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The Tax Burden Under Labour

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Summary

- Total Government receipts are forecast to be 37.0% of national income in 2010–11, up 0.5% of national income from the 36.4% (numbers do not sum due to rounding) Labour inherited. In today's terms this increase is equivalent to £7.5 billion or £230 per family in the UK.
- Over this period most other industrial countries have reduced their tax burden. Out of 28 industrial countries for which we have comparable data from the OECD in both years, the UK had the 8th lowest tax burden in 1997 whereas by 2010 it had the 13th lowest.
- Had the UK seen its tax burden fall by the same proportion of national income as the unweighted average of the other 27 countries between 1997 and 2010 then, on this internationally comparable definition, the tax burden in 2010 would be 3.3% of national income below that currently forecast by the OECD for this year. This is equivalent to £49 billion in today's terms, or £1,520 per family in the UK.
- Despite the increase in the tax burden since Labour came to power, total government receipts on the Treasury's definition have averaged 37.5% of national income over the last 14 years, which is lower than the 40.2% average under the Conservatives between 1979 and 1997.
- As the economy recovers, and as tax raising measures that have already been announced are implemented to help reduce Government borrowing, the Treasury forecasts that total receipts will climb to 38.3% of national income by 2014–15. This would be 1.9% of national income above the level that Labour inherited from the Conservatives, but still below the average experienced under the Conservatives. In today's terms the increase in the tax burden since Labour came to power would then be equivalent to £27.5 billion or £860 per family in the UK.
- Despite the financial crisis leading to the lowest rate of growth in national income over a five-year period since the second world war, the sharp fall in tax revenues means that national income minus tax revenues is still projected to continue growing – in other words people's incomes are being cushioned from the impact of the recession on the wider economy. This is in contrast to the experience of the early-to-mid 1980s or the late 1960s.
- The direct net impact of measures announced in Budgets and Pre-Budget Reports since Labour came to power has been to increase tax revenues in 2010–11 by £31.1 billion. This is equivalent to an average of £970 per family in the UK. By 2014–15 this is set to increase by almost half as much again, to £45.4 billion, which is equivalent to £1,420 per family.
- The increases in the headline tax burden are smaller than the net revenue raised by measures announced under Labour in Budgets and Pre-Budget Reports. This reflects weak economic performance depressing receipts, plus other economic factors, such as the financial crisis reducing the size of the hitherto relatively profitable (and thus tax-rich) financial sector.

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1. Introduction

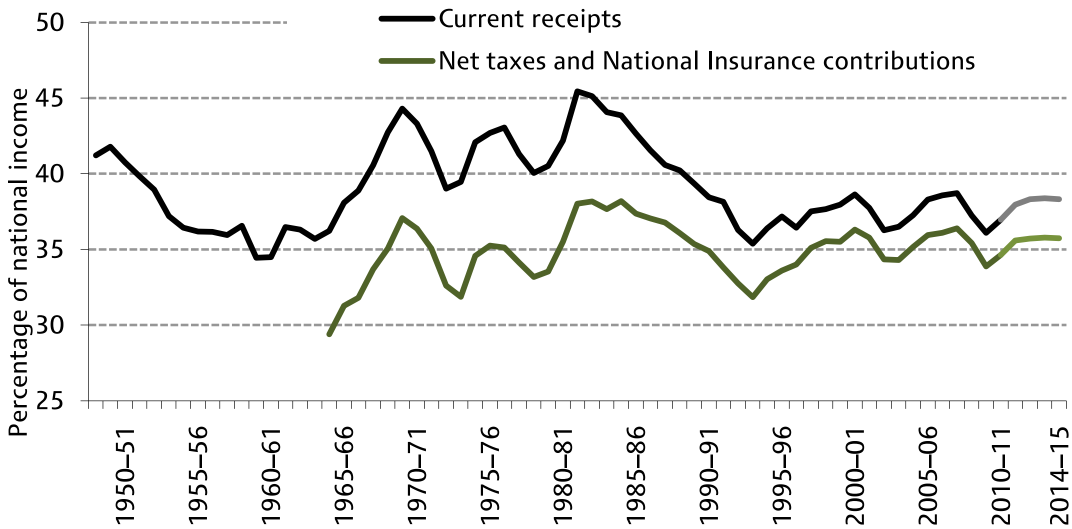
This election briefing note examines the evolution of the tax burden over the last 60 years. Section 2 begins by giving an overview of revenues over time, and then compares the changes in revenues over time with growth in national income. Section 2 also examines how the composition of tax revenues has changed since Labour came to power and compares this to the trend seen over the period in which the Conservatives were in power from 1979 to 1997. Finally this section puts the change in the tax burden since Labour came to power in an international context. Section 3 examines the extent to which changes in the tax burden since Labour came to power can be explained by discretionary policy changes, economic growth and other factors.

2. The headline UK tax burden

2.1 Changes over time

When we talk about the tax burden, two measures from official statistics are used most frequently.[2] The first, and most conventional, is net taxes and National Insurance contributions (NICs). As Figure 2.1 shows, since the late 1970s, the tax burden on this measure has fluctuated between a high of 38.2% of national income in 1984–85 and a low of 31.9% in 1993–94. Labour inherited a tax burden of 34.0% in 1996–97. It rose in Labour's early years in office, dropped as the stock market fell between 2000 and 2003, and then rose again reaching 36.1% of national income in 2006–07.

Figure 2.1. Government revenues since 1948–49



Note: Projections are from 2010 Budget.
Sources: Public sector current receipts to 2008–09 (series ANBT) from ONS. GDP to 2008–09 (series BKTL) from ONS. Net taxes and National Insurance contributions, and all projections, from HM Treasury, *Public Finances Databank*, 24th March 2010 (http://www.hm-treasury.gov.uk/psf_statistics.htm).

[2] The term '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.

The recession associated with the financial crisis, and the Government's temporary cut to the main rate of VAT aimed at helping to stimulate the economy, saw this measure of the tax burden falling to just 33.9% of national income in 2009–10. It is then forecast by the Treasury to climb to 34.6% of national income in 2010–11 and then to climb further as the economy recovers from recession and the tax raising measures announced in PBR 2008, Budget 2009, PBR 2009 and Budget 2010 (which are designed to reduce government borrowing from its current record levels) have an increasing impact.

An alternative broader measure of the tax burden is public sector current receipts. Net taxes and NICs are not the government's only source of revenues. It also generates revenues from sources such as interest payments and surpluses generated by public sector corporations. Generating revenue in this way affects people's welfare, albeit not as directly as taxation. For example, surpluses generated by public sector corporations reduce income, either of workers through lower wages or of consumers through higher prices. The gap between net taxes and NICs and current receipts shown in Figure 2.1 is the level of these other revenues in each year. These non-tax revenues were over 6% of national income in the late 1970s and early 1980s. As a result of the privatisation of many public corporations, the operating surpluses of public corporations fell and so non-tax revenues have been declining since the early 1980s. Since 1996–97 non-tax revenues have been relatively stable, at between 1.9% and 2.5% of national income.

Public sector current receipts is the broadest measure of government revenues. Figure 2.1 shows that, after a sharp rise from 34.4% of national income in 1959–60 to 44.3% in 1969–70 (in part to pay for the growing cost of the welfare state), they have fluctuated between 35.4% (1993–94) and 45.4% (1981–82) of national income over the last forty years. Since Labour came to power, current receipts have averaged 37.5% of national income, which is somewhat lower than the 40.2% average under the Conservatives between 1979 and 1997. However, in the current financial year current receipts are forecast to be 37.0% of national income, which is 0.5% of national income or £7.5 billion, higher than the 36.4% of national income that Labour inherited from the Conservatives (figures do not sum due to rounding). Dividing this by the 32.0 million families now living in the UK, this works out at an average of £230 per family. In 2014–15, the Treasury forecasts that current receipts will climb to 38.3% of national income, which would be 1.9% of national income (or £27.5 billion) higher than Labour inherited from the Conservatives. This works out at an average of £860 per family in the UK.

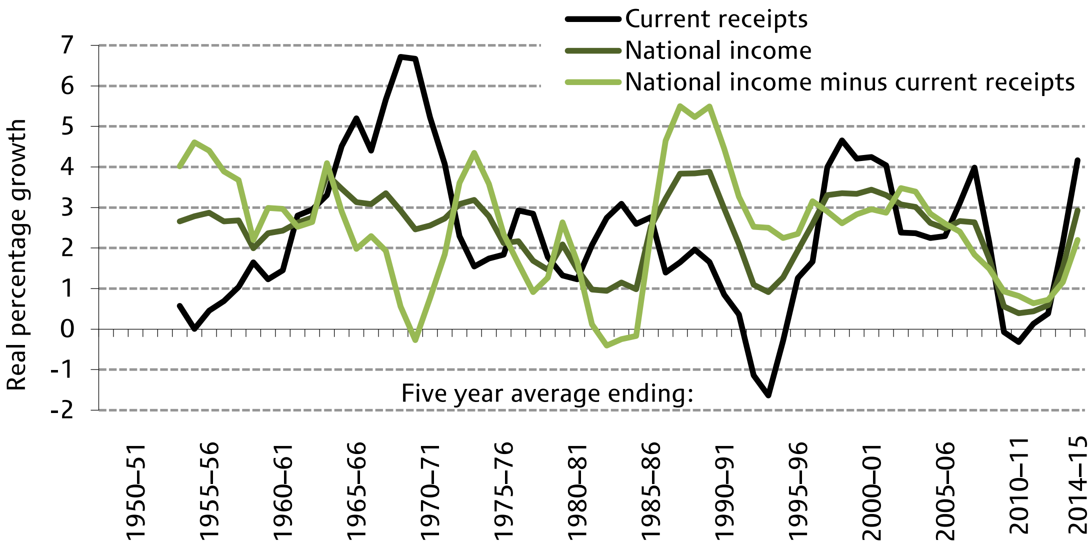
Increases in the tax burden mean that a lower proportion of national income is *not* collected in tax.[3] However, a rising proportion of income taken in tax does not necessarily imply that the amount of income not taken in tax is actually falling; only that it is rising less quickly than growth in the economy as a whole. Therefore, it is also interesting to examine how growth in national income breaks down between growth in what the government takes in taxes (and other receipts) and growth in what is not taken in tax. Since not all UK government revenue is paid by UK citizens and some UK citizens will have paid taxes to overseas governments, this is hard to do with precision. However, subtracting current receipts from national income provides a rough approximation. In Figure 2.2, this measure is called 'national income minus current receipts'.

Average increases in current receipts, national income and national income minus current receipts – all after economy-wide inflation (and hereafter described as "real terms") – are shown in Figure

[3] However, just under 30% of revenue collected by the government is returned to the private sector in the form of social security benefits and tax credits. See figure B.4 of HM Treasury, *Public Finances Databank*, London, March 2010 (http://www.hm-treasury.gov.uk/psf_statistics.htm).

2.2 for every five-year period ending between 1953–54 and 2014–15, using Treasury forecasts for future years. (Five-year moving averages have been selected in order to smooth out some of the variation in the annual data.) When current receipts grow more quickly than national income, the share of national income taken in taxes increases; when current receipts grow less quickly than national income, the share of national income taken in taxes falls. In general, national income after tax usually grows more quickly in real terms when the share of national income taken in tax is falling than when it is rising, but not always. The relationship between the change in national income after tax and the change in the share of national income taken in tax will depend on the reason for changes to the tax burden.

Figure 2.2. Growth in government revenues and national income



Note: Projections are from 2010 Budget.
Sources: Public sector current receipts to 2008–09 from ONS (series ANBT). GDP to 2008–09 from ONS (series BKTL). GDP deflator to 2008–09 from ONS (calculated using series ABMI and YBHA). All projections, from HM Treasury, *Public Finances Databank*, 24th March 2010 (http://www.hm-treasury.gov.uk/psf_statistics.htm).

Over the period from 1949–50 to 2007–08 (prior to the financial crisis) national income grew by an average of 2.5% a year in real terms. The highest period of growth over a five-year period, as shown in Figure 2.2, was the five years from 1985–86 to 1989–90 when it grew by an average of 3.9% a year in real terms. This was soon followed by the weakest five-year period of growth over this period, which was between 1989–90 and 1993–94, when the economy only grew by an average of 0.9% a year in real terms. Unfortunately the financial crisis has meant that this record is set to be surpassed: the period from 2005–06 to 2010–11 is forecast by the Treasury to see average growth in national income fall to just 0.4% a year, which would be the lowest average growth over a five-year period since this data series begins. Growth in national income after tax has fluctuated much more than growth in national income – between –0.4% and 5.5% a year – and over the five years to March 2011 is, despite the financial crisis, still forecast by the Treasury to grow more quickly than was the case in the early-to-mid 1980s or the late 1960s.

Table 2.1 shows figures for average growth in national income and average growth in government revenue under Labour (before and after the financial crisis) and compares this with the record under Margaret Thatcher and John Major's premierships.

On average over the Conservative period in office, current receipts grew less quickly than national income. As a result, current receipts fell from the 40.1% of national income that the Conservatives inherited in 1978–79 to 36.4% by the end of their period in office. Despite the fact that national income grew more slowly during Mr Major's term in office than during Mrs Thatcher's period in office, national income after tax grew faster under Mr Major than under Mrs Thatcher. This is because growth in current receipts was significantly lower during Mr Major's premiership than Mrs Thatcher's.

Prior to the financial crisis both national income and current receipts grew more quickly under Labour than they had under the previous Conservative governments. But national income after tax grew at a very similar rate to that seen under the Conservatives (2.6% under Labour to 2007–08, 2.4% under Mrs Thatcher and 2.6% under Mr Major). Faster growth in current receipts than national income under Labour prior to the outbreak of the financial crisis led receipts to grow from 36.4% of national income in 1996–97 to 38.7% of national income in 2007–08. This was the highest level seen since 1989–90.

Table 2.1. Real 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			
Labour's three parliaments: 1997–98 to 2010–11	2.2	2.1	2.0
Of which:			
Pre financial crisis: 1997–98 to 2007–08	3.5	2.9	2.6
Post financial crisis: 2008–09 to 2010–11	–2.6	–1.1	–0.2
Conservative years: 1979–80 to 1996–97	1.6	2.2	2.5
Of which:			
Thatcher years: 1979–80 to 1990–91	1.9	2.2	2.4
Major years: 1991–92 to 1996–97	1.2	2.1	2.6
Other periods of interest			
Current plans: 2011–12 to 2014–15	4.1	3.2	2.6
Labour's past + plans: 1997–98 to 2014–15	2.6	2.3	2.1
62-year period from 1949–50 to 2010–11	2.2	2.4	2.5

Note: As Figure 2.2.
Sources: As Figure 2.2.

The three years covering the start of the financial crisis to the current financial year (that is, 2008–09 to 2010–11) have seen a different pattern emerge. While in real terms current receipts have fallen sharply (2.6% a year on average), the fall in national income (1.1% a year on average) has still be sufficiently large to lead to falls in national income less current receipts, albeit by just 0.2% a year. This suggests that the more-than-proportionate fall in tax revenues is helping to cushion people's incomes during the crisis and its immediate aftermath, the price for which is slower growth in people's incomes during the recovery phase than in the economy as a whole.

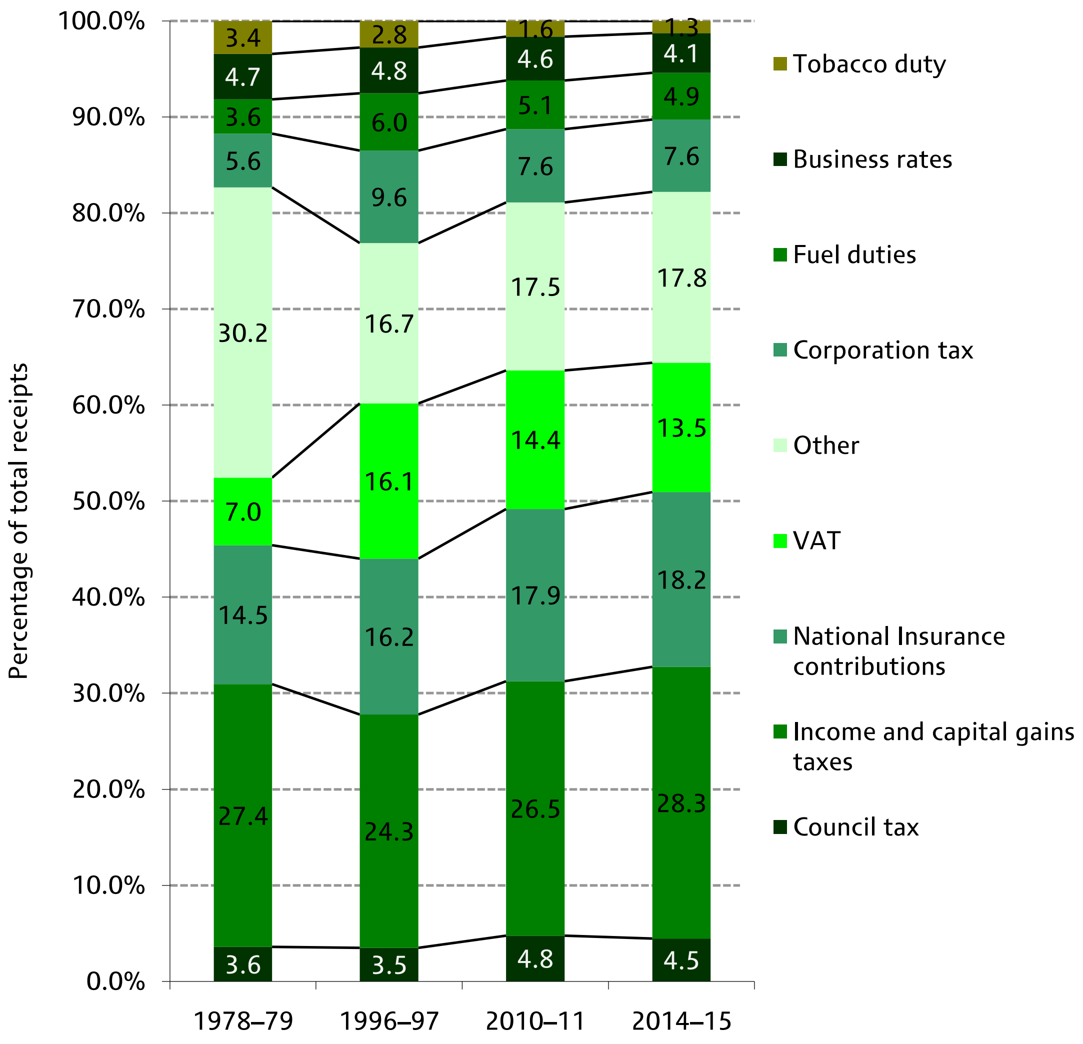
Looking forwards over the four years from 2011–12 to 2014–15, the Treasury forecasts imply that national income less current receipts will return to growing by an average of 2.6% a year, which would be comparable to that seen under Labour prior to the financial crisis and to that seen under Mrs Thatcher and Mr Major. This is not due to low forecast growth in the tax burden – receipts are forecast to grow by 4.1% a year on average over the next three years – rather it is driven by the Treasury's forecast that growth in national income will average 3.2% a year over these three years. If achieved this would actually be slightly below the growth in national income seen over the four years following the recession of the early 1980s (3.5% a year from 1983–84 to 1986–87) and the four years following the recession of the early 1990s (3.4% a year from 1994–95 to 1997–98).

2.2 Changing composition of tax revenues

Not only has the size of the tax burden changed over time, but so too has the way in which governments have raised revenues. Figure 2.3 shows how the composition of government receipts changed over the period the Conservatives were last in office (comparing 1978–79 to 1996–97) and over the period since Labour came to power (comparing 1996–97 to 2010–11) and the change projected by the Treasury under current policies (comparing 2010–11 to 2014–15).

Over the 18 years of Conservative governments, the share of receipts coming from "other" sources – in particular surpluses generated by public sector corporations – fell sharply. The share taken from income and capital gains taxes also declined, while the share coming from VAT more than doubled and that taken from National Insurance contributions, corporation tax and fuel duties also increased.

Figure 2.3. Changing composition of UK public sector receipts



Sources: For sources and underlying data see http://www.ifs.org.uk/ff/revenues.xls.

Under Labour, revenues from National Insurance contributions have continued to grow as a share of total receipts. But, in contrast to the pattern seen under the Conservatives, revenue from VAT, corporation tax and fuel duties have fallen as a share of total revenues, while revenues from income tax have grown as a share of the total. The decline in corporation tax revenues as a share of total revenues under Labour appears to be due to the financial crisis (they still accounted for 8.5% of total receipts in 2006–07), with the financial sector, which until the crisis was relatively profitable, now expected to be a smaller part of the economy going forwards. Relative to the size of their base there has been a sharp increase in the proportion of tax revenue coming from council tax and a sharp fall in the proportion coming from tobacco duties. Some other tax revenues – in particular those from stamp duty land tax – have also grown considerably. Looking forwards, the Treasury is projecting that income tax and National Insurance will continue to grow as a share of revenues while VAT and tobacco duties will continue to decline as a share of total revenues. Projected increases in income tax and National Insurance revenues are unsurprising given that the UK economy is forecast by the Treasury to recover strongly from the recession and significant tax raising measures have been announced by the Government for these two taxes. Overall, the picture under Labour shows a shift away from consumption taxes and company taxes, towards greater reliance on income- and earnings-based taxation and council tax.

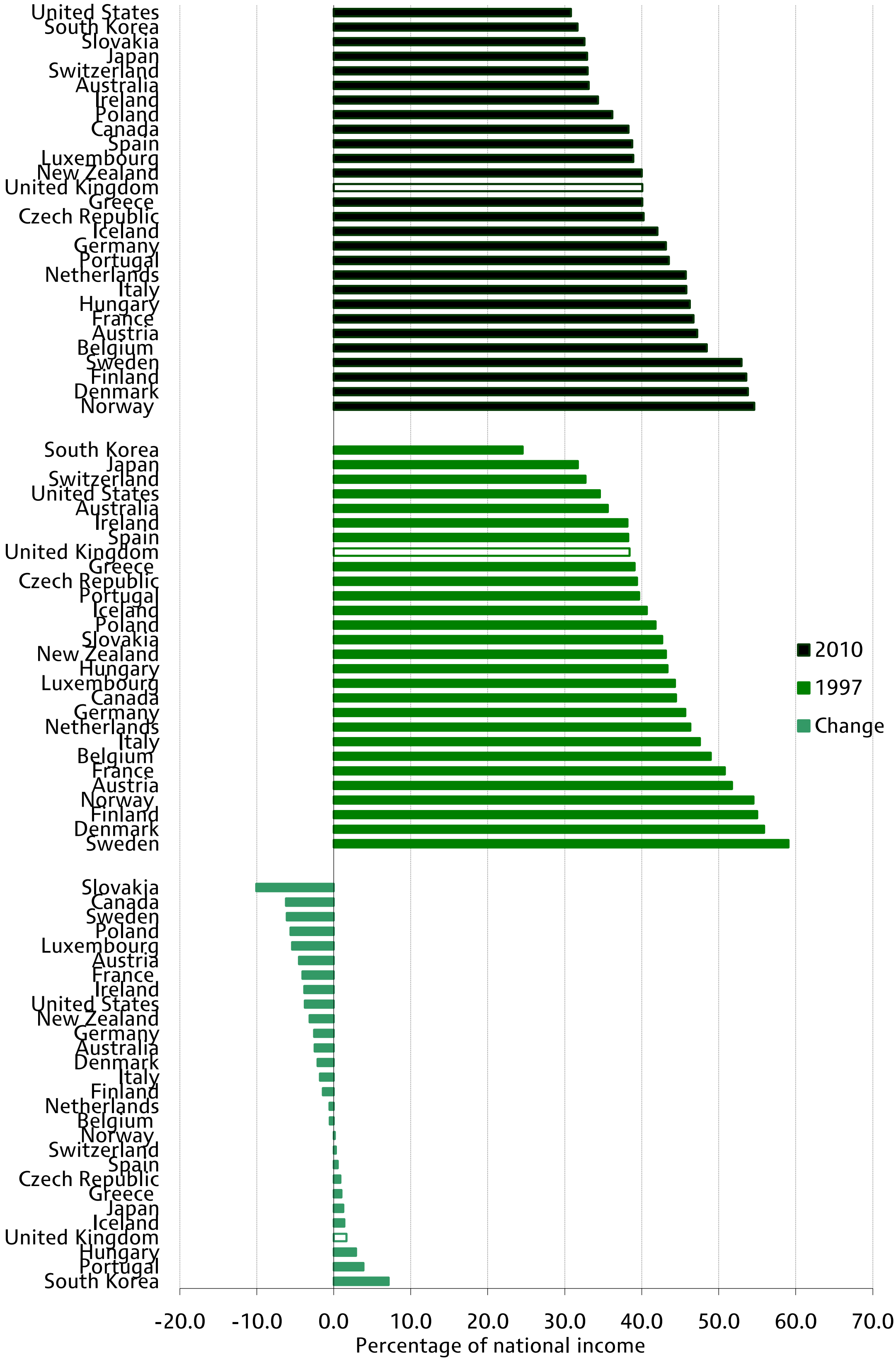
2.3 International comparisons

The increase in the tax burden in the UK between 1996–97 and 2007–08 occurred at a time when many other similar countries were actually experiencing falls in their tax burdens. Figure 2.4 shows a measure of the tax burden across a number of industrialised countries in 1997 and 2010. In order to compare figures across countries, Figure 2.4 presents a slightly different measure of government receipts than those discussed above. Specifically it shows general government current tax and non-tax receipts (expressed as shares of national income) – this is the closest internationally comparable version of current receipts in the UK context. It should be borne in mind, when making international comparisons, that differences in the tax burden over the longer term will reflect differences in the range and cost of public services provided, and in the generosity of transfer payments such as pensions and social security benefits.[4]

Figure 2.4 shows that in 1997, the UK had the 8th lowest tax burden out of the 28 countries featured in the graph, and the 3rd lowest among the EU countries shown. The increase in government revenues that we have seen since then means that the UK is now the 13th lowest-taxing economy, and the 6th lowest among the EU countries featured. The UK's move towards the middle of the tax league table reflects the fact that it has had the 4th largest increase in tax burden among the countries we look at. In fact, the majority of industrial countries have actually reduced their tax burdens over this period. Had the UK seen its tax burden fall by the same proportion of national income as the unweighted average for the other 27 countries between 1997 and 2010 then, on this internationally comparable definition, the tax burden in 2010 would be 3.3% of national income below that currently forecast by the OECD. This is equivalent to £49 billion in today's terms, or £1,520 per family in the UK.

[4] A comparison of public spending across the same set of countries over this period will be provided by R. Chote, R. Crawford, C. Emmerson and G. Tetlow (2010), *Public Spending under Labour*, IFS Election Briefing Note (http://www.ifs.org.uk/publications/4815).

Figure 2.4 General government current tax and non-tax receipts



Source: Annex table 26, OECD Economic Outlook no. 86 database, November 2009 (http://www.oecd.org/document/61/0,2340,en_2825_32066506_2483901_1_1_1_1,00.html).

3. Impact of Budget measures

The changes in the tax burden discussed in Section 2 arose for two main reasons: first, as incomes grew over time and the composition of the UK economy changed, tax rates and rules were not adjusted to ensure the level and composition of revenues remained the same; second, governments have implemented various new policies aimed at increasing or decreasing the amount of revenue derived from particular sources. This section turns to examine the change in the headline tax burden in more detail and, in particular, assess the extent to which changes can be explained by the direct net impact of the tax measures that have been announced in Budgets and Pre-Budget Reports.

There are various reasons why the tax burden can change; it is not necessarily the result of discretionary policy changes. For example, as the economy grows, more income becomes subject to higher rates of tax – in part due to income tax thresholds increasing automatically with prices while average earnings typically rise faster. This is a phenomenon known as fiscal drag. The composition of national income and movements in asset and commodity prices also affect tax revenue, and the position of the economy in the economic cycle plays a part as well. When economic activity is above its long-term sustainable level, receipts (in the absence of other changes) are high as a share of national income; when the economy is below trend, receipts are low. The Treasury estimates that, when national income rises by 1% above the level consistent with stable inflation, current receipts rise by about 0.2% of national income over two years.[5]

In the short run, such factors are not under the government's control. However, in the medium run, the Chancellor could choose to offset changes in the tax burden due to fiscal drag or economic factors in order to keep the tax burden constant. Therefore, over the medium term, all changes in revenues as a share of national income are effectively a policy choice of the government.

Table 3.1 attempts to decompose the change in total receipts as a share of national income between 1996–97 and 2010–11 (measured in 2010–11 terms) into that which can be explained by the direct impact of tax measures announced in Budgets and Pre-Budget Reports, that which can be explained by changes in the estimated impact of the economic cycle, and the residual which will comprise fiscal drag and the impact on tax revenues of other changes in the economy.

Over Labour's first term tax revenues rose as a share of national income by £19.2 billion in 2010–11 terms. Of this, £7.1 billion can be identified as the net impact of tax changes implemented over that parliament: those discretionary measures announced in the previous parliament by the Conservatives but introduced by Labour (including the duty escalators on tobacco and fuel) increased revenues by an estimated £9.6 billion, while the net impact of measures announced by Labour and introduced during its first term was to reduce tax revenues. In addition to the £7.1 billion from discretionary measures, the economy is judged by the Treasury to have moved from slightly below to slightly above the level of output consistent with stable inflation and unemployment (trend output). This boosted tax revenues by an estimated £4.2 billion. The remaining £7.9 billion (£19.2 billion less the £7.1 billion from discretionary measures and the £4.2 billion from changes in the cyclical position) cannot be easily decomposed further but will represent things such as the impact of fiscal drag leading to more individuals becoming higher-rate income tax payers over this period.

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[5] Source: Table 2.K, page 18, of HM Treasury, *Public Finances and the Cycle*, Treasury Economic Working Paper No. 5, November 2008 (http://www.hm-treasury.gov.uk/prebud_pbr08_publicfinances.htm).

In contrast, over Labour's second term the net impact of tax changes (+£13.3 billion) more than explains the increase in the tax burden over this period (£7.8 billion). While revenues were boosted by, in particular, the April 2002 Budget decision to increase all rates of National Insurance contributions, other factors – such as the economy being judged to have moved from slightly above trend to slightly below trend output over this period – reduced tax revenues as a share of national income.

A more stark pattern can be seen over Labour's third term. Again the net impact of measures announced in Budgets and Pre-Budget Reports is to increase revenues in 2010–11 (£10.6 billion). But the financial crisis, and the associated recession, have more than offset this and thus led to a fall in the tax burden. Specifically the extent to which the economy has been assessed to move below trend output depresses tax revenues as a share of national income by an estimated £15.8 billion, while other factors – which will include falling revenues from stamp duties on shares and property purchases and a sharp decline in the profitability of financial companies since 2007 – have led to a further decline in revenues.

Table 3.1 Contributions to changes in government revenue, £ billion (2010–11 terms)

	Labour's 1st term	Labour's 2nd term	Labour's 3rd term	Labour to date	Labour measures to come
Announcements:					
Conservative last term	+9.6	0.0	0.0	+9.6	0.0
Labour 1st term	–2.5	–0.4	0.0	–2.9	0.0
Labour 2nd term	n/a	+13.8	+1.0	+14.8	0.0
Labour 3rd term	n/a	n/a	+9.6	+9.6	+14.4
Total announcements	+7.1	+13.3	+10.6	+31.1	+14.4
Change in cyclical position	+4.2	–3.8	–15.8	–15.4	+9.8
Fiscal drag & other factors	+7.9	–1.7	–14.3	–8.2	–4.2
Total change	+19.2	+7.8	–19.5	+7.5	+20.0

Note: Measures defined as taxation using National Accounts definitions. 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. Impact of economic cycle estimated using figures from Table 2.K, page 18, of HM Treasury, *Public Finances and the Cycle*, Treasury Economic Working Paper No. 5, November 2008 (http://www.hm-treasury.gov.uk/prebud_pbr08_publicfinances.htm).

Overall the tax burden is expected to be 0.5% of national income or £7.5 billion in today's terms higher in 2010–11 than when Labour come to power. But this is despite the net impact of tax measures implemented since Labour came to power (including some pre-announced by the previous Conservative government) raising revenues in 2010–11 by an estimated £31.1billion. The net impact of tax measures is equivalent to £970 per family in the UK. The Treasury believes that receipts are temporarily depressed by the recession by around £15.4 billion, leaving a further £8.4 billion drop in revenues as a share of national income not explained (including the impact of fiscal drag over this period).

Note the £31.1 billion estimate of the amount rates from tax raising measures under Labour in 2010–11 is lower than the £36.2 billion estimate contained in the IFS election briefing note by

Browne and Phillips (2010).[6] The difference arises because £31.1 billion is the impact of all measures in 2010–11, whereas the £36.2 billion figure is the *long-run* impact of all measures in place in April 2010. The difference occurs for two reasons. First, temporary measures in place in fiscal year 2009–10 that depress revenues in 2010–11 are included in the £31.1billion figure but not in the £36.2 billion figure. Second, some measures implemented in April 2010 – most notably the new 50p rate of income tax for those on very high incomes – have a larger long-term impact on revenues than the impact they have in 2010–11. The £31.1 billion estimate only includes the latter effect, whereas the £36.2 billion figure includes the former.

Looking forwards the Treasury is forecasting that the tax burden will rise as a share of national income by a further £20.0 billion between 2010–11 and 2014–15. Most of this is explained by the net impact of tax raising measures (£14.4 billion) with the impact of the projected improvement in the cyclical position (£9.8 billion) being partially offset by declining revenues as a share of national income that are less easily explained (£4.2 billion).

By 2014–15, if the Treasury's Budget 2010 forecasts prove correct, then as a share of national income the tax burden would be £27.5 billion higher in 2010–11 terms then it was when Labour came to power (£7.5 billion plus £20 billion), and that the net impact of tax raising measures implemented by Labour since 1997 would be to boost revenues by £45.4 billion (which is equivalent to £1,420 per family in the UK). Other factors – such as the economy operating below assessed trend output – would depress revenues and make up the difference.

[6] Browne and Phillips (2010), *Tax and benefit reforms under Labour,* (http://www.ifs.org.uk/publications/4807).