

Good morning everyone. My name is Robert Chote, Director of the IFS.

Welcome to this launch event for the 12th and 13th in our series of our election briefing notes – who knows, unlucky for some. We are very grateful to the Nuffield Foundation for supporting all our election analysis during the campaign.

The briefing notes we will be talking about today cover two closely related topics, namely the parties' plans to repair the public finances, and their tax and benefit proposals. I will make some opening remarks and then we have four presentations for you:

- Carl Emmerson and then Gemma Tetlow will talk about the fiscal repair job
- James Browne and David Phillips will talk about the tax and benefit proposals.

The material will be up on the web as usual. And there will be time for questions.

Repairing the public finances will be the defining domestic policy task of the next government. For the voters to be able to make an informed choice in this election, the parties need to explain clearly how they would go about achieving it. Unfortunately, they have not. The opposition parties have not even set out their fiscal targets clearly. And all three are particularly vague on their plans for public spending. The blame for that lies primarily with the Government for refusing to hold a Spending Review before the election.

But let us say what we can from the information we have. Over the last two years the current Government has set out a fiscal tightening package – a combination of tax increases and projected spending cuts – that will build gradually to an eventual 4.8% of national income or £71 billion a year in today's terms, roughly the size of the hole in the public finances that the Treasury believes the financial crisis has created. The opposition parties have not challenged this figure and we assume that their silence implies consent.

Labour plans to withdraw its temporary fiscal stimulus package this year, start the tightening next year, and complete it in 2016–17. The Liberal Democrats have informally endorsed this timescale. The Conservatives want to start tightening this year and then move more quickly, getting almost all the job done a year earlier than Labour and the Lib Dems in 2015–16. This would make the tightening even more front-loaded than it already is, at a time when the recovery remains fragile and the effectiveness of monetary policy remains under debate. But it would not make an enormous difference to the long term outlook for the public finances. The Conservatives would still end up borrowing £604 billion over the next seven years, just 6% less than Labour and the Lib Dems. And, assuming no further change in borrowing beyond 2017–18, the Conservatives would bring government debt back below 40% of national income in the same year as Labour and the Lib Dems.

The differences between the parties appear much bigger when it comes to the composition of the tightening. Labour favours a ratio of 2 to 1 between spending cuts and tax increases, the Lib Dems 2½ to 1 and the Conservatives 4 to 1. Although by the end of the fiscal

tightening the differences in the levels of government spending between the parties and in the levels of the tax burden between the parties would both be less than 1% of national income. No party is proposing radically to change the size of the state from its pre-crisis level.

On tax, measured as a share of national income and converted into today's terms, Labour has already put a £17 billion a year tax increase into the pipeline for the coming parliament. We estimate that Labour would need to announce further tax increases worth £7 billion a year in today's terms to meet its goals. The Conservatives have announced a £6 billion net tax cut on top of what is in the pipeline, but we estimate that they would need to reverse about half of this to meet theirs. The Liberal Democrats have announced a £3 billion net tax increase and would not need to do any more unless they found the squeeze on spending unacceptable. When David Cameron said of the Liberal Democrat income tax cut in the first debate "It's a beautiful idea. It's a nice idea. We cannot afford it" that is a slightly odd accusation for a party advocating a net tax cut to make of one advocating a net tax increase.

On spending, no party has announced plans for significant welfare cuts and, without them, their plans would require deep cuts to spending on public services. Over the four years starting next year, Labour and the Liberal Democrats would need to deliver the deepest sustained cuts to spending on public services since the late 1970s. While, starting this year, the Conservatives would need to deliver cuts to spending on public services that have not been delivered over any five-year period since the Second World War.

All the parties have said they wish to protect some parts of public services spending. By 2014–15 the Conservatives need to find cuts of almost £64 billion a year in their unprotected areas, Labour almost £51 billion and the Liberal Democrats almost £47 billion. No party has come anywhere close to identifying where their savings would come from. The Liberal Democrats have identified about a quarter, the Conservatives less than a fifth and Labour about an eighth of what they would need. But bear in mind that the Liberal Democrats would need to find more spending cuts than the others in 2015–16 and 2016–17.

The Conservatives and Labour would claim to have found bigger cuts than these, because they have found efficiency savings. But even if they can find them – which will be very hard to verify even after the event – we believe that it is misleading to count claimed efficiency savings as a contribution to the looming spending cuts. Presumably the parties would try to spend public money as efficiently as possible whether or not they were trying to cut spending and would implement most if not all of these efficiencies anyway. And if the efficiencies the parties claim to have found to turn out to be genuine, then presumably whoever forms the government would strive to implement them.

Thinking about the overall composition again, it is worth noting that when the last Conservative government faced the need for a big fiscal tightening in the early 1990s, we estimate that the ratio of tax to spending cuts was roughly 1 to 1. This may suggest that all

the parties are being overambitious in the extent to which they expect spending on public services to take the strain. If so, the next government may rely more on further tax increases and welfare cuts than any of the parties are willing to admit to beforehand.

Let me turn briefly to the note on the parties' tax and benefit proposals. Be aware that the total figures for the net tax increases or cuts for each party are slightly different in this note, because the base for comparison is the tax and benefit system as it is today rather than last year, which needs to be the case when we look at other spending measures too. And the second note also costs all the measures as if they were introduced straight away.

Unfortunately we cannot quantify the total gains and losses by household as we would like to do. Many of the measures the parties propose – particularly some of the Lib Dem revenue raisers – are impossible to model accurately. But we can identify some patterns.

The tax and benefit changes already in the pipeline from Labour are progressive taken as a whole, with small losses for poorer households that increase in size on average as households get richer. The Conservatives would make the pattern less progressive, reducing the losses of households at the top of the income distribution proportionately more than those at the bottom. The Liberal Democrats would make the pattern more progressive, redistributing resources from the wealthy to middle-income households (though not the poorest).

The rise in the tax burden from Labour's measures will weaken work incentives for most people. Relative to these measures, the Conservative plans would strengthen the incentive for many people to be in paid work at all, but would do almost nothing to encourage most existing workers to earn a bit more. The Liberal Democrats would probably strengthen the incentive to be in paid work for more people than the Conservatives, as well as increasing the incentive for those earning less than £10,000 to earn more. But they would do more than the other two parties to harm incentives to work and save among richer households.

Looking at the structure and efficiency of the tax system, Labour's pre-announced measures are not an attractive package (even given the need to raise revenue). The Conservatives would not improve matters. They would partially reverse what is probably Labour's least bad tax increase and add new complexities and distortions of their own. The Liberal Dem package would remove some undesirable distortions and inconsistencies of treatment. But their plan to restrict pension contribution relief is misguided. Although it is somewhat more coherent and less complex than the other parties' plans it applies to many more people.

Having given you that overview, let me hand you over to Carl.