

Press Release

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Labour's tax and benefit increases prevent rapid rise in income inequality

The tax and benefit measures implemented by Labour since 1997 have increased the incomes of poorer households and reduced those of richer ones, largely halting the rapid rise in income inequality we saw under the Conservatives. Despite this, inequality was still slightly higher in 2007–08 than when Labour came to office, according to the first set of Election Briefing Notes to be released by the IFS to help inform public debate during the general election campaign.

Using the official costings in Budgets and Pre-Budget Reports, these tax and benefit changes will cost UK households more than £7.1 billion this year, or around £270 per household, with reforms increasing spending on benefits and tax credits by £29.2 billion a year, and increasing tax revenues by £36.2 billion a year.

Such official costings are against a baseline in which most benefits, tax allowances and thresholds are assumed normally to rise only in line with inflation. But this baseline implies an ongoing fall in the generosity of benefits relative to average living standards and an ongoing rise in the average tax rate that the Treasury itself has conceded would be unsustainable over the long term. Under a more realistic baseline where tax allowances and benefit levels rose in line with changes in national income per head, the 'takeaway' looks much larger, at £36.4 billion (£1,400 per household), assuming that fiscal drag has no net impact on revenues from taxes on businesses and capital such as stamp duty, inheritance tax and business rates.

Whichever baseline you use, Labour's tax and benefit changes have increased the incomes of poorer households and reduced those of richer ones, although they look much less 'pro poor' after adjusting for changes in national income than when using the Treasury baseline, as shown in Figure 1.

The real incomes that households have left to spend after receiving benefits and paying taxes have risen 2% a year on average under Labour – somewhat slower than the 2.5% a year rise under the Conservatives between 1979 and 1997. The rise in disposable incomes has also slowed from more than 3% a year in Labour's first term to 2% a year in its second and to less than 1% a year in its third. Viewed across the regions of the UK, incomes grew most rapidly in North-East England and London, and slowest in the West Midlands.

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Labour's tax and benefit changes also helped reduce the proportion of the population in poverty up to 2004–05, but with roughly half the decline subsequently being reversed by 2007–08. The proportion of the population in poverty in 2007–08 was 18.3% measured before housing costs (down from 19.4% in 1996–97) and 22.5% measured after housing costs (down from 25.3% in 1996–97). Since 1996–97, poverty has fallen most strongly for children and pensioners, but has risen for working-age adults without dependent children who have been less favoured by tax and benefit changes. Relative poverty has fallen in all nations of the UK, and all regions of England except the West Midlands.

It is difficult to argue conclusively that severe poverty has increased since 1996–97, but the rise since 2004–05 appears to represent a more genuine increase, and mirrors the rise in the government's official measure of relative poverty.

The Government has now in effect conceded that it will miss the child poverty target it set itself for 2010–11, having earlier missed the one it set itself for 2004–05. Under both government and IFS estimates, child poverty is expected to fall to 2.3 million in 2010–11, 600,000 short of the 1.7 million target, measuring incomes before housing costs (BHC). Looking ahead, neither the government nor the main UK opposition parties have yet explained credibly how they intend to meet the now legally-binding commitment to eradicate child poverty by 2020.

On average, Labour's reforms have slightly weakened the incentive for individuals to take paid work at all, and the incentive for workers to increase their earnings by a small amount. In particular, Labour's reforms have weakened the incentive for couples with children to have two earners rather than one, and have increased the number of workers facing marginal effective tax rates of 70% or more. However, Labour's reforms have strengthened the incentive to work at all, and the incentive to increase earnings, for some of those who had the weakest incentives in 1997, such as lone parents.

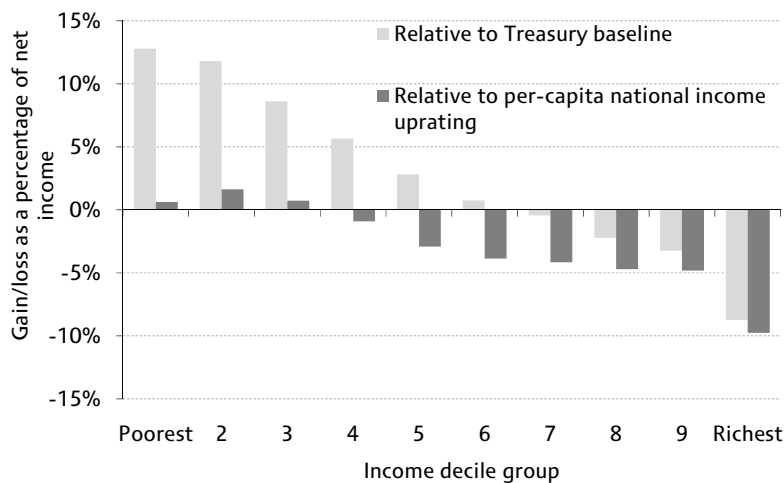
Policy reforms since 1997 have had a mixed record in reducing distorting differences in the tax treatment of different forms of saving. Tax-free savings vehicles have been expanded, and tax relief for mortgage interest for homeowners has been abolished. But Labour's capital gains tax reforms have reduced the attractiveness of investing in shares outside an ISA or pension fund when only nominal capital gains are accrued, and encouraged small business owners to invest in their own businesses.

ENDS

Notes to Editors:

1. The three reports that IFS is publishing today are: J. Browne and D. Phillips, *Tax and Benefit Reforms under Labour*; A. Muriel, D. Phillips and L. Sibieta, *Living standards, inequality and poverty: Labour's record*; M. Brewer, D. Phillips and L. Sibieta, *What has happened to 'Severe Poverty' under Labour?*
2. All reports, and other analysis by IFS researchers relevant to the forthcoming general election, can be downloaded free-of-charge from <http://www.ifs.org.uk/projects/323>;
3. For queries contact: Emma Hyman or Bonnie Brimstone at IFS: 020 7291 4800, emma_h@ifs.org.uk, bonnie_b@ifs.org.uk;

4. The IFS series of 2010 General Election Briefing Notes has been funded by the Nuffield Foundation, grant OPD/36607. Ongoing financial support from the ESRC Centre for the Microeconomic Analysis of Public Policy at IFS (grant number RES-544-28-5001) financed research upon which much of this analysis is based.
5. Notes to figure: Income decile groups are derived by dividing all households into 10 equal-sized groups according to income adjusted for household size using the McClements equivalence scale. Decile group 1 contains the poorest tenth of the population, decile group 2 the second poorest, and so on up to decile group 10, which contains the richest tenth. Sources: Family Resources Survey, 2006–07; Expenditure and Food Survey, 2007; various Budget and Pre-Budget reports; authors' calculations.
6. Figure 1: Gains and losses across the income distribution from tax and benefit reforms since 1997



The data points underpinning the Figure are as follows:

	Treasury baseline	Per capita National Income uprating
Poorest	12.8%	0.6%
2	11.8%	1.6%
3	8.6%	0.7%
4	5.7%	-0.9%
5	2.8%	-2.9%
6	0.7%	-3.9%
7	-0.4%	-4.2%
8	-2.2%	-4.7%
9	-3.2%	-4.8%
Richest	-8.7%	-9.8%