6. The tax burden under Labour

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Summary

- By next year, Labour will be taking 2.1% more of national income in tax and other receipts than the Conservatives did in 1996–97. It expects to take a further 1.3% of national income by 2009–10, increasing government revenues to 40.5% of national income. This is the highest since the mid-1980s, but still lower than the average during the Conservatives' four terms in government from 1979 to 1997.
- About a third of the £26 billion a year increase in government revenues expected by the end of Labour's first two terms reflects policy announcements by Gordon Brown. Another third reflects Conservative decisions he has chosen not to fully reverse. The economic cycle and fiscal drag contributed £23.3 billion, offset by other factors that cost £14.9 billion, such as falling profits of financial companies.
- The Treasury expects tax revenues to grow more quickly over the next five years than they have under Labour to date, despite weaker economic growth and the absence of explicit tax-raising measures. 'National income after tax' is forecast to grow more slowly over the next five years than at any time since the early 1980s.
- The last six pre-election Budgets have cut taxes. Labour increased taxes shortly after the 1997 election, cut them in the run-up to the 2001 election and increased them again in the subsequent Budget. This suggests that if the Chancellor believes that new tax increases are necessary, he may wait until after polling day to announce them.

6.1 Introduction

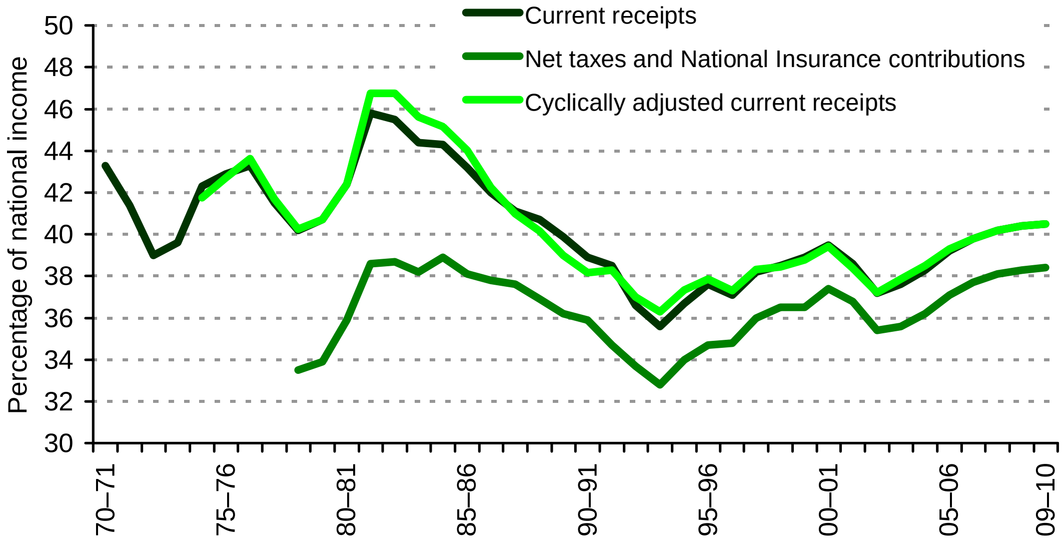
This chapter examines the evolution of the tax burden[1] and government revenues as a share of national income under Labour and the extent to which it is explained by policy decisions and other factors. Section 6.2 puts the change in the tax burden and revenues since 1997 into historical context and analyses how it reflects changes in the relative growth rates of revenue and national income. Section 6.3 looks at changes in the revenues derived from individual taxes and how movements in government revenues overall break down between the impact of policy decisions, 'fiscal drag' and changes in the size and composition of the economy. Section 6.4 concludes by asking whether looming general elections affect the announcement of tax and spending decisions.

[1] The phrase 'tax burden' is not meant in a pejorative sense. Taxation in practice distorts people's behaviour in ways that generate economic costs, but voters may be happy to see the government take a higher share of national income in tax and other receipts if they derive greater utility from the spending it finances (despite the economic costs of the taxes used to fund it) than if taxes and spending were lower.

6.2 The tax burden in historical context

The tax burden is conventionally measured by looking at net taxes and National Insurance contributions as a share of national income.[2] Figure 6.1 shows that the tax burden on this measure has fluctuated between around 33% and 39% since the late 1970s. It also shows the Treasury forecast in the last Pre-Budget Report that this measure of the tax burden would rise from 36.2% of national income this year to 38.4% in 2009–10, its highest level for 25 years.[3]

Figure 6.1. Government revenues since 1970–71



Note: The cyclically adjusted figures for public sector current receipts were obtained using the 'ready reckoner' formula in table A5 of HM Treasury, *End of Year Fiscal Report*, London, December 2003 (http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr03/assoc_docs/prebud_pbr03_adend.cfm.
Sources: HM Treasury, *Public Finances Databank*, London, December 2004 (http://www.hm-treasury.gov.uk/media/F6C/7E/public_fin_databank_211204.xls); HM Treasury, *Pre-Budget Report*, London, December 2004 (http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr04/prebud_pbr04_index.cfm).

But the government also collects revenues from other sources, such as interest payments and surpluses generated by public sector corporations. These non-tax revenues exceeded 6% of national income in the late 1970s and early 1980s, but declined subsequently as many of the public corporations were privatised and therefore the operating surpluses of public sector corporations fell.[4] Since 1996–97, non-tax receipts have fluctuated in a relatively narrow range, between 1.8% and 2.4% of national income.

The 'current receipts' line in Figure 6.1 adds these non-tax sources of revenue to net taxes and National Insurance contributions to give the broadest measure of government revenues. Over the past 35 years, this has fluctuated between 36% and 46% of national income. The Treasury forecasts revenues of 38.3% of national income in the current financial year, in line with the

[2] Throughout this chapter, we refer to 'money GDP' as 'national income'. The Treasury uses money GDP as the denominator when comparing revenues and spending with the size of the economy.

[3] Statements referring to the tax burden in this chapter will be true of both 'current receipts' and 'net taxes and National Insurance contributions'.

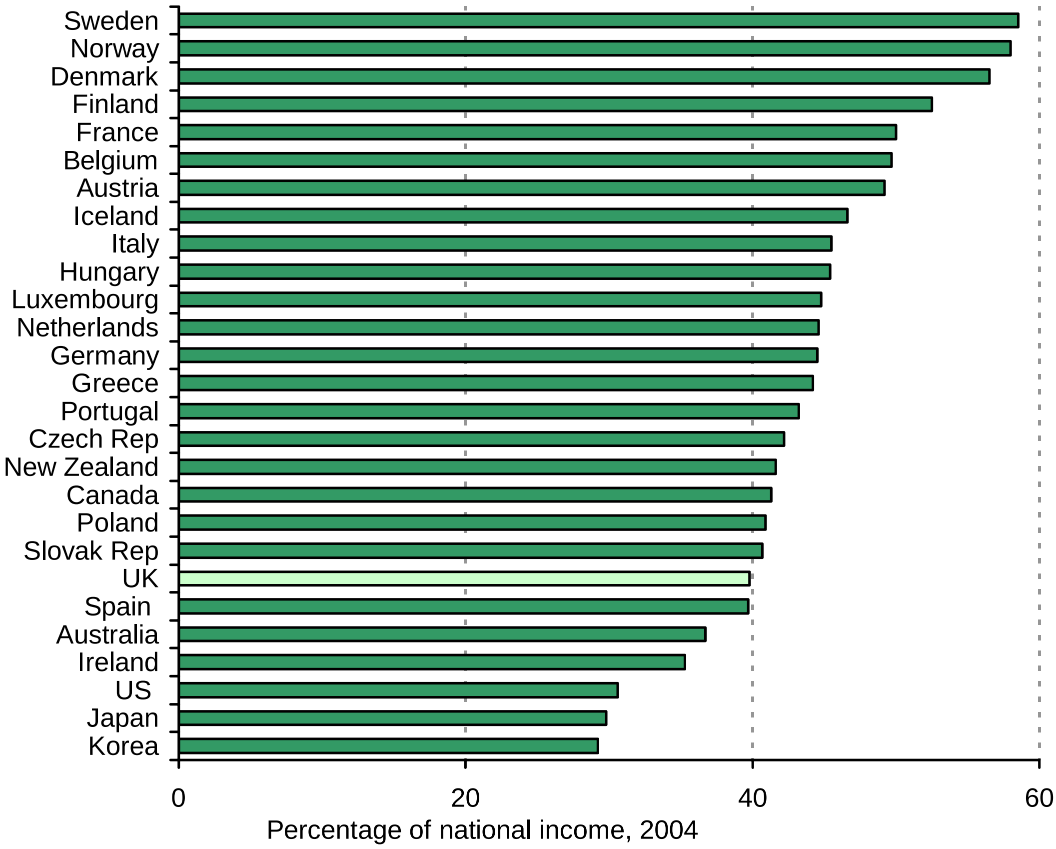
[4] The operating surplus of public corporations fell from 6.1% of national income in 1980–81 to 2.0% in 1992–93.

38.4% average seen since Labour came to power in 1997, but somewhat lower than the 40.6% average under the Conservatives from 1979 to 1997. The Treasury now expects government revenues to rise significantly as a share of national income over the next five years. It predicts that current revenues will reach 40.5% of national income in 2009–10, their highest level since 1988–89.

Current receipts fluctuate in part because of the ups and downs of the economic cycle: when the economy is doing well, receipts rise as a share of national income; when it is doing badly, they decline. To be precise, the Treasury estimates that when national income rises by 1% relative to the sustainable level consistent with stable inflation, current receipts rise by around 0.2% of national income over two years. Figure 6.1 also shows current receipts as a share of national income after taking this cyclical effect into account. It shows that weak economic activity depressed government revenues during the recessions of the early 1980s and early 1990s and boosted revenues during the economic boom of the late 1980s. But the impact of the economic cycle was relatively modest compared with the overall changes in revenue.

Measured on an internationally comparable basis, government revenues in the UK were slightly higher as a share of national income last year than in the rest of the G7 (Group of Seven leading industrial) countries, but lower than in most other European countries (Figure 6.2). Differences in revenue as a share of national income across countries are principally explained by differences in the proportions that different governments spend on public services and income transfers.

Figure 6.2. Government revenue in various industrial countries

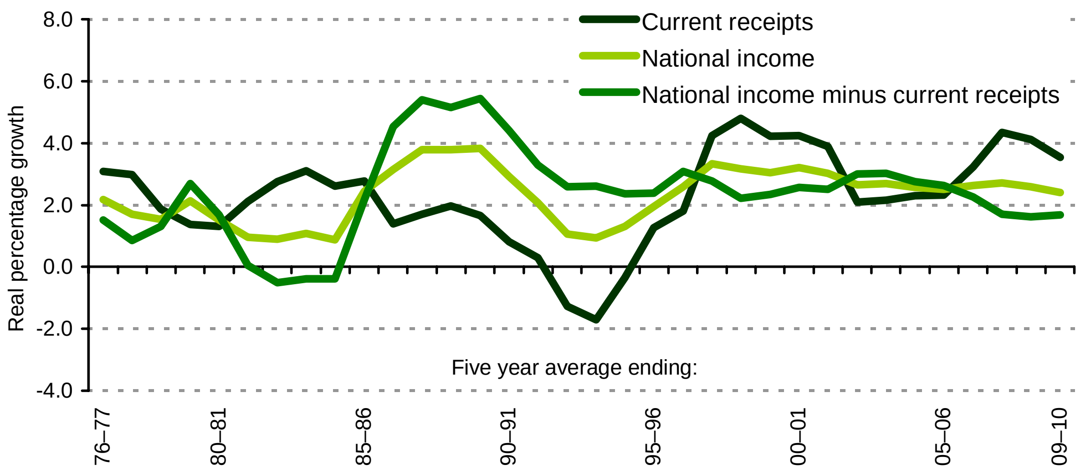


Note: The G7 countries are Canada, France, Germany, Italy, Japan, the UK and the US.
Source: Annex table 26, OECD, *Economic Outlook*, no. 75, June 2004.

In explaining movements in government revenues over time, it is interesting to examine how growth in national income breaks down between growth in what the government takes in tax (and other receipts) and growth in what the private sector has left (although just under 30% of revenue collected by government ends up back in the hands of the private sector in the form of social security benefits and tax credits[5]). This is hard to do with precision, as not all UK government revenue is paid from UK national income (for example, VAT payments by visiting foreign tourists) and some UK citizens will have paid taxes to overseas governments on part of their income. But, as a very rough proxy, we can subtract current receipts from national income to produce a series for 'national income after tax'.

Figure 6.3 shows average increases in government revenues, national income and 'national income after tax' over every five-year period ending between 1976–77 and 2009–10, after taking account of economy-wide inflation. When government revenues increase more quickly than national income, the share of national income taken by government rises; when government revenues increase less quickly than national income, the share of national income taken by government falls. 'National income after tax' usually grows more quickly in real terms when the share of national income is falling than when it is rising, but not always. It is interesting to look at how the relationship between national income and government revenue has varied across parliaments?

Figure 6.3. Growth in government revenues and national income



Note: Projections from 2004 Pre-Budget Report.
Sources: HM Treasury, *Public Finances Databank*, London, December 2004 (http://www.hm-treasury.gov.uk/media/F6C/7E/public_fin_databank_211204.xls); HM Treasury, *Pre-Budget Report*, London, December 2004 (http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr04/prebud_pbr04_index.cfm).

Government revenues and national income by parliament

The Conservatives

Current receipts jumped sharply as a share of national income soon after the Conservatives took office, when Geoffrey Howe increased taxes in his 1981 Budget. Government revenue

[5] See figure B.4 of HM Treasury, *Public Finances Databank*, London, December 2004 (http://www.hm-treasury.gov.uk/media/F6C/7E/public_fin_databank_211204.xls).

then declined steadily by more than 10% of national income over the following 12 years, until Kenneth Clarke increased taxes again after Britain left the European exchange rate mechanism in 1992. Current receipts ended the Conservative era at 37.1% of national income, compared with the 40.2% of national income the party inherited. This reflected the fact that, over this period, national income grew by an average of 2.1% a year in real terms, while government revenues grew by only 1.7% (see Table 6.1). This allowed ‘national income after tax’ to grow by 2.4% a year. The economy grew more slowly under John Major’s premiership than Margaret Thatcher’s, but tax revenues grew even more slowly. So ‘national income after tax’ actually rose faster under Mr Major (2.6% a year) than under Mrs Thatcher (2.3% a year).

Table 6.1. Growth in government revenues and national income by parliament

	Annualised average real increase (%) in:		
	Current receipts	**National income**	**National income minus current receipts**
Comparisons across parliaments			
This parliament (5 years): 2000–01 to 2005–06	2.3	2.5	2.6
This parliament (4 years): 2000–01 to 2004–05	1.6	2.4	2.9
Last parliament (4 years): 1996–97 to 2000–01	5.0	3.3	2.3
Conservative years (18 years): 1978–79 to 1996–97	1.7	2.1	2.4
Of which:			
Major’s period in office: 1990–91 to 1996–97	1.2	2.1	2.6
Thatcher’s period in office: 1978–79 to 1990–91	1.9	2.2	2.3
Other periods of interest			
Labour’s two parliaments plus plans: 1996–97 to 2009–10	3.4	2.7	2.2
First 8 years of Labour parliaments: 1996–97 to 2004–05	3.3	2.8	2.6
Current plans: 2004–05 to 2009–10	3.5	2.4	1.7
33 year period from 1971–72 to 2004–05	2.1	2.4	2.5

Note: Projections from 2004 Pre-Budget Report.
Sources: HM Treasury, *Public Finances Databank*, London, December 2004 (http://www.hm-treasury.gov.uk/media/F6C/7E/public_fin_databank_211204.xls); HM Treasury, *Pre-Budget Report*, London, December 2004 (http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr04/prebud_pbr04_index.cfm); authors’ calculations.

Labour’s first two terms

By the end of the current financial year, the Treasury estimates that government revenues will have grown by 3.3% a year in real terms since Labour took office, almost twice as quickly as under the Conservatives. But the economy has also grown more strongly under Labour than under the Conservatives, so ‘national income after tax’ has actually risen faster under Labour to date (2.6% a year in real terms) than under the Conservatives (2.4% a year).

Government revenues grew much faster in Labour’s first term than they have done in its second. Between 1996–97 and 2000–01, government revenues grew on average by 5.0% a year, comfortably outpacing economic growth of 3.3% a year. Hence, as we saw in Figure 6.1, government revenues increased as a share of national income and the tax burden rose.

Assuming that the Treasury's December Pre-Budget forecast is accurate, the tax burden will have fallen between April 2001 and March 2005. This is a result of growth in national income of 2.4% a year outstripping much weaker growth in government revenues of 1.6% a year. So even though the economy grew more strongly in Labour's first term than its second, 'national income after tax' is likely to have grown more strongly in its second (2.9% a year) than in its first (2.3%). This reflects the fact that rapid increases in government spending in Labour's second term have been paid for by increasing borrowing rather than increasing revenues.

Labour's plans for the next five years

The Chancellor has accepted that in order to pay for his spending plans and to reduce borrowing sufficiently to meet his 'golden rule' looking forward, the tax burden will need to increase sharply if Labour is re-elected – increasing current receipts from 38.3% of national income this year to 40.5% in 2009–10. (Similarly, net taxes and National Insurance contributions are forecast to grow from 36.2% of national income this year to 38.4% of national income in 2009–10.) With the economy projected to grow by 2.4% a year over this period, this will require revenues to grow by 3.5% a year – even greater than the increase seen under Labour to date. This implies that having allowed 'national income after tax' to grow by 2.6% a year since taking office, the Chancellor will now have to squeeze the increase down to 1.7% a year if Labour is re-elected. As Figure 6.3 shows, 'national income after tax' will not have grown this slowly since the early 1980s, when the Conservatives increased taxes while the economy was in recession and employment was falling.

As we show in Section 6.3, Labour required significant discretionary tax-raising measures to bring about the 3.3% a year real increase in revenues that it has achieved to date. The Chancellor forecasts that revenues will increase even more strongly over the next five years, even though the economy is expected to grow more slowly and he has yet to announce any significant tax-raising measures. As we explained in Chapter 4, we are not so sure.

6.3 Government revenues and policy decisions

The tax burden can change as a result of discretionary policy measures, fiscal drag (the fact that 'unchanged' policies are defined in Treasury forecasts in such a way that they lead to a rise in the tax burden over time[6]) or economic factors, such as changes in the size and composition of national income and movements in asset and commodity prices.

Of course, the Chancellor could choose to offset changes in the tax burden resulting from fiscal drag or economic factors with discretionary measures. (He has, for example, chosen to make discretionary cuts in fuel duties during periods when higher oil prices have brought him more revenue from the North Sea.) Hence, over the medium term, all changes in revenues as a share of national income are in effect a policy choice of the government.

In this section, we start by breaking down the overall change in government revenues seen since Labour came to power by individual tax. We then examine the extent to which changes in government revenues have been due to specific Budget announcements or other factors.

[6] See Chapter 2, Section 2.4.

Sources of government revenue

In descending order, the most important sources of government revenue are income tax, National Insurance contributions, VAT, excise duties and corporation tax. Net taxes and National Insurance contributions are forecast to raise 37.1% of national income next year, compared with the 34.8% of national income Labour inherited in 1996–97. Over the same period, total revenues are forecast to have risen from 37.1% of national income to 39.2%.

Table 6.2 shows how the major taxes have contributed to these increases. Between 1996–97 and 2005–06, revenues from income tax and capital gains tax are forecast to have grown by 2.1% of national income (from 9.2% to 11.3%), while revenues from National Insurance contributions are forecast to have grown by 0.5% of national income. This will have increased the share of total government revenue collected through these taxes from 41% to more than 45%. Meanwhile, council tax revenues are forecast to have grown by 0.4% of national income. Council tax has a relatively small overall yield, so this is a proportionately larger increase than for either income tax and capital gains tax or National Insurance contributions. In contrast, there have been falls in revenue from corporation tax (0.3% of national income), fuel duties (0.2% of national income) and tobacco duties (0.3% of national income).

Table 6.2. Revenues from individual taxes as shares of national income

	1996–97	2004–05	2005–06	2009–10
Income tax and capital gains tax (gross of tax credits)	9.2	11.0	11.3	11.8
Corporation tax (gross of tax credits)	3.6	2.8	3.3	3.7
Tax credits	–0.3	–0.4	–0.3	–0.2
Value added tax	6.0	6.3	6.2	6.1
National Insurance contributions (NICs)	6.1	6.6	6.6	6.8
Fuel duties	2.2	2.0	2.0	
Tobacco duties	1.0	0.7	0.7	3.1
Alcohol duties	0.7	0.7	0.7	
Business rates	1.8	1.6	1.6	
Council tax	1.3	1.7	1.7	7.1
Other taxes	3.1	3.2	3.3	
Net taxes and NICs	**34.8**	**36.2**	**37.1**	**38.4**
Other receipts and accounting adjustments	2.3	2.2	2.1	2.1
Total current receipts	**37.1**	**38.4**	**39.2**	**40.5**

Sources: HM Treasury, *Public Finances Databank*, London, December 2004 (http://www.hm-treasury.gov.uk/media/F6C/7E/public_fin_databank_211204.xls); HM Treasury, *Pre-Budget Report*, London, December 2004 (http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr04/prebud_pbr04_index.cfm).

Looking forward, government revenues are forecast to increase by 1.3% of national income by 2009–10 (as measured either by current receipts or by net taxes and National Insurance contributions). Receipts of income tax and capital gains tax are forecast to grow by 0.5% of national income, National Insurance contributions by 0.2% of national income and 'other taxes' (for which the Treasury does not provide a breakdown into business rates, council tax and the other individual taxes) by 0.5% of national income. Conversely, excise duty receipts (i.e. fuel, alcohol and tobacco duties) are forecast to fall by 0.3% of national income. As discussed in Chapter 4, the Green Budget forecasts lower growth in receipts from corporation tax in particular over this period.

The revenue effect of Budget measures

As discussed above, over the medium term any change in government revenues is discretionary since changes due to fiscal drag or economic factors could always be reversed through policy decisions. For example, in order to prevent government revenues from increasing as a share of national income over time as a result of fiscal drag, a Chancellor could choose to over-index tax thresholds or cut tax rates. There is a case for presenting public finance forecasts in such a way that ‘unchanged’ policies imply that, other things being equal, tax allowances and thresholds are adjusted to keep the tax burden constant. The Treasury uses this ‘comprehensive form of “real indexation”’ when projecting some tax revenues beyond its short-term forecasting horizon in its *Long Term Public Finance Report*.[7]

Table 6.3. Contributions to changes in government revenue

Net increase in revenue	**Labour’s 1st term**		**Labour’s 2nd term**		**Labour to date**	
	% of national income	Cash equivalent	% of national income	Cash equivalent	% of national income	Cash equivalent
Announcements						
Conservative	0.7%	£9.1bn	0.0%	0.0	0.7%	£9.1bn
Labour 1st term	–0.2%	–£2.3bn	0.0%	–£0.5bn	–0.2%	–£2.8bn
Labour 2nd term	n/a	n/a	0.9%	£11.6bn	0.9%	£11.6bn
All announcements	0.5%	£6.8bn	0.9%	£11.1bn	1.4%	£17.9bn
Fiscal drag	1.0%	£12.4bn	0.8%	£9.6bn	1.8%	£22.0bn
Economic cycle	0.4%	£5.1bn	–0.3%	–£3.8bn	0.1%	£1.3bn
Other factors	–0.3%	–£4.7bn	–0.8%	–£10.1bn	–1.2%	–£14.9bn
Total	**1.6%**	**£19.6bn**	**0.6%**	**£6.9bn**	**2.1%**	**£26.4bn**

Notes: Measures defined as taxation using national accounts definitions. Hence only a proportion of the cost of the new tax credits is scored as a tax cut. The escalators on tobacco and fuel duty that were announced in the Spring 1993 Budget, and increased in the Autumn 1993 and Spring 1997 Budgets, are assumed to have been intended to run to 2001–02. The cost of abolishing these escalators is attributed to the Autumn 1999 Pre-Budget Report. For more details of classifications prior to January 2001, see table 3.1 of A. Dilnot, C. Emmerson and H. Simpson (eds), *The IFS Green Budget: January 2001*, Commentary no. 83, IFS, London, January 2001 (http://www.ifs.org.uk/budgets/gb2001/chap3.pdf).
Sources: Announcements from HM Treasury, Financial Statement and Budget Report, various years. Fiscal drag estimated using HM Treasury estimate of 0.2% a year from paragraph A.24 of HM Treasury, *End of Year Fiscal Report,* December 2003 (http://www.hm-treasury.gov.uk/media/324/70/end_of_year_352%5B1%5D.pdf). Impact of economic cycle estimated using figures in table A5 of HM Treasury *ibid.*

Bearing this in mind, we now discuss the impact of specific Budget announcements.

The Conservatives have claimed that Labour has implemented ‘66 stealth tax increases’ since coming to power in May 1997.[8] In fact, Budgets since April 1997 have contained a total of 157 tax-raising measures, but also 215 tax-cutting measures. But the number of individual tax changes has little economic significance, as the sums involved differ widely. A better measure of the impact of Budget measures is to work out the net revenue raised.

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[7] Footnote 13, page 51 of HM Treasury, *Long-Term Public Finance Report: An Analysis of Fiscal Sustainability*, London, December 2004 (http://www.hm-treasury.gov.uk/media/8F5/85/pbr04long-term_473.pdf).

[8] Conservative Party Press Release, ‘Brown is Britain’s “clickety click” Chancellor’, 19 March 2004 (http://www.conservatives.com/tile.do?def=news.story.page&obj_id=93816).

Table 6.4. Change in government revenues over various parliaments resulting from Budget announcements

£ billion 2005–06 **Announcement**	**Labour's first parliament impact in 2001–02**	**Labour's second parliament impact in 2005–06**
	Effect over and above any effect on previous parliament	
Conservative Budgets since the 1992 election:		
Conservative Budgets from 1992–97 parliament	**9.1**	**n/a**
Labour Budgets after the 1997 election:		
Summer 1997 Budget	6.7	0.0
Spring 1998 Budget	4.6	0.0
Spring 1999 Budget	–3.1	0.0
Autumn 1999 Pre-Budget Report	–4.9	–0.2
Spring 2000 Budget	–0.8	0.2
Autumn 2000 Pre-Budget Report	–0.7	–0.3
Spring 2001 Budget	–4.1	–0.2
Total Labour Budgets during first parliament	**–2.3**	**–0.5**
Labour Budgets after 2001 election:		
Autumn 2001 Pre-Budget Report	n/a	–0.0
Spring 2002 Budget	n/a	9.9
Autumn 2002 Pre-Budget Report	n/a	0.8
Spring 2003 Budget	n/a	0.6
Autumn 2003 Pre-Budget Report	n/a	–0.0
Spring 2004 Budget	n/a	0.4
Autumn 2004 Pre-Budget Report	n/a	0.1
Total Labour Budgets during second parliament	**n/a**	**11.6**
Total effect of Budget changes on revenues over parliament	**6.8**	**11.1**
Average change in revenues over parliament	*21.6*	*–8.5*
Actual change in revenues over parliament	*19.6*	*6.9*

Notes: See Table 6.3.
Sources: HM Treasury, *Financial Statement and Budget Report*, various years; authors' calculations.

Table 6.3 shows the impact of discretionary policy measures over Labour's first two terms (1997–2001 and (we assume) 2001–05). In addition, it shows the total change in revenues in each of these terms and provides a decomposition into the impact of fiscal drag (from taxes such as income tax and stamp duty), the economic cycle and other economic factors. We assume that the revenues collected in the first financial year of a parliamentary term were the result of policy decisions taken in the previous terms. So, for example, the impact of policy measures in Labour's first term is calculated looking at revenues up to 2001–02, even though most of that financial year fell in Labour's second term.[9] In addition, measures announced by

[9] We also assume that Labour's first term benefited from five years of fiscal drag compared with four in the second term. Although tax policy measures typically affect revenues with a one-financial-year lag, the government had a summer Budget on taking office and announced a tax increase with immediate effect (the windfall tax). This was not a permanent increase in tax, but the government could presumably have made a permanent change to offset at least some of the fiscal drag it inherited in 1997–98.

the Conservatives between 1992 and 1997 would, if implemented, have had an impact on revenues during Labour's first term. The costing for all measures is converted to 2005–06 terms by assuming that each measure raises or costs the same share of national income over time. A more detailed breakdown of Labour's policy measures by Budget is provided in Table 6.4. In both tables, we are looking at how government revenue differed at the end of the parliament from that at the beginning, so they do not include the impact of temporary tax measures that come and go within a parliament.

Labour's first term

Government revenues increased by 1.6% of national income by the end of Labour's first term, equivalent to £19.6 billion a year by 2005–06. Gordon Brown in fact announced discretionary net tax cuts worth £2.3 billion a year by the end of the term, most significantly by cutting the basic rate of income tax by 1p and introducing, and widening, the starting rate of income tax. But these cuts were more than offset by ongoing tax increases announced by the Conservatives that Mr Brown chose not to reverse or completely offset, notably the fuel and tobacco duty 'escalators' announced in Norman Lamont's Spring 1993 Budget and increased in Kenneth Clarke's Autumn 1993 Budget.[10] These would have increased government revenues by £9.1 billion a year by 2005–06, compared with the beginning of Labour's first term.[11] Discretionary measures announced or inherited by Labour therefore account for about a third of the rise in revenue seen over the government's first term. By 2001–02, fiscal drag contributed another 1.0% of national income a year, equivalent to £12.4 billion by 2005–06, the economic cycle is estimated to have contributed £5.1 billion a year and other factors cost £4.7 billion a year.

As shown in Table 6.4, the first two Budgets of Labour's first term in power contained net tax increases (and also included the windfall tax worth a total of £5.2 billion which is not shown in the table as it had no effect on revenues in the last year of the parliament), while subsequent announcements contained net tax cuts. Hence the average increase in taxes during Labour's first term is higher than the impact in the final year. Whilst the increase in current receipts was £19.6 billion a year when comparing the final year of the parliament with the first, the average increase in receipts was higher, at £21.6 billion a year.

Labour's second term

Compared with Labour's first term, government revenues are forecast to increase by a relatively modest 0.6% of national income in the current parliament, equivalent to £6.9 billion a year by 2005–06. This is despite the fact that policy measures announced by Mr Brown since the 2001 election have increased revenues by £11.6 billion a year (only fractionally offset by tax cuts carried over from the first term which have reduced revenues by £0.5 billion a year).

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[10] After the Autumn 1993 Budget, these were a commitment to raise tobacco duties by at least 3% a year in real terms and to raise road fuel duties by at least 5% a year in real terms.

[11] The projections for government revenues to 2001–02 in Kenneth Clarke's November 1996 Budget assumed that the fuel and tobacco escalators would be retained throughout this period. Of course, it is not possible to know what would have happened had the Conservatives been re-elected in May 1997. For example, the fuel and tobacco escalators could have been abolished or reduced earlier, or other taxes could have been reduced. But this would not have been possible without lower levels of public spending or higher levels of public borrowing.

No Pre-Budget Report or Budget during the second Labour parliament contained a significant net tax cut. With the notable exception of the Spring 2002 Budget, all the net increases have been small. The main tax-raising measures in the 2002 Budget were the freezing of the point at which individuals become liable for income tax and National Insurance contributions and the 1 percentage point increase in the rates of National Insurance contributions for employees, employers and the self-employed on all earnings above this level. These measures combined raise an estimated total of £9.6 billion in 2005–06.[12]

Table 6.3 shows that the economic cycle has had a small negative impact (reducing revenues by £3.8 billion a year), while fiscal drag has raised an estimated £9.6 billion a year. So the overall weakness of revenues is down to other economic factors – in particular, the impact of falls in the profitability of financial companies on tax payments by firms and individuals in that sector. These factors have cost the government an estimated total of £10.1 billion.

Unlike Labour's first term, the average impact of Budget announcements in Labour's second term will actually be lower than the impact on the final year of the parliament. This is because there have not been any large net tax-cutting Budgets. Looking at the overall change in current receipts, while these are forecast to have increased by £6.9 billion by the end of the parliament, the fact that receipts fell sharply in the middle of the parliament has meant that, on average, receipts have been £8.5 billion a year lower in Labour's second term than in its first.

Labour's whole period in office

Taken as a whole, and assuming that December's Pre-Budget Report forecasts are accurate, government revenues have risen by 2.1% of national income since Labour came to office, equivalent to £26.4 billion in 2005–06 prices. About a third of this increase is the result of tax measures inherited from the Conservatives, about a third due to tax increases announced by Gordon Brown and a third due to other factors. Among the other factors, fiscal drag has increased revenues by £22.0 billion, the economic cycle has increased them by £1.3 billion and other economic factors have cost the government £14.9 billion. This suggests that the boost to revenues from rising employment has been offset by lower payments from the financial sector.

6.4 Government revenues and general elections

The Treasury concedes that the tax burden will have to rise over the next five years to pay for the government's spending plans and to meet the golden rule looking forward with what it regards as adequate margin for error. In Chapter 4, we argued that new tax-raising measures might need to be announced in order to bring this about. Alternatively, the Chancellor could trim his spending plans, but he has not done this in the past when revenues have come in below forecast.

[12] HM Treasury, *Budget 2002*, Hc 592, London, 2002 (http://www.hm-treasury.gov.uk/budget/bud_bud02/budget_report/bud_bud02_repindex.cfm), estimates that they will raise £9.1 billion in 2004–05. Uprating by expected growth in nominal national income gives a total of £9.6 billion in 2005–06.

In this section, we briefly look at recent pre-election Budgets and conclude that if Mr Brown's past behaviour (and that of his predecessors) is any guide, significant tax-raising measures are more likely to be announced after the general election than in this year's Budget. It is worth remembering that the only significant revenue-raising measures implemented by Labour since 1997 were announced in the Budgets of July 1997, March 1998 and April 2002 – all of which occurred in the first 12 months after a general election.

Table 6.5 compares changes in government revenues, spending and borrowing in election and non-election years between 1964–65 and 2003–04. On average, government revenues rose by just over 0.1% of national income in election years and were little changed in non-election years. This in itself provides no evidence that governments were more likely to implement tax-cutting Budgets in election years, although these averages do not differentiate between discretionary policy changes and other factors.

Table 6.5. Changes in the public finances and general elections

Average annual change as % of national income from 1964–65 to 2003–04	Current receipts	Total managed expenditure	Public sector net borrowing
1) All years	0.06	0.06	0.00
2) Election years	0.14	0.57	0.43
3) Non-election years	0.03	–0.13	–0.16

Note: Election years are taken to be the financial years in which a general election took place: 1964–65, 1965–66, 1970–71, 1973–74, 1974–75, 1979–80, 1983–84, 1987–88, 1992–93, 1997–98 and 2001–02.
Sources: HM Treasury, *Public Finances Databank*, London, December 2004 (http://www.hm-treasury.gov.uk/media/F6C/7E/public_fin_databank_211204.xls); authors' calculations.

There is more evidence that looming elections sway spending decisions (or vice versa). Total managed expenditure rose, on average, by nearly 0.6% of national income in election years, only to decline by just over 0.1% of national income in non-election years. The Chancellor would doubtless argue that setting out spending plans in three-year rolling reviews guards against such behaviour, although it remains to be seen whether the government can keep to its spending plans this year. The net impact of changes in spending and revenues is that public sector net borrowing has, on average, increased by just over 0.4% of national income in election years and fallen by just under 0.2% of national income in non-election years.

As we have noted, changes in the economy at election times could have affected the averages in Table 6.5. For example, governments might have used monetary policy to boost the economy in election years, or they might have chosen to hold elections when the economy was performing strongly. Either would tend to lead to stronger growth in government revenues in election years. In addition, if pre-election Budgets did contain tax-cutting measures, these might take time to feed through into lower government revenues.

Table 6.6 shows that the last six pre-election Budgets all included reasonably significant tax cuts.[13] But on the last two occasions that the party in power was re-elected (the Conservatives in April 1992 and Labour in June 2001), the first post-election Budget contained substantial tax-raising measures.

[13] Further details of the main measures in all Budgets since 1979 can be found in Appendix B.

Table 6.6. Summary of pre-election tax measures

Election	Ruling party prior to election	Major tax measures in pre-election Budget
1979	Labour	1p off basic rate of income tax
		New reduced-rate band of income tax
1983	Conservative	Real increases in income tax allowances
1987	Conservative	2p off basic rate of income tax
1992	Conservative	Introduction of lower-rate band of income tax
1997	Conservative	1p off basic rate of income tax
2001	Labour	Increase in starting-rate income tax band
		Fuel duty cut

Source: Various.

Looking at the impact by the end of the relevant parliament, Labour increased taxes by £11.3 billion after the 1997 election (in the July 1997 and March 1998 Budgets), cut them by £4.1 billion in the pre-election Budget of 2001, and then increased them again by £9.6 billion after the 2001 election (in the April 2002 Budget). Should tax-raising measures prove necessary to finance the government's spending plans and comply with the fiscal rules, past experience – to the extent it is any guide – suggests that tax increases are more likely to be announced after the election than in the run-up to polling day.