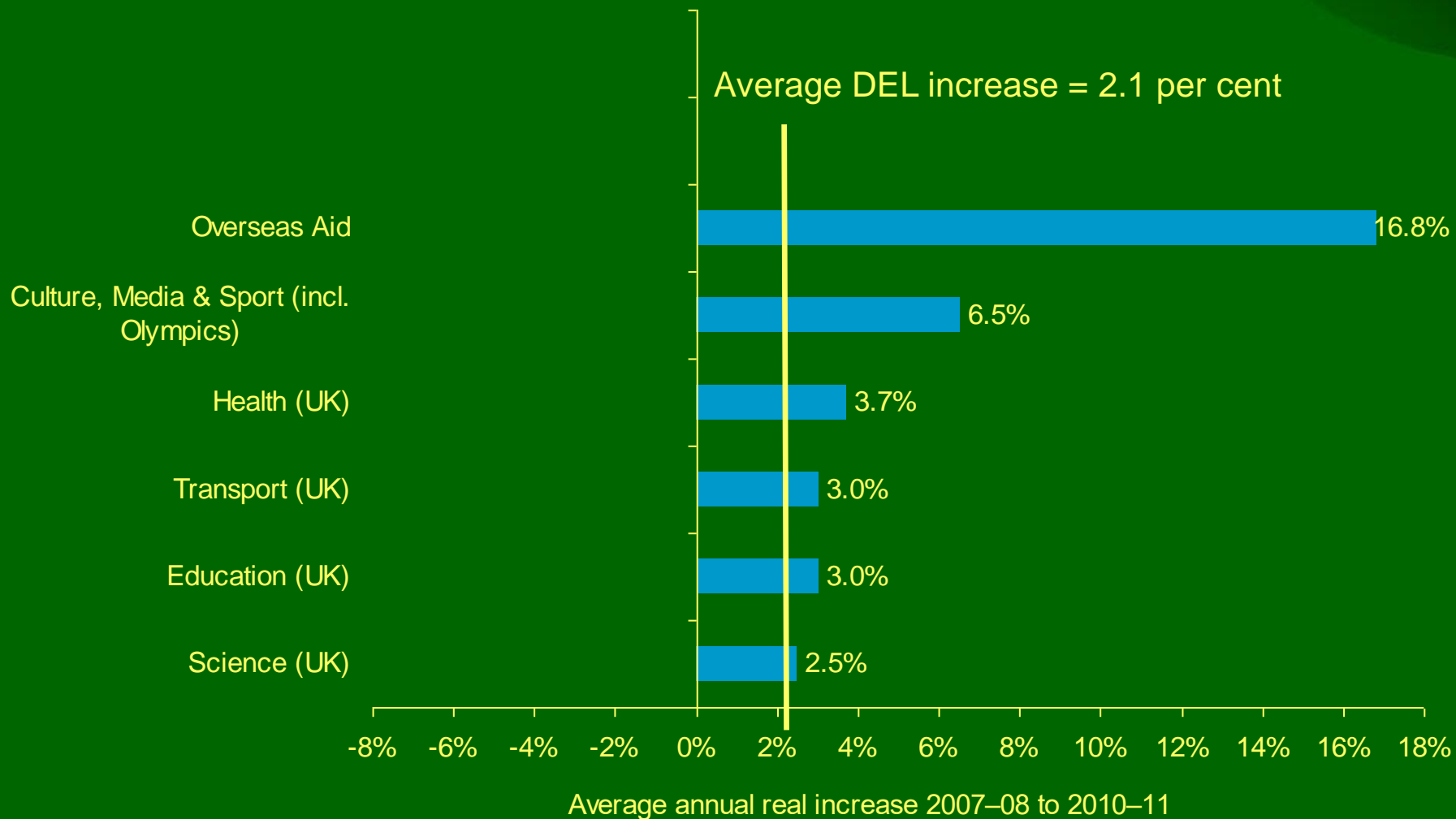
Breakdown of spending growth



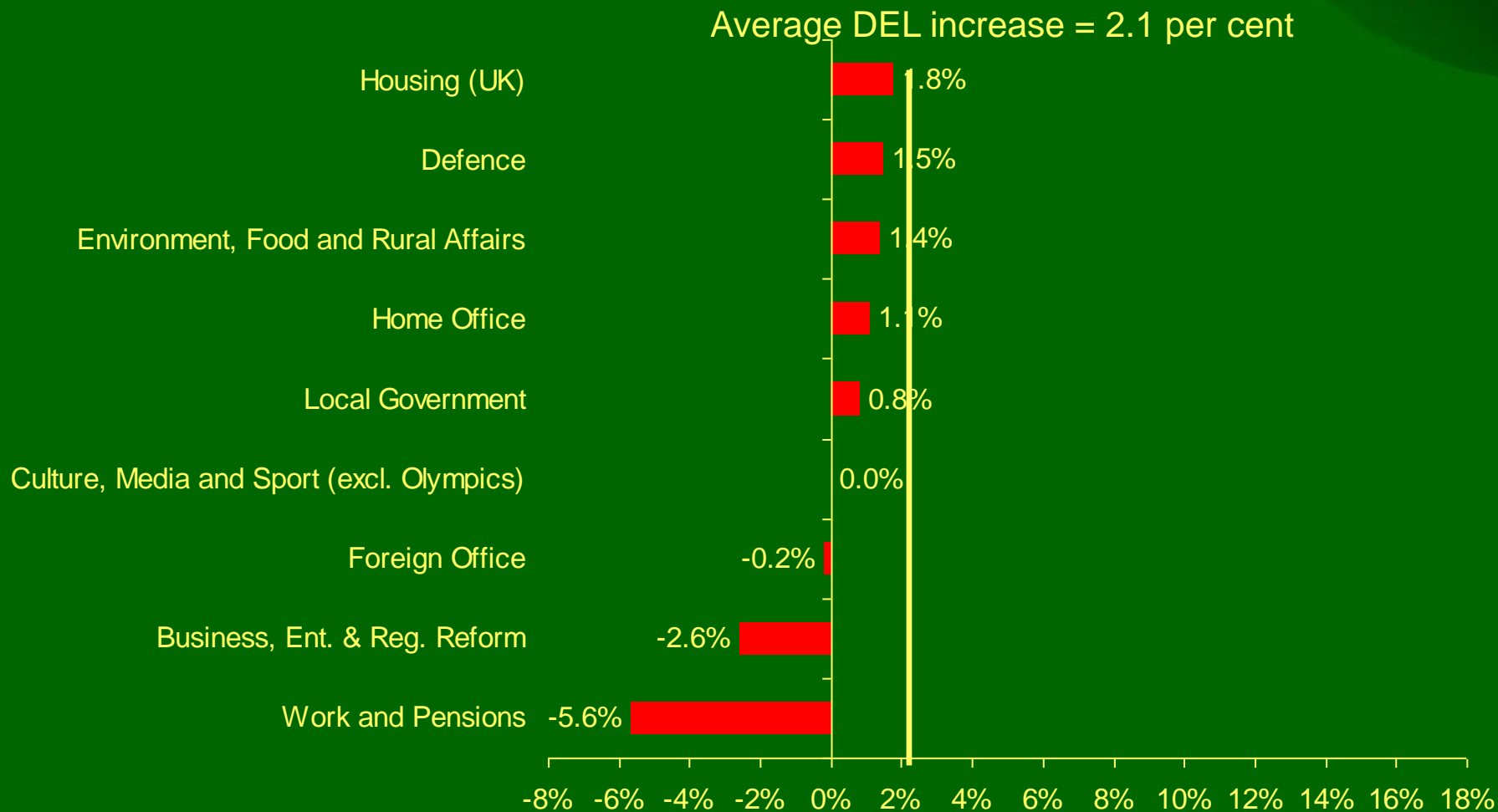
Breakdown of spending growth



Relative winners?



Relative losers?

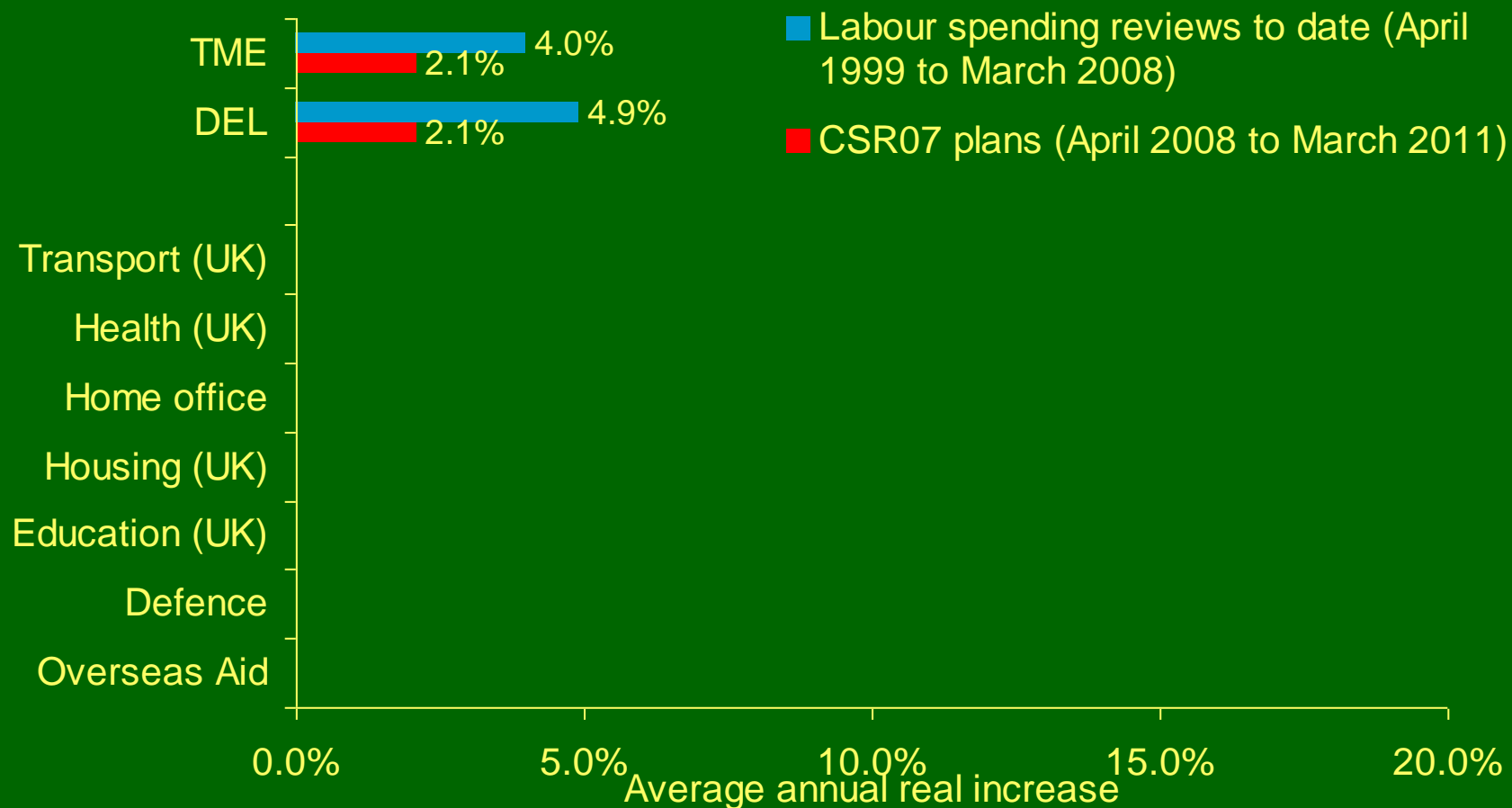


Average annual real increase 2007–08 to 2010–11

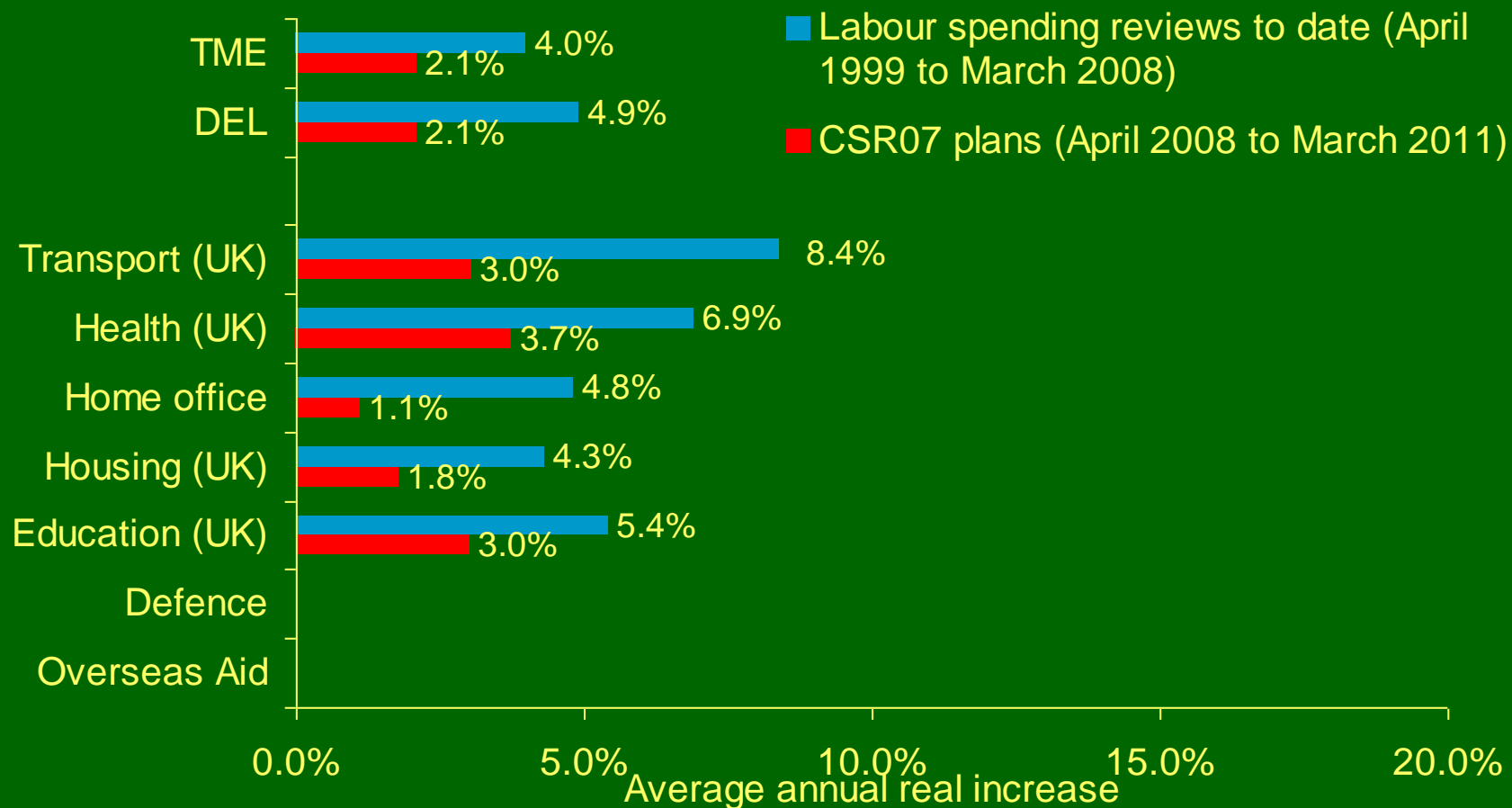
Note: Assumes GDP deflator of 2.7% per year going forwards

Source: HM Treasury; IFS calculations

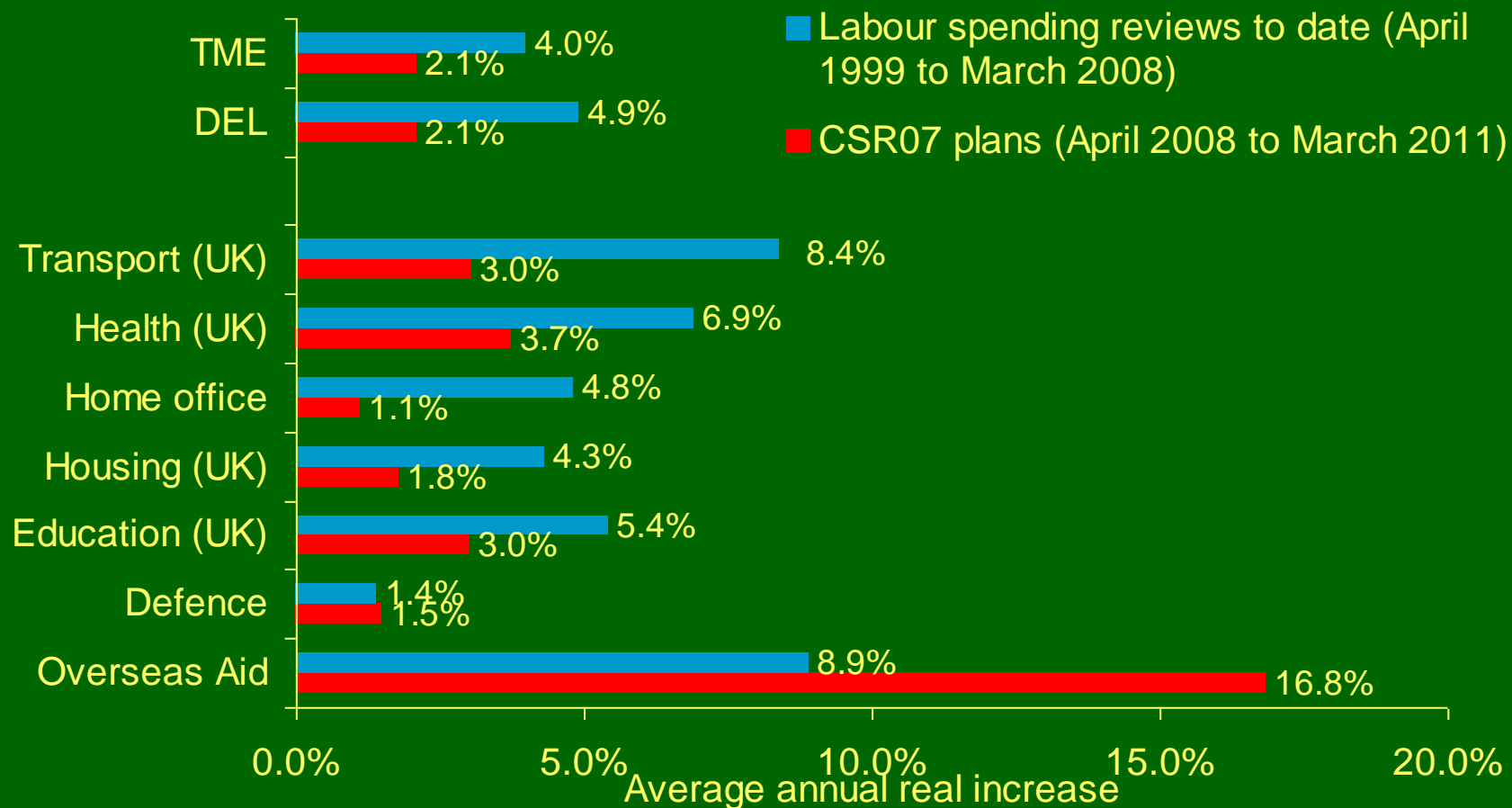
Winners and losers?



Winners and losers?



Winners and losers?

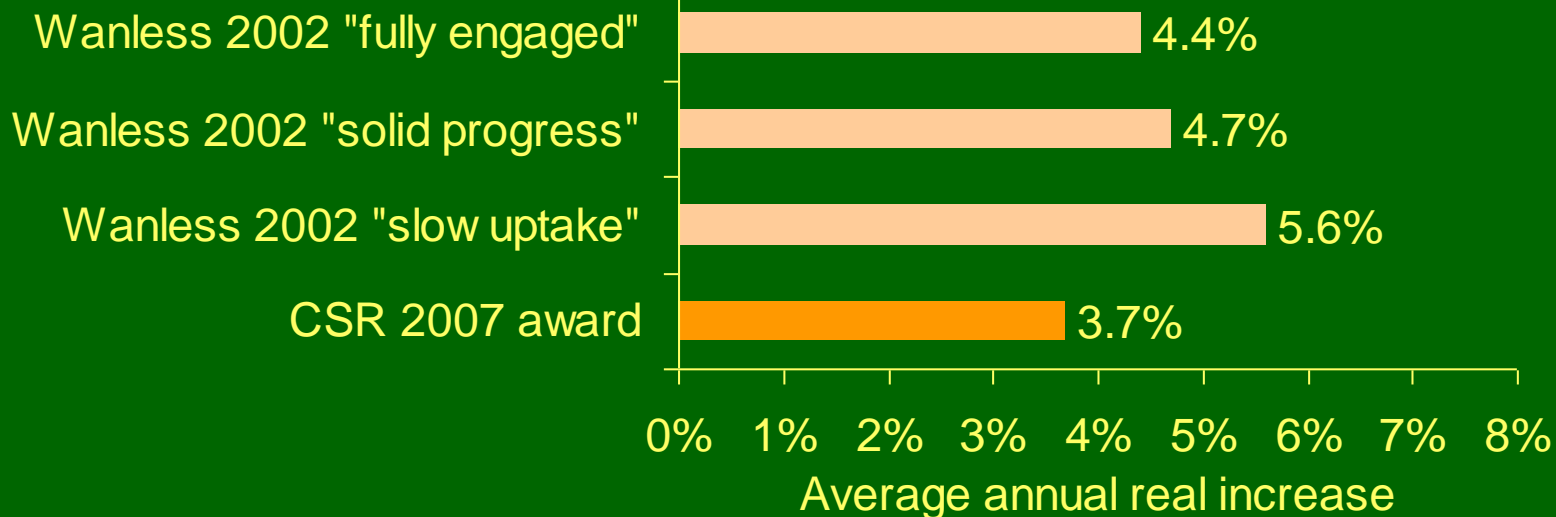


UK health spending

April 2003 to March 2008



April 2008 to March 2011



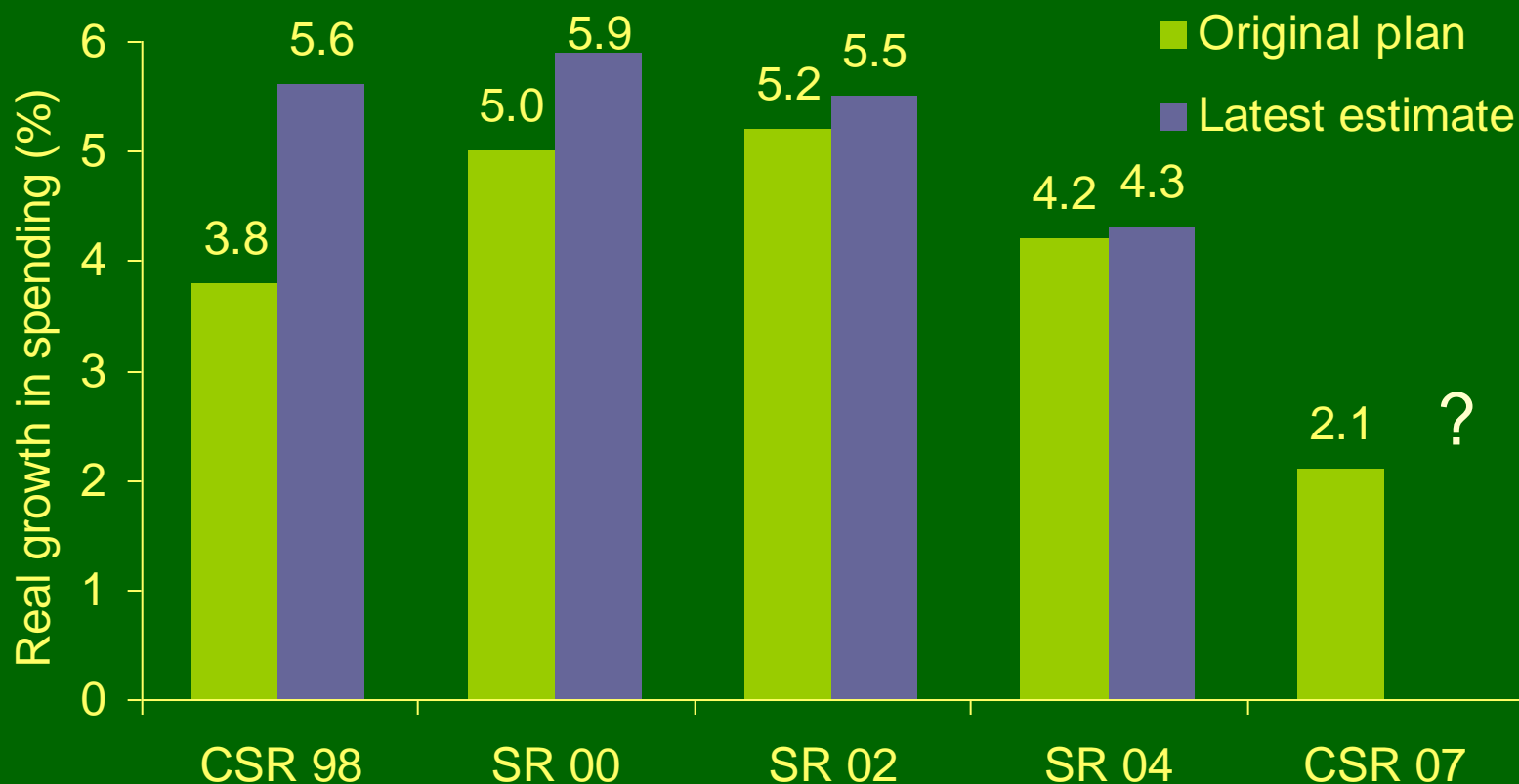
Health spending shortfall?

- CSR 2007 settlement below Wanless 2002 recommendations for 2010–11
 - £2bn under “fully engaged” scenario
 - £3bn under “solid progress” scenario
 - £6bn under “slow uptake” scenario

Wanless (2007) “neither the assumed rate of productivity improvement nor the changes in personal behaviour that the more optimistic scenarios in the 2002 review envisaged have been achieved”

But plans could be topped up?

Departmental Expenditure Limits



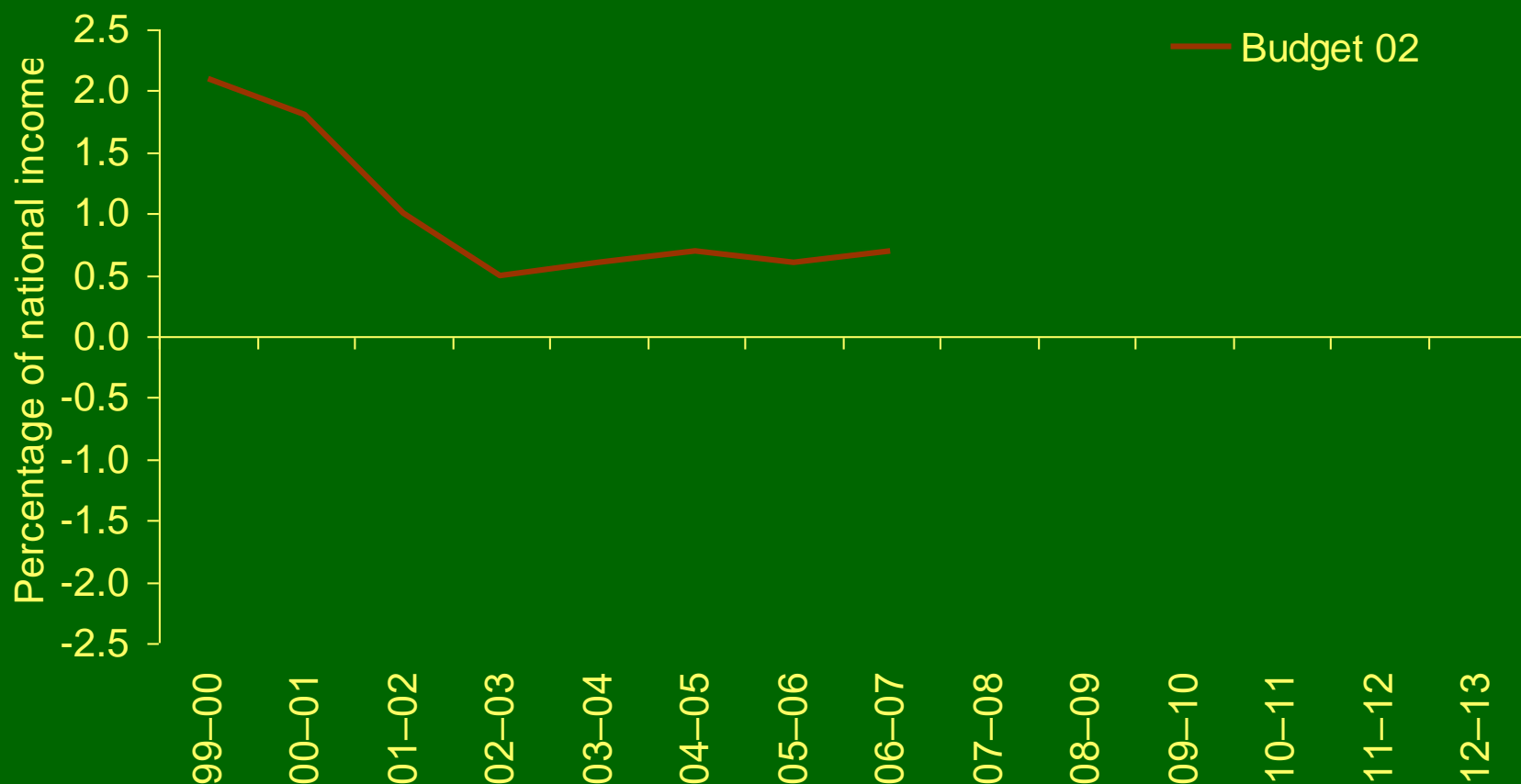
Conclusions

- Spending growth considerably slower than Labour's spending reviews to date
- If delivered would comply with the Conservatives proposed 3rd fiscal rule
- Might prove incompatible with aspirations for improving public services and reducing child poverty

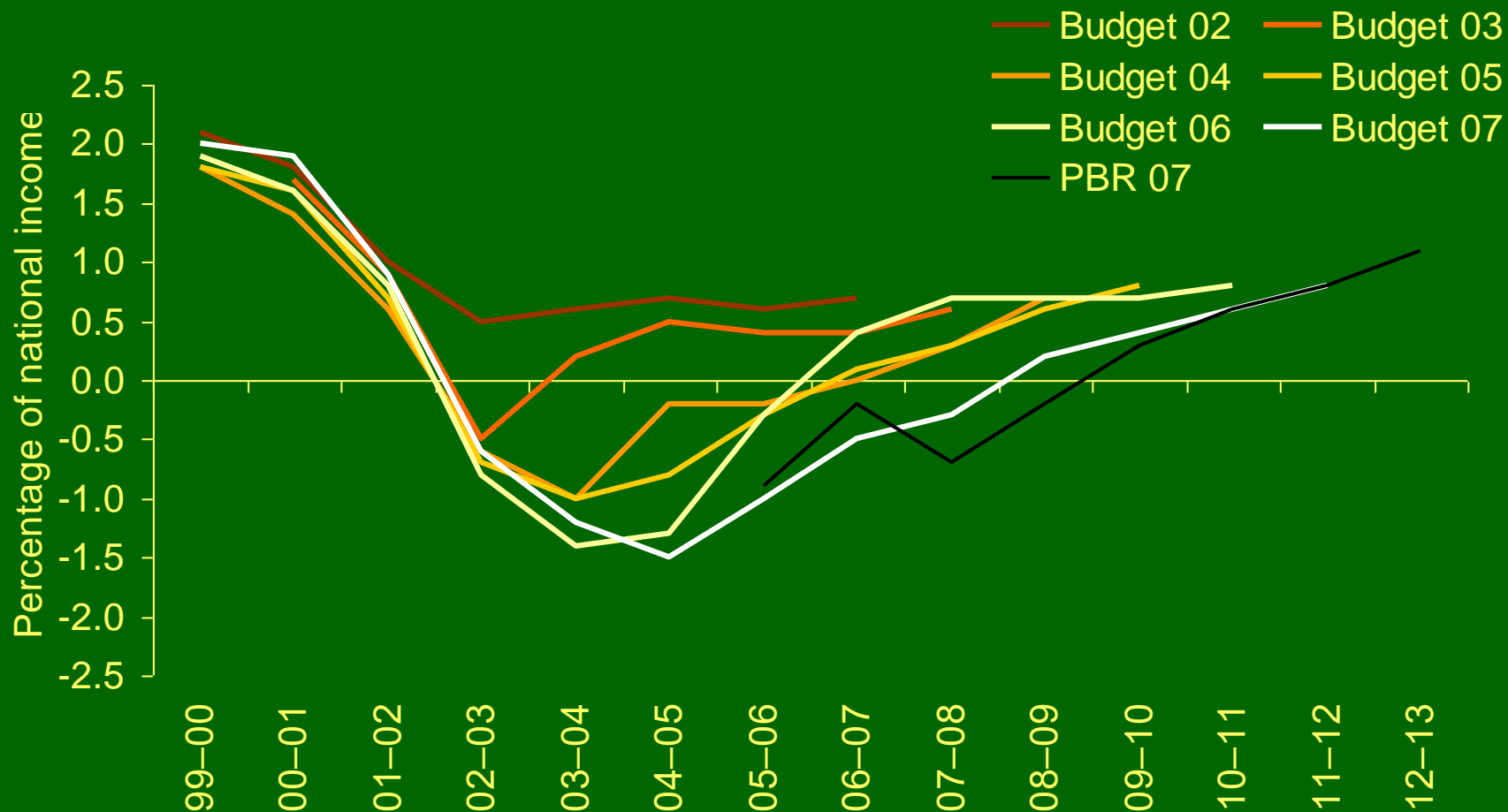
The public finances

Gemma Tetlow

Structural current budget balances



Structural current budget balances



Measures

£billion	2007–08	2008–09	2009–10	2010–11
<i>Current budget</i>				
Give-aways	–0.5	–1.1	–1.3	–1.5
Take-aways	+0.1	+0.7	+2.5	+2.9
Net effect on current budget	–0.4	–0.4	+1.2	+1.4

Current budget: total change

£billion	2007-08	2008-09	2009-10	2010-11	2011-12
Budget 2007	-4.3	+3	+6	+9	+13
PBR 2007	-8.3	-4	+3	+9	+14

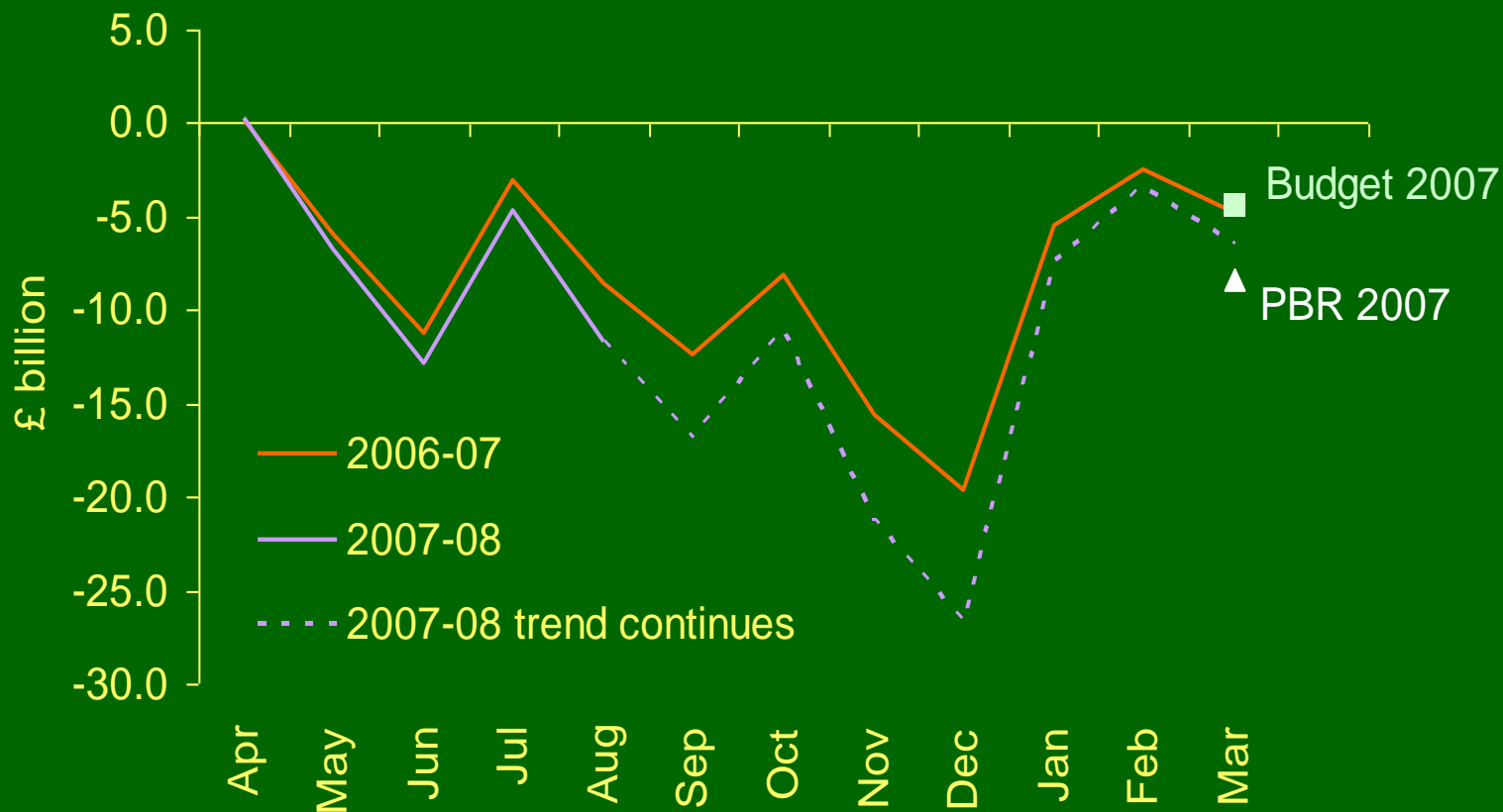
Current budget: total change

£billion	2007-08	2008-09	2009-10	2010-11	2011-12
Budget 2007	-4.3	+3	+6	+9	+13
Total (no measures)	-7.9	-3.6	+1.8	+7.6	+12.6
PBR measures	-0.4	-0.4	+1.2	+1.4	+1.4
PBR 2007	-8.3	-4	+3	+9	+14

Current budget: total change

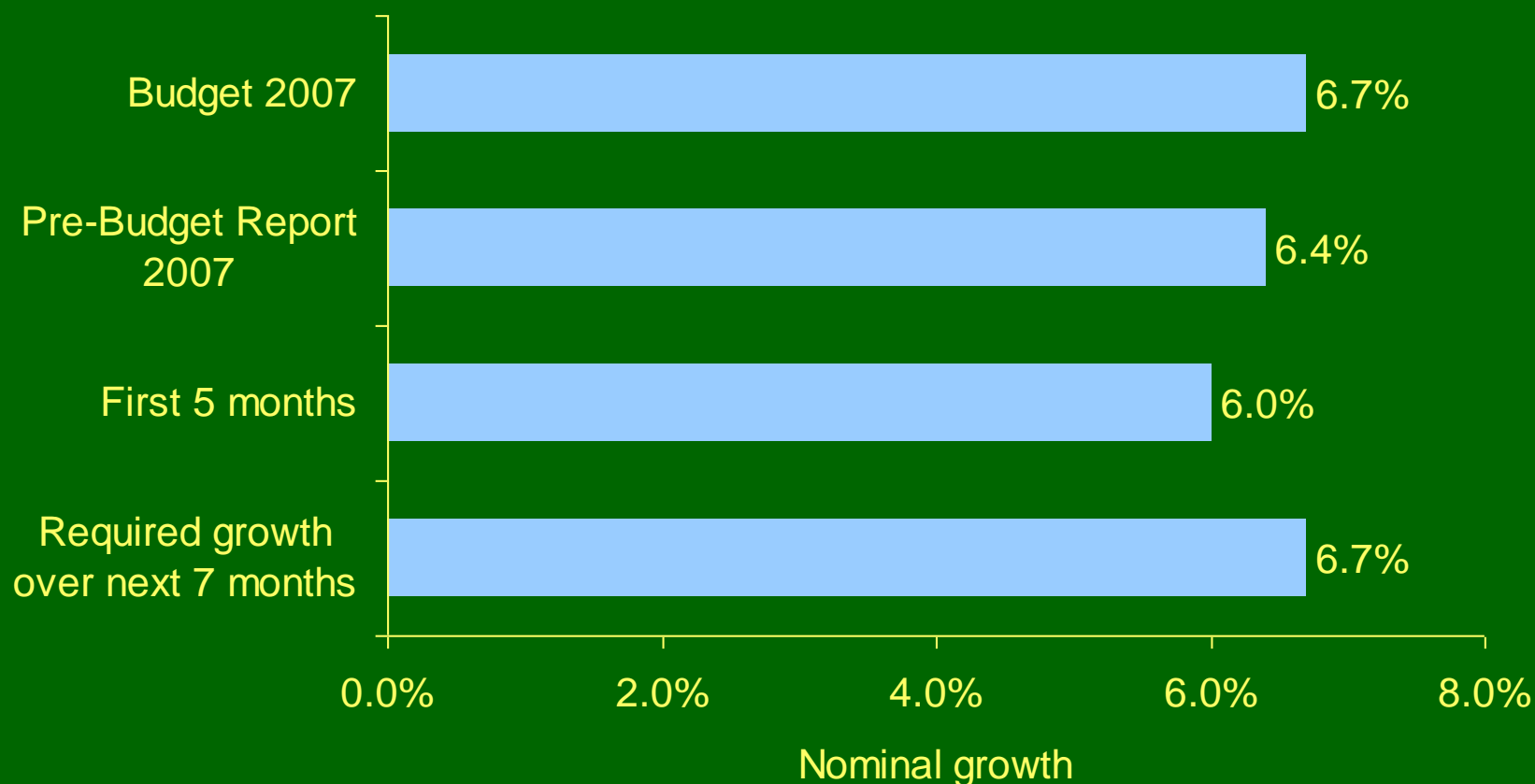
£billion	2007-08	2008-09	2009-10	2010-11	2011-12
Budget 2007	-4.3	+3	+6	+9	+13
Forecasting changes	-3.6	-6½	-4	-1½	-1
Total (no measures)	-7.9	-3.6	+1.8	+7.6	+12.6
PBR measures	-0.4	-0.4	+1.2	+1.4	+1.4
PBR 2007	-8.3	-4	+3	+9	+14

Monthly current budget surplus



Receipts

Growth in net taxes and social security contributions in 2007–08



The fiscal rules

- Golden Rule
 - Borrow only to invest
 - Current budget balance or surplus
 - Judged over the economic cycle

Current budget balance

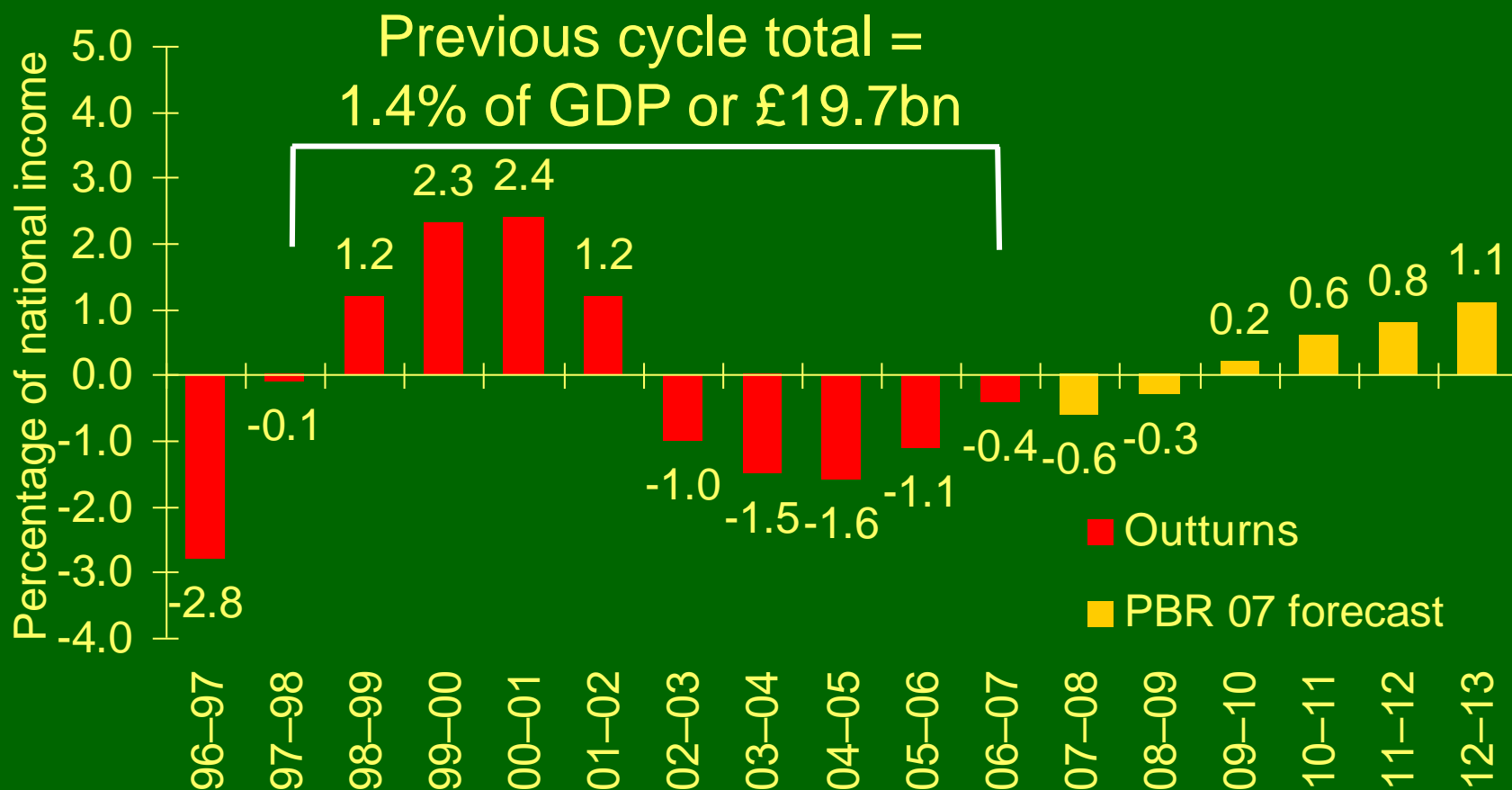
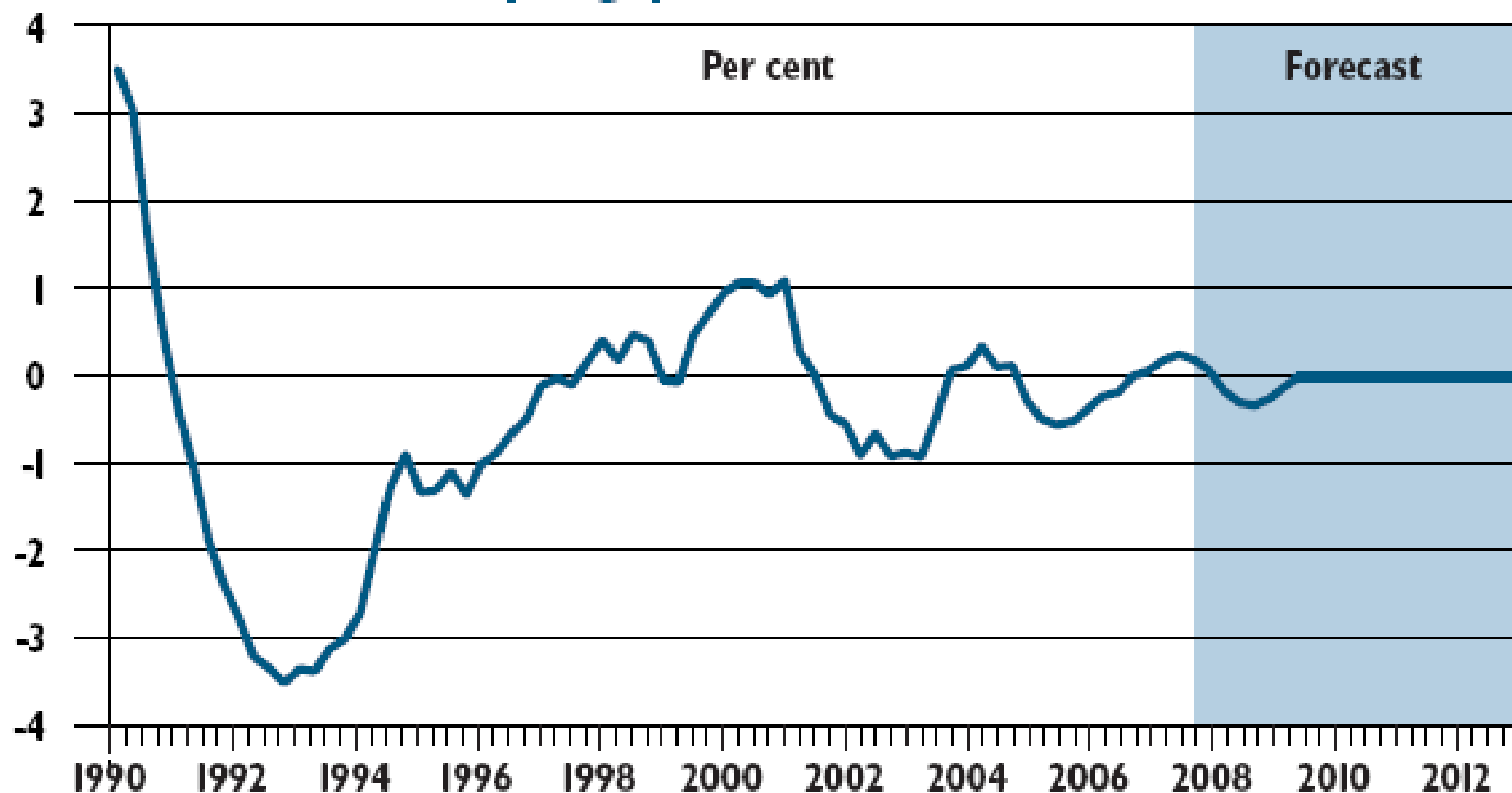
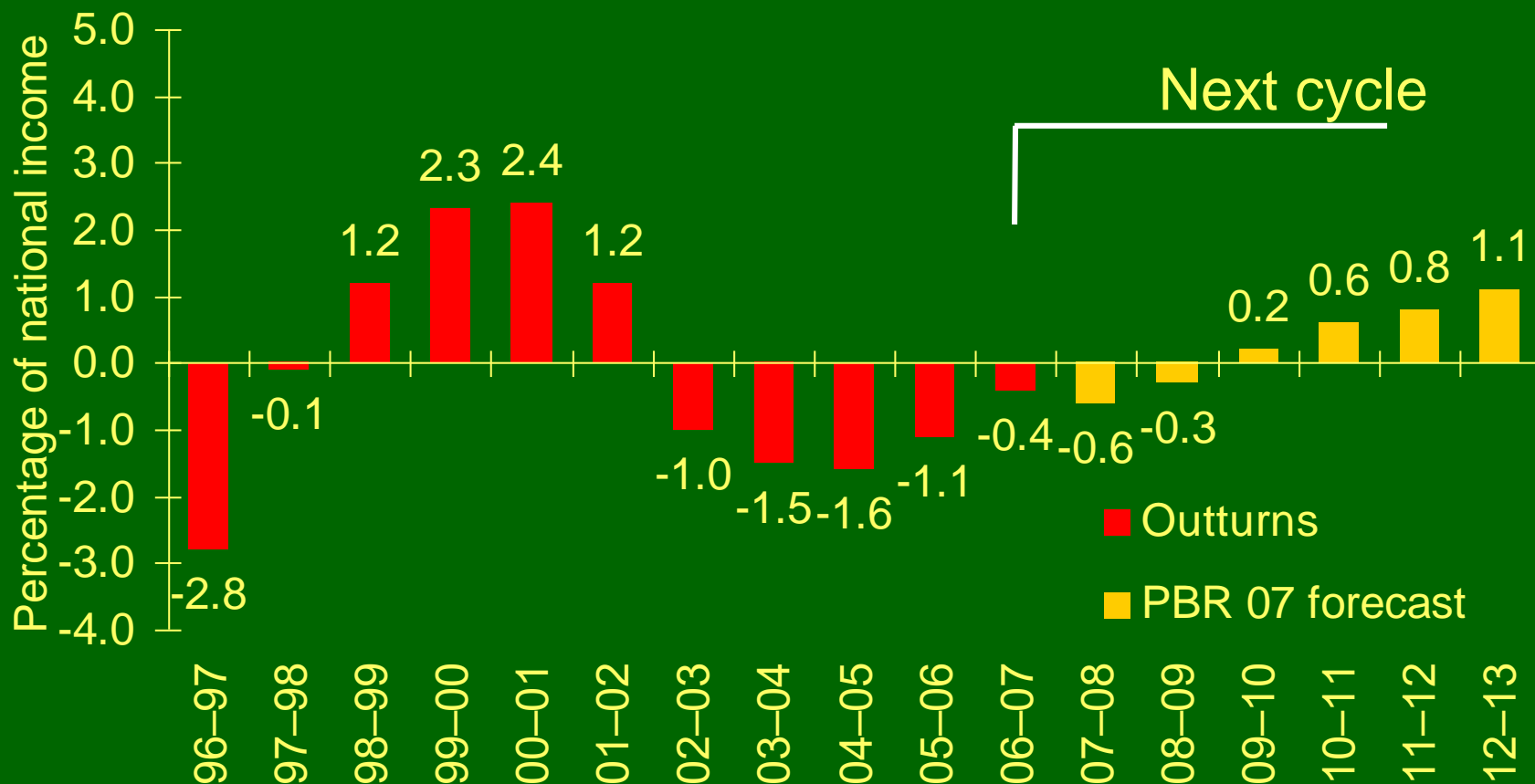


Chart A3: The output gap¹

¹ Actual output less trend output as a percent of trend output (non-oil basis).

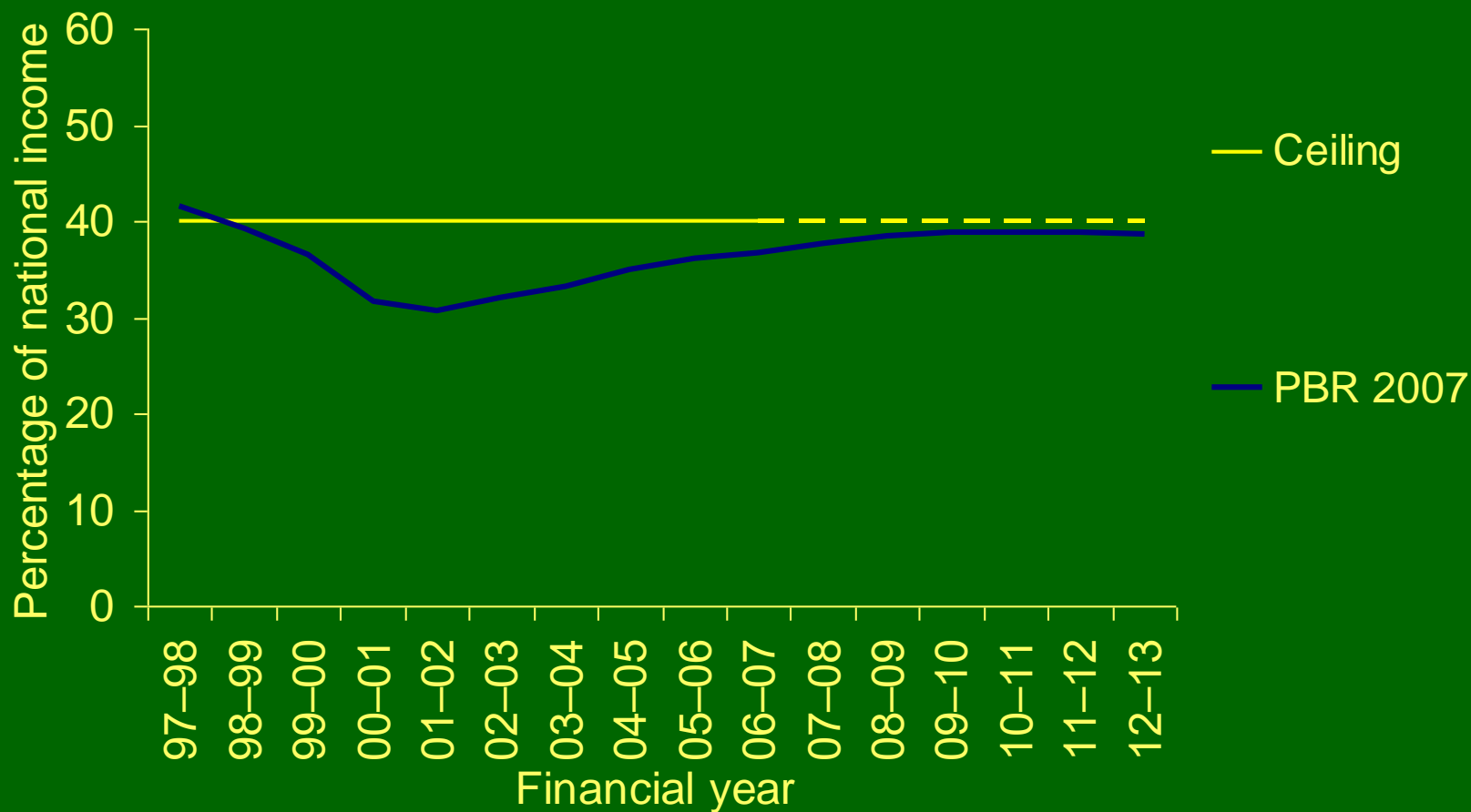
Current budget balance



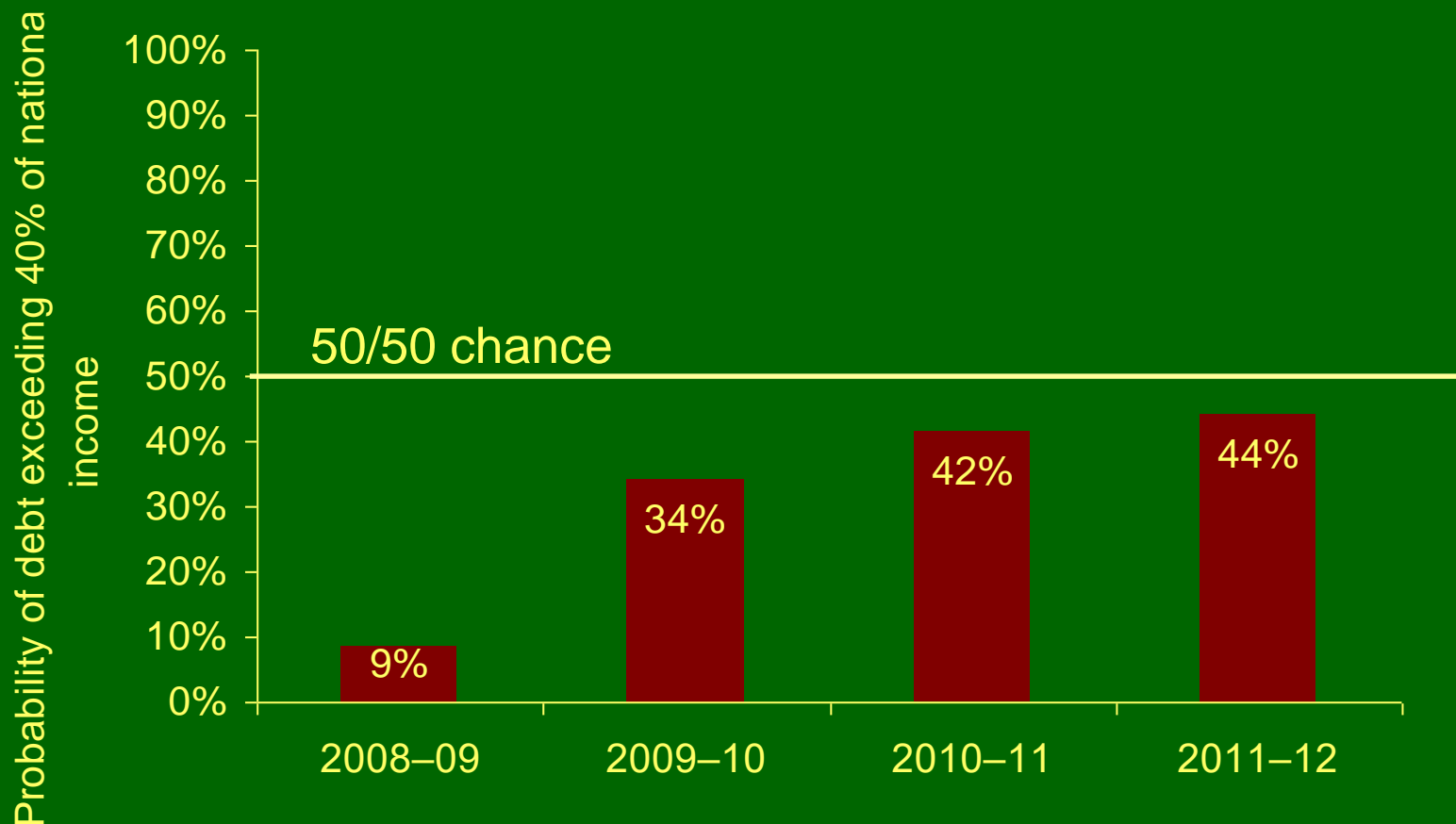
The fiscal rules

- Golden Rule
 - Borrow only to invest
 - Current budget balance or surplus
 - Judged over the economic cycle
- Sustainable Investment Rule
 - Debt at a stable and prudent level
 - Last cycle: $\leq 40\%$ of national income every year
 - New cycle: HM Treasury still to confirm

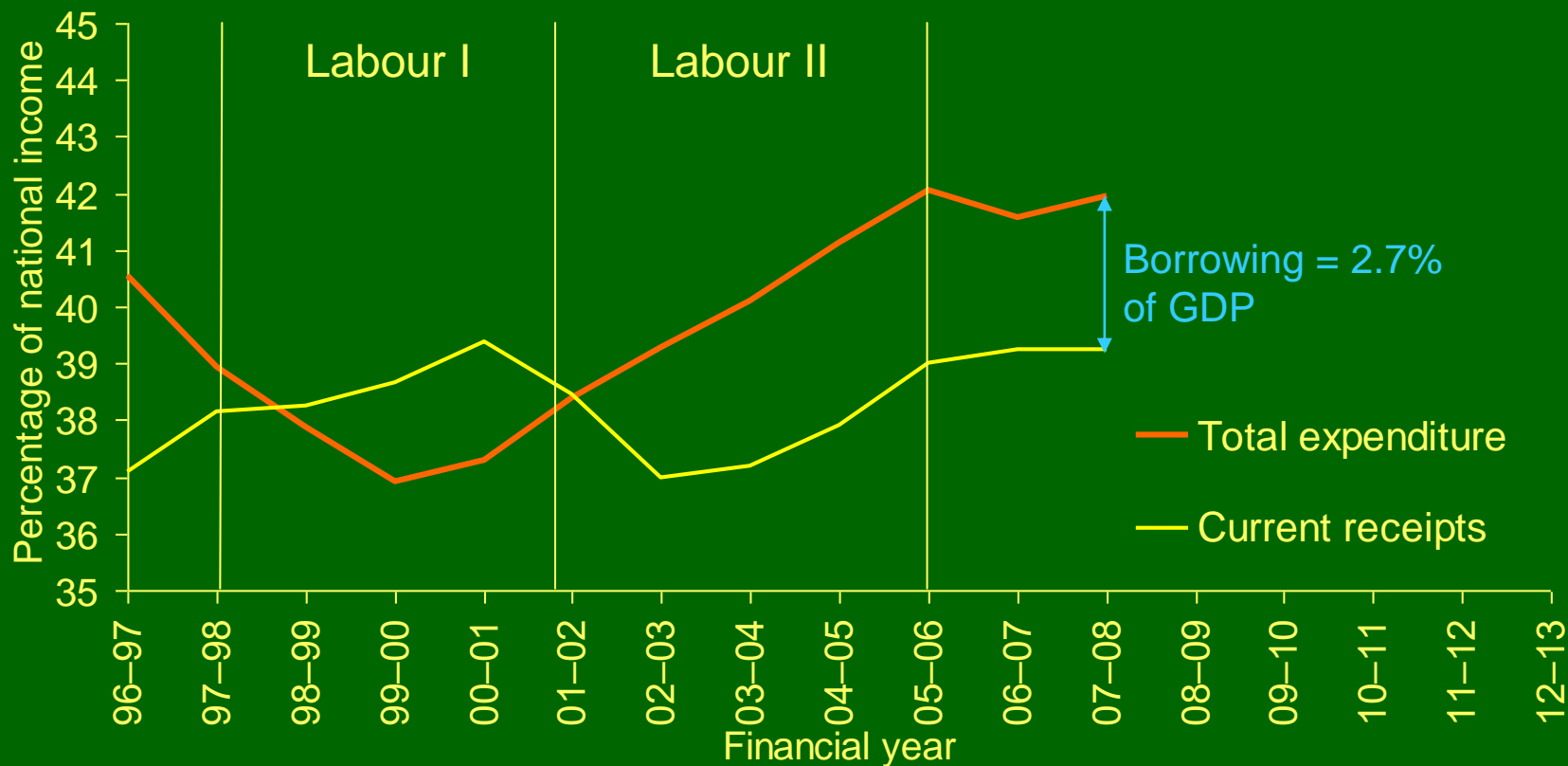
Will the investment rule be met?



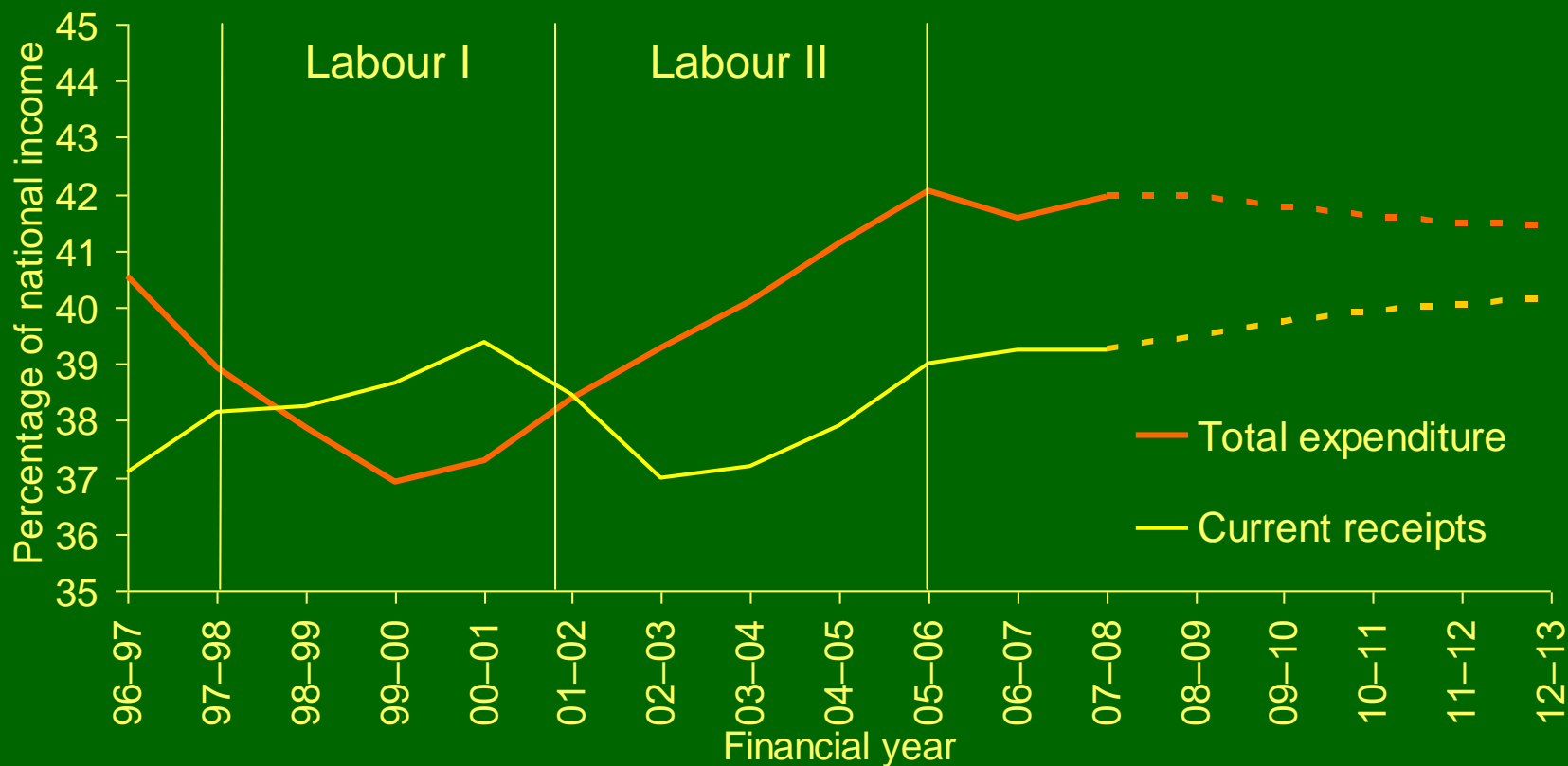
Debt could exceed 40%



The big picture: Labour's record



The big picture: going forwards



Labour's record and plans

% national income	1996–97	2007–08	2012–13
Current spending	39.9	39.8	39.1
Net investment	0.7	2.1	2.3
Revenues	37.1	39.2	40.2
Net borrowing (PSNB)	3.5	2.7	1.3
Current budget surplus	–2.8	–0.6	1.1
Net debt	43.3	37.6	38.6

Why have tax revenues gone up?

	% of national income	Cash equivalent (£bn)
<i>Announcements</i>		
Conservative		
Labour 1 st term		
Labour 2 nd term		
Labour 3 rd term		
All announcements		
Other		
Total	+3.1	+43.5

Why have tax revenues gone up?

	% of national income	Cash equivalent (£bn)
<i>Announcements</i>		
Conservative	+0.7	+9
Labour 1 st term	-0.2	-3
Labour 2 nd term	+1.0	+15
Labour 3 rd term	+0.5	+8
All announcements	+1.9	+28
Other	+1.2	+17
Total	+3.1	+43.5

Sharing the proceeds of growth

- In 2007–08 compared with 1996–97
 - national income up £382bn, on average £12,100 per family
 - families on average pay £5,400 more tax after inflation
 - after tax families on average keep £6,600 more
- In 2012–13 compared with 2007–08
 - national income up £173bn, on average £5,500 per family
 - families on average pay £2,600 more tax after inflation
 - after tax families on average keep £2,900 more

Summary: Labour's record

- Borrowing reduced as taxes increased by more than spending
- Borrowing to fall further as taxes to increase and spending to fall as a share of national income

Public finances: conclusions after PBR

- Current budget deficit up this year and next
 - largely temporary?
 - remainder filled by new measures
- Additional capital spending in 2010–11
 - moves debt even closer to 40% of national income
- Risks
 - larger part of deficit could be permanent
 - fiscal rule(s) could be breached
 - spending plans already have had to be revised up

Tax and benefit reforms

Stuart Adam

Outline

- Inheritance tax
- Capital gains tax
- Non-domiciled residents
- Air passenger duty
- Child poverty package
- Other announcements

Inheritance tax

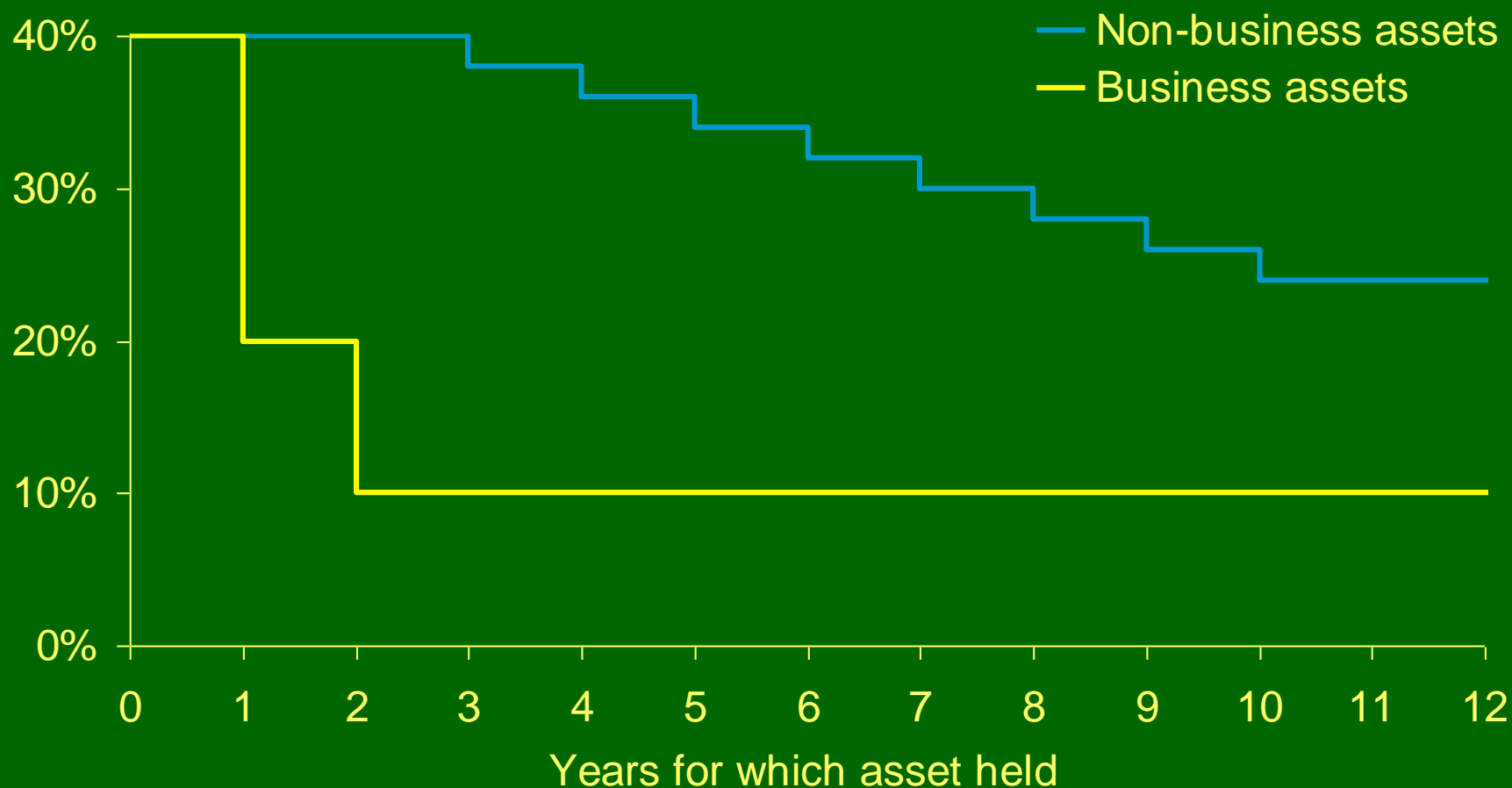
- Already no inheritance tax on bequests to a spouse or civil partner
- Each individual can bequeath £300,000 tax-free to others
 - Rising to £350,000 by 2010-11
- If each spouse uses their full allowance, couples can therefore pass on £600,000 tax free
- But many don't – just leave everything to their spouse
 - No tax at that stage, but only a single allowance when the spouse dies
- PBR reform: any unused allowances transferred to surviving spouse
 - So widow(er) can bequeath up to £600,000 tax-free
 - Also backdated so existing widow(er)s benefit
- Helps those who didn't successfully plan
 - Particularly where wealth is tied up in their home
- Unlike Conservatives' proposals, doesn't benefit:
 - Singles, divorcees and cohabiting couples
 - Couples already using both spouses' allowances
- Costs £1.4bn

Capital gains tax

- Charged on an asset's sale price minus purchase price
 - Annual gains above an allowance effectively subject to income tax
- “Taper relief” reduces tax rate the longer the asset is held
 - Introduced by Gordon Brown in 1998
- PBR abolishes taper relief, moving to a flat 18% rate
 - Lib Dems proposed abolishing taper relief, but not reducing rates
- More generous in some cases, less generous in others
 - Overall, raises £0.9bn in 2010-11

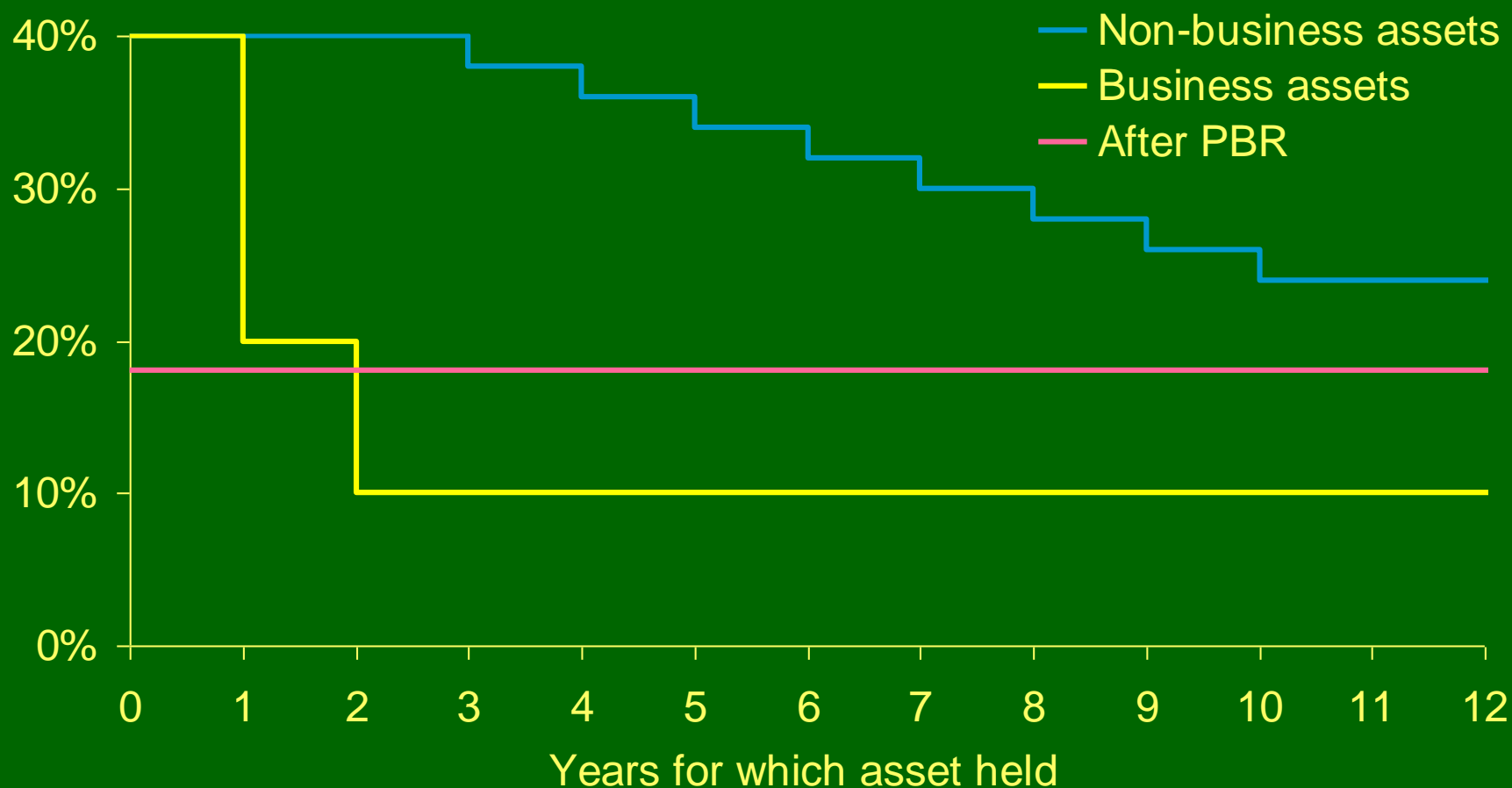
CGT taper relief

Effective tax rate for higher rate taxpayer



CGT taper relief

Effective tax rate for higher rate taxpayer



Capital gains tax

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- PBR abolishes taper relief, moving to a flat 18% rate
 - Lib Dems proposed abolishing taper relief, but not reducing rates
- More generous in some cases, less generous in others
 - Overall, raises £0.9bn in 2010-11
- Major simplification – very welcome
- Economically sensible – justification for taper relief never clear
- Serious economic distortions remain
 - Capital gains treated much more generously than ordinary income
- A rush to sell business assets before April 2008?

Taxing non-domiciled residents

- Non-doms: “foreigners” who live in the UK
- Don’t pay tax on their *foreign* income *unless* they bring it into the UK
- Conservatives want to charge them £25k a year
 - If unremitted foreign income below £62.5k, better off becoming UK domiciled and paying UK tax on all income
 - Would raise £3.5bn, say Conservatives; £0.6bn, say Labour
- Labour want to charge them £30k a year and remove their income tax allowances
 - Except for first 7 years here or if foreign income below £1k
 - Also tighten up some “loopholes”
 - Better becoming UK domiciled if foreign income below £80k
 - PBR says would raise £0.5bn in 2010-11

Non-doms: how much revenue?

- Lots of unknowns in both parties' estimates:
 - How many non-doms are there?
 - How many have unremitted foreign income above £62.5k / £80k?
 - How much foreign income do the remainder have?
 - Might people with high foreign income fail to declare it?
 - Could clever advisors find ways around the new charge?
 - How many would leave the country?
- No-one really knows the answers to these questions
- Labour are being more cautious than the Conservatives
 - If the Conservatives are right, Labour's reforms will raise more than the PBR forecasts

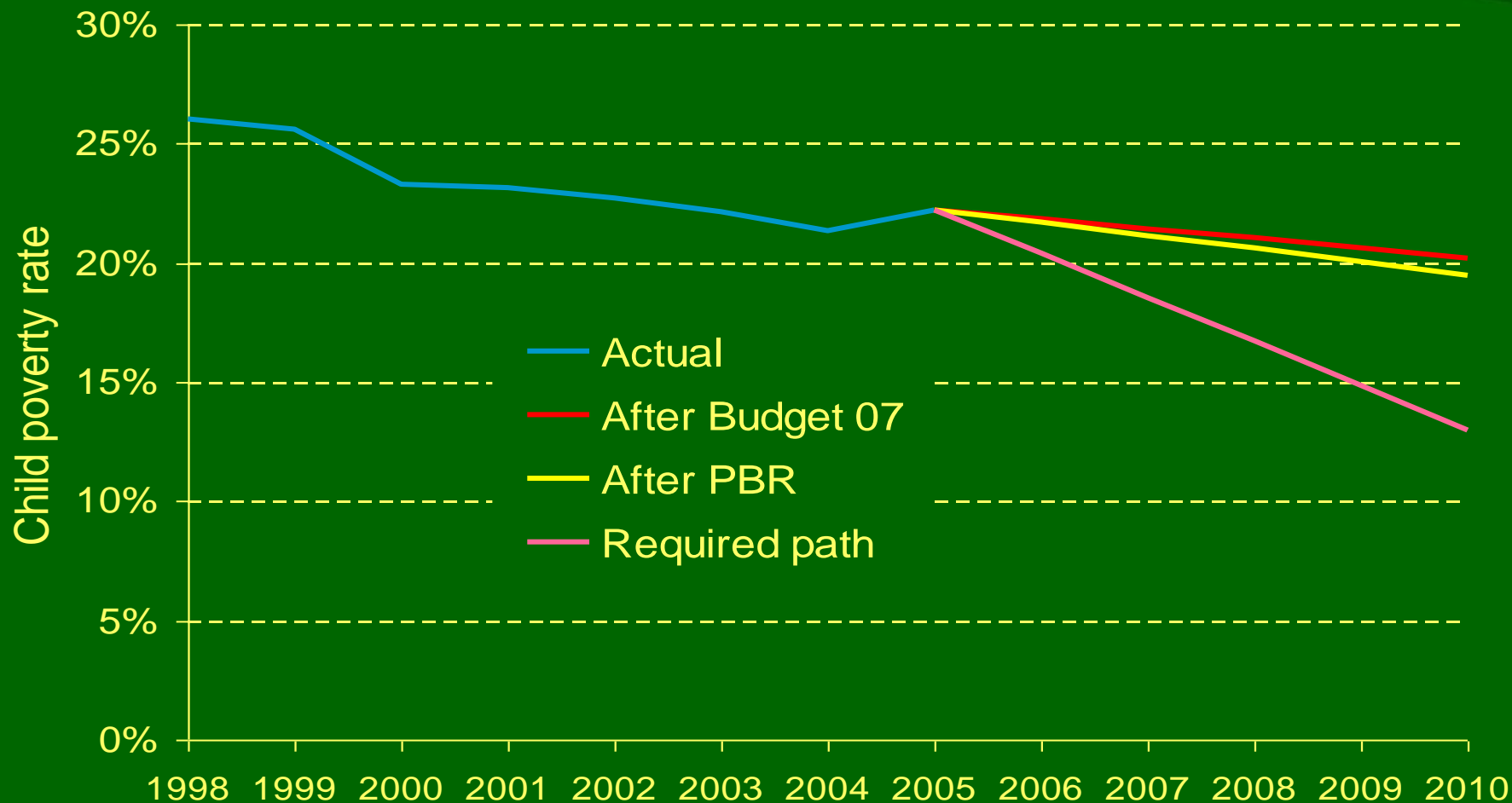
Air passenger duty

- Move from per-passenger to per-flight tax
 - From November 2009: rates frozen for 2008-09
 - Possibly related to distance travelled etc.
 - Raises £0.5bn in 2010-11
- Very similar to policies proposed by the Liberal Democrats and (more recently) the Conservatives
 - But Lib Dems wanted much higher rate, to raise £2.2bn
- Sensible reform: better environmental targeting since emissions depend little on passenger numbers

Child poverty package

- Three-part package
 1. Additional £50 per child per year in tax credits by 2010-11. Cost: £340m
 2. More maintenance payments ignored as income for means-tested benefits. Cost: £140m
 3. Back-to-work payments for lone parents (£40 a week for the first year in work) rolled out nationwide. Cost: £100m
- Helps the poorer half of families with children, and especially lone parents who receive maintenance or who move from benefits to work
- Reduces child poverty by 100,000
 - But much more needed to hit 2010 target

The 2010 child poverty target



Other announcements

- State second pension reform (+£440m)
- Higher tax on free company car fuel (+£25m)
- Tax breaks for biofuels abandoned (+£35m)
- Anti-avoidance etc. (+£470m)
- Planning gains supplement abandoned
- Local supplementary business rate power
- 3 reviews on tax simplification

Conclusions

- Lots of familiar-looking policies
- CGT and APD reforms look sensible
- Winners:
 - Well-off married couples who don't plan well
 - Low-income lone parents families
 - Owners of second homes
 - People who realise quick capital gains
- Losers:
 - Non-doms
 - Business owners (including private equity executives and ordinary shareholders) who hold on to their assets
 - People who fly long distances in empty planes

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