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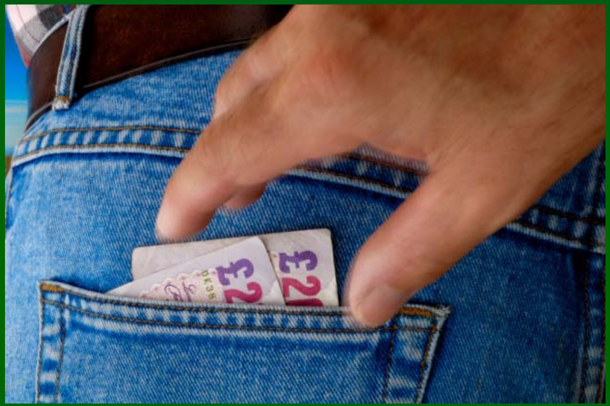

Options for fiscal tightening: tax increases and benefit cuts

Mike Brewer, James Browne, Andrew Leicester and Helen Miller

Introduction

- Motivation
  - With no change to benefit and tax credit policy, departmental spending would have to be cut by 10.9% after four years
- Increasing tax revenues
  - Raising more revenue from “the big 3”
  - Six tax changes that remove distortions and raise revenue
- Options for cutting social security and tax credit spending

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Raising 1% GDP from “the big 3”

- For illustrative purposes, looked at how could raise £15bn in 2011/12 with one single tax rise:
  1. Increasing basic- and higher-rates of income tax by 3 ppts
  2. Increasing employee and self-employed NI rates by 3 ppts
  3. Increasing VAT by 3.5 ppts (to 21%)
  4. Align income tax allowances & NI thresholds, and then freeze for Parliament

- All affect rich more than poor, all weaken incentives to work, earn more and save. Key differences:
  – Cutting tax thresholds less progressive than increasing rates
  – Retired and savers unaffected by NI rise
  – VAT rise affects everyone
  – VAT rise like a windfall tax on savers

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Limiting the pain to the richest 10%

Option	Revenue	Comment
Increase higher-rate of income tax from 40% to 50% (and scrap personal allowance phase-out at £100,000)	0.4% (£5.8bn)	Those below £43,875 unaffected
Increase Upper Earnings Limit in NI to £100,000	0.3% (£4.2bn)	Those below £43,875 unaffected
Restrict income tax personal allowance to basic-rate for all higher-rate taxpayers (equivalent to cutting point at which pay 40% income tax)	0.3% (£4.1bn)	Those below £37,400 unaffected

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Other tax changes that remove distortions and raise revenue (1)

Option	Revenue	Remark
Charge standard rate VAT on zero- and reduced-rate items	1.7% (£24.3 bn) 1% (£15 bn) with compensation package	Would move closer to equal VAT treatment on all spending
Charge NI on employers' pensions contributions	Up to 0.6% (£8.3 bn)	Would equalise NI treatment of employee and employer pension contributions, but administratively complicated
Increase NI for self-employed	Up to 0.4% (£6.8 bn)	Would equalise NI treatment of employees and self-employed

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Other tax changes that remove distortions and raise revenue (2)

Option	Revenue	Remark
Increase small companies rate of corporation tax from 22% to 28%	0.2% of GDP (£3.2bn)	No justification for lower rate. Would reduce tax incentive for self-employed to incorporate
Comprehensive carbon tax	Up to 0.7% of GDP (£10bn) after cuts in fuel duty, climate change levy	Efficient way to give all of UK incentive to cut GHG emissions
Tax capital gains more heavily	Increase rate: £3.2bn Cut allowance: £0.9bn Charge at death: £0.3bn Charge on main homes: up to £5bn	Would treat CG more like dividends and earnings Yield depends what combination adopted

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Options for cutting social security and tax credit spending

- Do not consider welfare-to-work reforms, as hard to estimate additional savings
- Also hard to think of cuts that remove obvious distortions.
- Instead, next government will need to be clear on purpose of social security benefits, and distributional objectives

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Options for cutting social security spending

Option	Saving
Freeze benefits	£4.1bn for a one-off freeze in 2011-12
Means-test more aggressively	£4.4bn from tax credits £3.0bn from pension credit £0.6bn from housing or council tax benefit
Means-test, or scale back, the non-means-tested and contributory benefits	£6.5bn from child benefit £1.4bn from winter fuel payments and free TV licenses ???? from Disability Living Allowance and Attendance Allowance Up to £2.2bn from time-limiting contributory Employment and Support Allowance
State pension	£2.1bn from delaying indexation of state pension to earnings £2.2bn - £10bn from increasing state pension age
Other	Benefits for 16-18 year-olds, childcare, council tax benefit, housing benefit, asset-based welfare …

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Summary

- Straightforward to use “big 3” taxes to raise 1% of GDP, or to raise 0.4% from higher-rate taxpayers, but other tax rises can reduce distortions and raise revenue
- Savings can always be made from social security and tax credits. To determine which looks least bad, need to be clear on purpose of social security benefits, and distributional objectives
- “How the public finances are rebalanced will probably be the most important influence on how economic inequalities evolve”

  From the National Equality Panel’s report, January 2010

  http://www.equalities.gov.uk/pdf/NEP%20Summary.pdf

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