Institute for Fiscal Studies

Election Briefing 2010 Summary

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Election Briefing Note No. 1
Tax and benefit reforms under Labour

- Tax and benefit changes implemented between May 1997 and April 2010 represent a net 'takeaway' from the public or a boost to the government's finances of £7.1 billion, costing each household about £270, on average, in 2010–11, relative to the conventional 'unchanged policy' baseline the Treasury uses in Budgets and Pre-Budget Reports.
- The £7.5 billion 'giveaway' in Labour's first term and the £6.4 billion 'takeaway' in its second were term highly progressive relative to this same 'unchanged policy' baseline, significantly reducing the incomes of richer households and increasing those of poorer ones. The £8.1 billion takeaway in Labour's third term comes mostly from the richest households, with the incomes of the rest little changed on average.
- Labour's measures have particularly benefited low-income families with children and pensioners receiving tax credits or means-tested benefits.
- Over time, the Treasury's 'unchanged policy' baseline would imply an ongoing increase in the average tax rate and an ongoing fall in the value of benefits and tax credits relative to overall living standards. This suggests that a more meaningful definition of 'unchanged policy' would be one in which tax thresholds and allowances, and benefits and tax credit levels, rise in line with national income rather than prices. Judged against this benchmark, and assuming that the net revenue from 'fiscal drag' from taxes that are difficult to assign to particular households (such as corporation tax, stamp duties and business rates) is zero, Labour's measures constitute a much larger 'takeaway' of £36.4 billion (around £1,400 per household or 4.7% of net household income) in 2010–11. They also appear slightly less progressive.
- Labour's tax and benefit reforms have, on average, slightly weakened both the incentive to work at all and the incentive for workers to increase their earnings. 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 with 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.
- Note that we do not consider reforms that have been announced by the current government to come into effect after the general election. Those measures, and alternatives proposed by the Conservative Party and the Liberal Democrats in their manifestos, will be analysed in a subsequent Election Briefing Note.

Election Briefing Note No. 2
Living standards, inequality and poverty: Labour's record

Living standards

- Living standards have grown during Labour's time in office. Between 1996–97 and 2008–09, real household disposable incomes grew by 2.0% per year on average. However, this growth has not been evenly spread over time. Real household disposable income grew by over 3% per year on average in Labour's first term, by 2% per year in its second term and by less than 1% per year in its third term.
- Much of this slowdown reflects sluggish growth in earnings from employment – a slowdown which began before the recession got underway in 2008.
- Between 1996–97 and 2007–08, average incomes grew most rapidly for pensioners, lone parents and non-working couples with children (at 2% or more a year, on average). They grew most slowly for working-age adults without children (at 1.4% or less per year, on average).
- Average incomes grew fastest in the North East of England and London (about 2.3% per year, on average) and slowest in the West Midlands (about 1.2% per year). In the latest years of data, adjusting for differences in the cost of living in different regions, average incomes were highest in the South East of England (at 110% of the national median) and lowest in the West Midlands (at 93% of the national median).
- The 'middle-class recession' predicted by some commentators did not materialise. This recession, like previous recessions, has seen low-skilled and low-educated workers bear the brunt of worsening labour market conditions.

Income inequality

- The latest data show that in 2007–08 income inequality was slightly higher than when Labour came to power and higher than in any year since at least the 1950s. However, the rise in income inequality under Labour is far smaller than the rise observed under the Conservatives during the 1980s.
- The small increase in income inequality under Labour between 1996–97 and 2007–08 was largely driven by trends at the extremes of the income distribution: above-average growth amongst the richest 10% and below-average growth amongst the poorest 5%. Income growth was relatively even over the rest of the distribution.
- Under the Conservatives between 1979 and 1996–97, income growth increased with income right across the income distribution, with the lowest growth at the very bottom of the income distribution and the fastest growth at the very top.
- Labour's tax and benefit reforms have reduced income inequality compared with what would have happened if benefits and tax credits had simply been uprated in line with prices, the normal practice of the previous Conservative government. Labour's tax and benefit reforms thus seem to have prevented a larger rise in income inequality.
- Given that high-income individuals are more dependent on financial markets for their income, the recent financial crisis is likely to have led to lower growth or even reductions in top incomes. This may well have acted to reduce income inequality since 2007. Increases in income tax for the very rich from 2010 onwards are also likely to exert downward pressure on income inequality.

- The UK has a higher level of income inequality than the OECD average. Inequality is higher in the UK than in the likes of Sweden, France and Germany, but lower than in the likes of the US, Italy and Mexico.

Poverty

- The proportion of the population in relative poverty fell from 19.4% in 1996–97 to 18.3% in 2007–08 using incomes measured before housing costs (BHC), and from 25.3% to 22.5% after housing costs (AHC). However, poverty has increased since 2004–05 on both measures, when it was 17.0% (BHC) and 20.5 % (AHC), reversing roughly half the decline since 1996–97.
- Poverty has fallen since 1996–97 for children and pensioners, but it is higher for working-age adults without children. In part, this reflects the fact that Labour's tax and benefit changes have largely favoured the incomes of the first two, with little effect on the third.
- It is difficult to argue conclusively that severe poverty has increased since 1996–97 in a meaningful way, 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.
- After adjusting for the cost of living, poverty is highest in London (21.8%) and lowest in Scotland (14.6%) in the most recent three years of data. The rate of poverty has fallen most under the present government in the North-East of England and in Yorkshire and the Humber, but it has risen in the West Midlands.
- In Budget 2010, the government as good as conceded that its relative child poverty target for 2010 would not be met, a conclusion supported by previous IFS analysis. Looking ahead to the 2020 target to eradicate child poverty, neither the government nor the main opposition parties have yet produced a credible and detailed strategy about how they will meet the now legally-binding commitment to eradicate child poverty by 2020.
- However, the most important determinant of the path of living standards, poverty and inequality over the course of the next parliament will be how the public finances are rebalanced. All are committed to tax-raising measures on the very rich and a substantial fiscal tightening. However, there is currently little detail from any of the main parties about the areas of spending that will receive the deepest cuts and how these will be achieved.
- On the basis of the limited proposals they have published to date, there is little reason to believe that the outlook for overall living standards, poverty and inequality going forwards would be dramatically different under the opposition parties from under Labour. We will revisit this question following the publication of the party manifestos.

Election Briefing Note No. 3
What has happened to 'Severe Poverty' under Labour?

- Between 1996–97 and 2007–08, the fraction of the population living in households with an income less than 40% of median income increased. It rose from 4.3% to 6.0% using incomes measured before housing costs, and from 8.8% to 9.6% using incomes measured after housing costs. The Conservative Party, amongst others, uses this fact to claim that 'severe poverty' has increased under Labour.
- A closer look at this rise suggests that it is difficult to argue convincingly that severe poverty has increased since 1996–97. However, there is considerably stronger evidence that severe poverty has risen since 2004–05, mirroring an increase in the government's preferred measure of poverty. In particular, the first phase of the increase (between 1996–97 and 2000–01) is

explained mainly by an increase in the fraction of people with an income measured as zero or between zero and 20% of median income. Households with an income below 20% of the median income are less deprived, on average, than those households with an income between 40% and 60% of the median (who would not be labelled as severely poor under the 40% of median income). The second phase of the increase (between 2004–05 and 2007–08) is concentrated very much amongst those households with an income between 20% and 40% of median income, who do appear to be very deprived, as well as having very low incomes.

- Some households with zero or very low incomes are making large payments (such as student loan repayments and contributions to private pensions) that are subtracted from their gross incomes to give their final net household income. About one-third of the rise in the fraction of households with an income less than 40% of median income between 1996–97 and 2004–05 is due to implausibly high student loan repayments (first taken into account in the construction of income in 1997–98). However, student loan repayments cannot explain any of the rise in the fraction of households with an income less than 40% of median income between 2004–05 and 2007–08.
- Reference to a wider selection of possible measures of severe poverty (based on expenditure, material deprivation, absolute poverty and persistent poverty) show that trends depend on the measure chosen. Since 2004–05, however, measures based on relative income poverty (that used by the Conservative Party), absolute income poverty and material deprivation have all showed a meaningful increase in severe poverty, although persistent poverty (i.e. being in poverty for an extended period) fell until 2007 and expenditure-based measures of severe poverty have not increased since 2004–05.

Election Briefing Note No. 4
The tax burden under Labour

- 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.

Election Briefing Note No. 5
Public spending under Labour

- Total public spending is forecast to be 48.1% of national income in 2010–11, up by 8.2% of national income from the 39.9% Labour inherited from the Conservatives. This would be the highest level of public spending as a share of national income since 1982–83.
- Most industrial countries have increased public spending as a share of national income since 1997. But between 1997 and 2007 – prior to the financial crisis – the UK had the 2nd largest increase in spending as a share of national income out of 28 industrial countries for which we have comparable data. Over the period from 1997 to 2010 – including the crisis – the UK had the largest increase. This moved the UK from having the 22nd largest proportion of national income spent publically in 1997 to having the 6th largest proportion spent publically in 2010.
- Spending on public services has increased by an average of 4.4% a year in real terms under Labour, significantly faster than the 0.7% a year average seen under the Conservatives from 1979 to 1997. This is largely due to increases in spending on the NHS, education and transport. Since 2000–01 public investment spending has increased particularly sharply and is now at levels not seen since the mid to late 1970s. Despite large increases in the generosity of benefits for lower income families with children and lower income pensioners social security spending has grown less quickly than it did under the Conservatives.
- Estimates from the Office for National Statistics suggest that public services have improved considerably over the period from 1997 to 2007 with measured outputs suggesting a one third increase in the quantity and quality of public services. But this increase in measured public service outputs is less than the increase in inputs over the same period; in other words productivity has fallen. The relative price of these inputs has also risen, so we find that the "bang for each buck" that we get from spending on public services (output per pound spent, adjusted for whole economy inflation) has fallen more than productivity.
- If the Government had managed to maintain the "bang for each buck" at the level it inherited in 1997, it would have been able to deliver the quantity and quality of public services it delivered in 2007 for £42.5 billion less. Alternatively, it could have improved the quality and quantity of public services by a further 16% for the same cost. But perhaps service quality has improved in ways not captured by the ONS's measures. Or perhaps we were to bound to see diminishing

returns to additional spending when it was increasing so rapidly. To the extent that additional spending boosts output fully only with a lag, we may not yet have seen the full benefit.

Election Briefing Note No. 6
The public finances: 1997 to 2010

- Over the first eleven years of Labour government, from 1997 to the eve of the financial crisis in 2007, the UK public finances followed a remarkably similar pattern to the first eleven years of the previous Conservative government, from 1979 to 1989. The first four saw the public sector move from deficit to surplus, while the following seven saw a move back into the red.
- By 2007 Labour had reduced public sector borrowing slightly below the level it inherited from the Conservatives. And more of that borrowing was being used to finance investment rather than the day-to-day running costs of the public sector. Labour had also reduced public sector debt below the level it had inherited. As a result the 'golden rule' and 'sustainable investment rule' that Gordon Brown had committed himself to on becoming Chancellor in 1997 were both met over the economic cycle that he eventually decided had run from 1997–98 to 2006–07.
- But over the same ten years the vast majority of other leading industrial countries reduced their borrowing by more than the UK. And most also reduced their debt by more. So while the UK public finances were in better shape when the financial crisis began than they were when Labour came to power, the UK was in a worse position relative to most comparable countries.
- The financial crisis and the associated recession subsequently saw public sector net borrowing balloon to levels not seen since the Second World War – and far higher than was seen in the latter years of the Conservative government, including during the aftermath of the 1990–92 recession (when the previous post Second World War high borrowing occurred).
- Once again, the UK public finances have underperformed relative to comparable industrial countries. The UK is forecast by the OECD to experience the highest level of borrowing in 2010 and the fifth largest increase between 2007 and 2010 out of 26 industrial countries. Only Ireland and Iceland are projected to see a larger increase in debt over this period with the UK sliding further from its 'mid-table' position in the international public debt league table.

Election Briefing Note No. 7
Environmental policy since 1997

Emissions Reductions

- The UK will meet its Kyoto obligation to reduce Green House Gas (GHG) emissions by 12.5% below 1990 levels by 2008-12. But it is highly unlikely to meet its own domestic target to reduce carbon dioxide (CO_2) emissions by 20% by 2010 relative to 1990 levels.
- Since 1997, CO_2 emissions have fallen at a relatively low rate – just 0.3% per year. Emissions from energy supply and transport (the two biggest sectors) have risen over this period.
- Emissions of other GHGs have fallen relatively fast – by 4.5% a year. Overall, emissions have fallen at about the same rate since 1997 as they did between 1990 and 1997.
- If the UK is to meet its 'carbon budget' target for GHGs in 2020, more will need to be invested in renewable energy and transport emissions will need to be reduced – requiring potentially painful and expensive decisions. The government estimates that its various energy policies will add around 8% to household electricity bills relative to 2009 by 2020.

- There has been some success at raising the share of renewables in electricity generation – from about 3.6% in 1997 to 6.8% in 2008– though this is still a very long way below the ambition for 2020 of 30%, and well below the EU average. The largest change in generation has been the rise of gas-fired power at the expense of nuclear power, which means there has been a rise in energy supply emissions since 1997.

Taxes and Policy

- Between 1997 and 2009, green taxes as a share of total receipts fell from 9.5% to 7.9%. There has been no substantial change in the composition of environmental revenues: fuel duty still accounts for more than ¾ of the total, as it did in 1997.
- Real-terms rates of fuel duty first rose substantially under Labour as part of the fuel duty escalator, then fell back after it was abandoned in 1999. Fuel taxes are now about 11% higher in real terms than they were when Labour took office.
- The Vehicle Excise Duty system has been substantially reformed to make payments contingent on the CO2 emissions of the vehicle. But payments have fallen on average: someone buying a new car of average emissions in 2009 paid less in real terms than someone buying a new car in 1997.
- Rates of Air Passenger Duty have risen substantially since 1997, though the Government abandoned a reform of the system into a per-plane tax (a policy that at the time appeared to have cross-party support) in 2008.
- The UK has moved off the bottom of the EU 15 league table for the proportion of waste recycled since 1997, and looks set to hit EU Landfill Directive targets. This is in part through very large increases in Landfill Tax to rates that will, by 2014–15, be ten times the original estimates of the marginal externality from landfill.
- Existing energy and transport taxes imply ‘carbon taxes’ that are higher for business than domestic energy use, lower for coal-generated power than gas-generated power, and higher for transport fuel. The fact that households pay only 5% VAT on energy – as opposed to the standard 17.5% rate – probably more than offsets increases in bills they face because of environmental measures.
- It is not clear that targets for emissions have been set in a very coherent way as the necessary carbon price they imply for emissions under the European Emissions Trading System (ETS) and outside the ETS are very different. This suggests the total cost of hitting emissions reduction targets is higher than it needs to be.

Election Briefing Note No. 8
Welfare reform and the minimum wage

Work and training schemes

- Sensibly, there is general agreement between the three main parties on the need to tackle the large rise in youth and long-term unemployment caused by the recession.
- All three main parties plan to target unemployed people under the age of 25. The Liberal Democrats would introduce voluntary work placements solely for this group for one year. Labour and the Conservatives would make work or training compulsory for under-25s after ten and six months of unemployment respectively.

- The Conservative Party's proposals for welfare-to-work policies follow the general direction taken by the current government, but go a little further, spending £600 million more than the government over three years on welfare-to-work and training programmes.
- Labour and the Conservatives both plan to make the long-term unemployed partake in community work or face benefit sanctions.

Disabled people and incapacity benefits

- It is existing government policy to move all existing recipients of incapacity benefits to Employment and Support Allowance (or another – usually less generous – benefit if they are deemed fit to work by the medical test in ESA) by 2014. This reform will save money relative to the status quo. The Conservatives plan to do the same thing, but by 2012. The Conservatives' claim that they would save £600 million more over three years than the government's plans in this area (and that this would therefore offset the extra cost of their welfare-to-work reforms above) is not credible, precisely because the government has already set out plans to do the same thing. On the other hand, if the Conservatives can complete this process two years faster than the government is planning, there may be some temporary savings in 2012 to 2014.
- The Liberal Democrats do not comment on this area in their manifesto. But they propose better 'practical help' for people with disabilities to get to work, and funding of disability-related equipment to be 'already in place' when disabled people apply for a job (it is currently available only when a job has already been offered or started). Without more detail, it is impossible to assess the likely impact of this.

Lone parents

- None of the three main parties has suggested any changes to existing policy in this area.

Minimum wage

- Labour proposes to ensure that the minimum wage rises at least in line with average earnings over the period to 2015. There is currently no explicit rule about changes over time. Since its introduction, the minimum wage has risen slightly faster than average earnings overall, so the main impact may be solely to reduce uncertainty about the future path of the minimum wage, which is sensible.
- The Liberal Democrats propose to equalise the minimum wage for all workers aged 16 and over (currently, there is a lower rate for 16- and 17-year-olds, a middle rate for 18- to 21-year-olds and a higher rate for those aged 22 and over). Although the Low Pay Commission has recommended that 21-year-olds be paid the adult rate, it has recommended that the lower rates for those aged 16–20 remain. A higher minimum wage for these young people might reduce the fraction in full-time education, but also lead to employers offering fewer jobs to these people if they have to pay the same as they pay to those aged 22 and over.

Benefit and tax credit reform

- The Labour Party has highlighted its plan to introduce a Better-off in Work Credit (BWC), for people who move into work and were previously on out-of-work benefits for 26 weeks or more, to ensure that they are at least £40 per week better off in work than on benefits for six months. A pilot of this policy was not a success. This suggests that Labour's preference for the BWC over use of the existing Working Tax Credit may reflect the fact that the former would be cheaper (because it is time-limited and existing workers are ineligible) rather than more effective.

- The Liberal Democrats propose to fix tax credit awards for six-month periods. This should make it considerably easier for families to work out what their entitlements would be if their circumstances changed (e.g. they moved into work). The disadvantage is that entitlements would be based on past circumstances, not current ones. This is an inescapable trade-off, but IFS researchers have previously argued that fixing tax credit payments for periods of time would be a sensible reform, all things considered.
- The Conservatives also plan to reform the administration of tax credits, to reduce fraud and overpayments. But no further details have been given.

Election Briefing Note No. 9
Productivity, innovation and the corporate tax environment

- The UK has had a persistent productivity gap with the US and other major European countries: with a given level of labour input, we produce fewer outputs. The gap has narrowed since the mid-1990s but increased again in the most recent period.
- The UK also consistently lags behind in terms of the proportion of national resources that are devoted to research and development (R&D). There has been a decline in business expenditure on R&D as a proportion of GDP (BERD) since the mid-1980s, which has resulted in a deterioration of the UK position vis-à-vis other developed economies.
- The UK has performed historically well on measures that capture the outputs of basic science and universities. For example, with only 1% of the world's population, the UK produces 9% of all scientific papers and receives 12% of citations.
- Labour governments since 1997 have stated that productivity and innovation are a priority and have enacted a number of related policies. Notably, there have been significant increases in spending on science and the introduction of R&D tax credits.
- Whoever wins the upcoming general election will need to make significant cuts to public spending. The three main UK political parties seem to agree on the importance of science and innovation. However, none has set out specific details on the extent to which cuts in public spending will need to be made in the areas of science, research and skills. While cutting spending in these areas may arouse little protest from the electorate, they are areas that will feed into the UK's long-run success. Cuts should therefore be considered with caution.
- In 2009, the UK had the second-lowest statutory corporate tax among the G7 and the tenth lowest among the EU15. A new Labour government would leave the main rate unchanged at 28% in 2011–12 and increase the small companies' rate to 22% in 2011–12, while an incoming Conservative government would reduce the main rate to 25% and the small companies' rate to 20%, paid for by broadening the base of the tax.
- Increasing internationalisation and mobility of capital have put pressure on national tax systems. Most recently, the main issue in relation to the UK corporate tax system has been the taxation of foreign income. In 2009, the UK moved to an exemption system under which much of the foreign income of UK firms is exempt from UK corporation tax.
- At the end of 2009, the Labour government announced its intention to introduce a 'Patent Box' – a new policy that would tax the income from patents at a reduced 10% rate of corporation tax. This is a poorly targeted and expensive innovation policy. The Conservative Party has highlighted plans to create an 'attractive tax environment for intellectual property'.

Election Briefing Note No. 10
UK productivity in the recession

- Labour productivity in the UK fell over the recession that began in the first quarter of 2008 and, according to the latest statistics, ended in the final quarter of 2009.
- In contrast, US productivity grew throughout the recession; output declined more rapidly in the US than in the UK, but US hours worked also fell by relatively more. In the UK, hours worked fell by less than output.
- In both countries, hours worked fell by more than the number of workers, indicating a reduction in hours worked amongst those still in employment - for instance, through an increase in part-time working.

Election Briefing Note No. 11
Education policy

- Education spending has risen by an average of 3.9% per year in real terms under Labour. This is substantially faster than under the Conservatives between 1979 and 1997 (1.5% per year), but only slightly faster than the long-run historical trend before Labour came to power (3.7% per year). Schools, the under-fives and further education institutions have seen the most generous funding increases under Labour, with spending on higher education growing much more slowly.
- In 2006, the UK had the eighth largest level of education spending as a share of national income amongst 26 industrial countries. This follows a period between 1995 and 2006 when the UK saw the fourth largest increase in spending as a share of income amongst this group. Only the United States, Denmark and Mexico increased spending as a share of national income by more. UK education spending as a share of national income now exceeds its mid 1970s peak and is at a higher level than at any point since (at least) the mid 1950s.
- Within the education budget, the UK is a comparatively 'big spender' on early years education and services. In 2006 the UK had the 2nd highest level of spending per pupil in the pre-primary sector amongst the 26 OECD countries for which comparable data are available.
- England's early years spending includes free part-time nursery care for three and four year olds, and the Sure Start programme, providing health and education information to parents with children under five. The Conservatives have pledged to support the provision of free nursery care for pre-school children, while the Liberal Democrats have expressed a long-term ambition to increase the hours of provision funded by the government, and extend the age range at which it is available. They have not, however, stated when they would seek to implement this extension.
- Labour has committed to protect non-investment funding for Sure Start Children's Centres in real terms until 2012–13. The Conservatives have pledged to retain the Sure Start programme, but plan to refocus it primarily on deprived families, and to change its method of delivery (by involving more outside organisations).
- National school results in England have improved under Labour across all age groups. However, these improvements have not been as fast as the government hoped, with numerous national targets being set and subsequently missed. On average, English school results at ages 9-10 and 13-14 appear to be well above the Western European average for Mathematics and

Science (using TIMSS data), but England's 15 year olds score around the OECD average for both reading and Mathematics (using PISA data).

- All three main parties would introduce a pupil premium into the school funding system in England. The Liberal Democrats have been quite clear about their proposal for a £2.5 billion pupil premium largely targeted at pupils poor enough to be eligible for free school meals, which would be on top of all existing funding. Labour has proposed a 'local pupil premium', which may simply involve a re-badging of existing deprivation funding. It is unclear what the Conservatives' proposals for a pupil premium would mean in practice, and it is thus impossible to quantify its likely impact on individual schools' funding or overall levels of public spending.
- Labour has proposed an expansion of the academy programme, whilst the Liberal Democrats would replace them with 'Sponsor-Managed Academies' and return them to local authority control. The Conservatives would 'break down barriers to entry so that any good education provider can set up a new Academy school', emulating the Swedish 'free schools' system (which allows charities, businesses and parent co-operatives to open new schools) and charter schools across a number of US states. However, it is unclear whether such a liberalisation and increase in school competition would significantly improve pupil achievement.
- Under Labour, higher education in the UK has undergone significant and sometimes controversial reform, accompanied by increases in participation and small increases in achievement at university. However, despite these reforms, the UK still ranks roughly in the middle among OECD countries for participation in higher education. Furthermore, recent tighter funding settlements combined with limits on additional places may impede the Government's progress towards its target of a 50% participation rate by 2010.
- In this election campaign, the opposition parties have considerably more to say on higher education than Labour does. The Liberal Democrats have proposed to abolish tuition fees for both full-time and part-time students over a six-year period, with an eventual cost of £1.8 billion. Meanwhile, the Conservatives have proposed to fund 10,000 additional student places in 2010–11 by offering graduates a discount if they repay their student loan earlier. While this policy is likely to bring some cash forward, it has some economically undesirable features.

Election Briefing Note No. 12
Filling the hole: how do the three main UK parties plan to repair the public finances?

- The financial crisis and the recession have prompted a huge increase in government borrowing over the last two years. The Treasury believes that a significant part of this increase will persist even after the economy fully recovers. Discretionary tax increases and spending cuts are therefore needed to keep government debt and interest payments on a sustainable path.
- Given that this fiscal repair job is likely to be the major domestic policy challenge for the next government, it is striking how reticent all three main UK parties have been in explaining how they would confront the task. Their public spending plans are particularly vague. Our analysis thus necessarily involves making some informed assumptions about how they would proceed.
- Since the impact of the crisis became apparent in the Treasury's forecasts for the public finances, the current Labour government has set out a fiscal tightening that will build gradually to 4.8% of national income or £71 billion a year in 2010–11 terms. The opposition parties have not challenged this number and we assume that they would aim for the same.

- The Labour government's 2010 Budget set out the size of its planned tightening in each year. It aims to withdraw the temporary fiscal stimulus package this year, start tightening in 2011–12 and finish the job in 2016–17, with the pain front-loaded in the earlier years. The Liberal Democrats have informally endorsed this tightening profile.
- The Conservatives want to start tightening earlier and proceed more quickly. They plan an additional £6 billion tightening this year and would aim to get almost all the repair job done a year earlier than Labour and the Liberal Democrats in 2015–16.
- The Conservatives' greater ambition would make a relatively modest difference to the long-term outlook for government borrowing and debt. The Conservative plans imply total borrowing of £604 billion over the next seven years, compared with £643 billion under Labour or the Liberal Democrats. Assuming no further change in borrowing beyond 2017–18, we project that the Conservative plans would return government debt below 40% of national income in 2031–32, the same year as it would under Labour or the Liberal Democrats.
- Differences between the parties are much more pronounced with regards to the composition of the tightening. Labour favours a 2:1 ratio of spending cuts to tax rises (£47 billion and £24 billion, respectively), the Liberal Democrats a 2½:1 ratio (£51 billion and £20 billion) and the Conservatives a 4:1 ratio (£57 billion and £14 billion). Measured as shares of national income, the Labour and Liberal Democrat plans would reduce public spending to a level last seen in 2004–05 and increase tax revenues to their highest since the peak of the late 1980s boom in 1989–90. The Conservatives would reduce total spending to the level seen in 2003–04 and increase revenues to the level seen in 2006–07.
- Measured as a share of national income and converting into 2010–11 terms, Labour has already put a £17 billion tax increase into the pipeline for the coming Parliament. We estimate that its goals for borrowing and the overall composition of the fiscal tightening would require it to announce further tax increases worth around £7 billion. The Conservatives have announced a £6 billion net tax cut on top of what is in the pipeline from Labour, but their goals would probably require them to reverse about half of it. The Liberal Democrats have announced a £3 billion tax increase on top of what is in the pipeline and would not need to do anything further. The rise in the tax burden by 2016–17 would be largest under Labour and lowest under the Conservatives, with the Liberal Democrats in the middle.
- Far more significant is the gap in the parties' plans for reducing public spending. None has announced plans for significant cuts to social security spending and, without them, their plans would require deep cuts to spending on public services. Over the four years starting in April 2011, both Labour and the Liberal Democrats would need to deliver the deepest sustained cut to spending on public services since the four years from April 1976 to March 1980. Starting this year, the Conservative plans imply cuts to spending on public services that have not been delivered over any five-year period since the Second World War.
- Once we take into account their various pledges to protect spending in certain areas, in real terms the Conservatives would need to cut public services spending in their unprotected areas by £63.7 billion, Labour by £50.8 billion and the Liberal Democrats by £46.5 billion between April 2011 and March 2015. Of these, the Conservatives have announced measures that would bring about 17.7% of the total cuts they need, leaving a shortfall of £52.4 billion. Labour has announced measures that would bring about 13.1% of what it would need, leaving a shortfall of £44.1 billion. The Liberal Democrats have announced measures that would bring about 25.9% of what they would need, leaving a shortfall of £34.5 billion.

- Forecasting components of public spending beyond 2014–15 becomes very difficult, but all three parties would be likely to require further cuts to spending on public services between 2014–15 and 2016–17. Over this period, the cuts would be smallest under the Conservatives, as they would have already done most of the job over the previous five years, and greatest under the Liberal Democrats, if they are to meet their aspiration of avoiding further net tax rises.
- Both Labour and the Conservatives claim to have identified efficiency savings that could help achieve the spending cuts they need. But all governments presumably try to spend public money as efficiently as they can, whatever the fiscal climate. So presumably they would aim to deliver these efficiency savings whether there was a need to cut spending or not. If so, they do not narrow the gap between the quality and quantity of public services that would be delivered in a world of spending cuts versus a world without. In any case, genuine efficiency savings do not reduce the size of any relative shortfall between the different parties' stated plans, as they would be available to whoever forms the next government.
- The parties are all aiming to deliver at least two-thirds of their fiscal tightening through spending cuts rather than tax increases, and have not announced any measures cut welfare spending substantially. When the last Conservative government required a significant fiscal tightening in the early 1990s they aimed to split the burden roughly 50:50 between tax increases and spending cuts. This might suggest that all the parties are overambitious in the amount they think they can squeeze out of public services. Whoever forms the next government, that points to greater reliance on tax increases and welfare cuts after the election than the parties are willing to admit to beforehand.

Election Briefing Note No. 13
Taxes and benefits: the parties' proposals

- Tax and benefit measures already announced by the current Government and due to take effect over the coming Parliament will cost households around £15.8 billion a year in total or £610 per household, compared with the tax and benefit system in place now.
- Labour's manifesto contains no significant additional tax or benefit proposals. The Conservatives propose to offset about a third of Labour's pre-announced net 'takeaway' with tax cuts, paid for predominantly by deeper cuts to spending on public services than planned by Labour. The Liberal Democrats would increase Labour's net 'takeaway' by about a quarter through a net tax increase, thus providing scope to cut spending on public services by less than Labour until 2014–15 while borrowing the same.
- There is greater uncertainty around the net fiscal impact of the Liberal Democrat proposals than those of the other parties. We can be pretty confident that the Liberal Democrats' headline giveaway (increasing the income tax personal tax allowance to £10,000) will probably cost roughly what they expect. There is much more uncertainty around the estimates for their revenue raising measures, but no clear overall bias: some look likely to raise more than they expect and some less.
- Labour pre-announced measures are progressive taken as a whole, with small losses for poorer households that increase in size on average as households get richer – especially for the richest 1%. The Conservative proposals would make the net 'takeaway' somewhat 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 'takeaway' more progressive,

redistributing resources from the wealthy to middle-income households (though not the poorest households).

- The increase in the tax burden implied by Labour's pre-announced measures will weaken work incentives for most people. Relative to these measures, the Conservative plans (notably their proposed National Insurance cut) would strength the incentive for many people to be in paid work, but would do almost nothing to encourage most existing workers to earn a bit more. The Liberal Democrats' proposed income tax cut would probably strengthen the incentive to be in paid work for more people than the Tory NI cut (thus increasing employment more), 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 weaken incentives to work and save among richer households.
- Looking at the structure of the tax system, Labour's pre-announced measures are not an appealing set of reforms (even given the need to raise revenue). For example: their plans to restrict tax relief on pension contributions for those with high incomes create significant complexity, unfairness and inefficiencies; increasing stamp duties for houses worth over £1 million increases a particularly damaging and inefficient tax; the stamp duty holiday for first-time buyers adds complexity and creates new distortions (even though it cuts a damaging tax); and the cut in corporation tax on patent income will largely benefit a few big companies while doing little to achieve its stated goal of promoting innovation. Labour's planned NI increase is a relatively straightforward way to raise significant revenue; it is a "tax on jobs", but the same would be true of increases in income tax or VAT.
- The Conservatives propose to offset partially perhaps the least badly-designed of Labour's major tax increases (National Insurance), but to maintain perhaps its worst designed one (the restriction of pension contributions relief for high earners). They also intend to cut income tax (to recognise marriage) and stamp duty (for first-time buyers) in ways that would complicate the tax system further.
- The Liberal Democrats are proposing the most radical and far-reaching set of tax reforms of the three parties. Several of them would reduce or remove features that distort people's behaviour in damaging ways, for example equalising tax rates between income and (some) capital gains, between property repairs and new build, and between benefits-in-kind and other remuneration. Replacing air passenger duty with a per-plane tax also looks sensible on environmental grounds. The glaring exception is their proposal to restrict tax relief on pension contributions for many more people than planned by the Government.
- The role that the Westminster government would have over future UK tax policy would be different under each of the parties. The Conservative Party seems the least keen on the Calman Commission's proposals for devolving more tax-raising powers to the Scottish Parliament, and would give local authorities less control over their revenue and spending in the short-run. But the Liberal Democrats would give greater powers to Edinburgh by implementing all of the Calman Commission's proposals, and give local authorities control over a far greater share of their revenues.

Election Briefing Note No. 14
Environmental policy proposals

- All three main UK parties have broadly signed up to the very ambitious carbon reduction targets set out in the Climate Change Act 2008. Achieving them would require any government to implement policies leading to large reductions in emissions. But there are few significant new policies, and certainly no radical departures from current plans, being proposed by any of the three main parties in the current election campaign.

- For example, it is noteworthy that none of the main parties plans to tax household energy consumption, which would continue to be subsidised through the reduced rate of VAT payable on energy. Nor do they have any serious plans to introduce consistent carbon pricing across sectors.
- The Labour Party announced no significant new environmental proposals in its manifesto, although it has already set out a number of significant policy interventions in legislation.
- Among the most important changes to environmental policy that have recently been introduced are the Carbon Reduction Commitment (a cap and trade scheme for firms not covered by the European Emissions Trading System), a fuel duty escalator, the introduction of banding for renewable obligation certificates, and the introduction of the Clean Energy Cash Back scheme ('feed-in' tariff). The three main parties seem committed to keeping these.
- The Conservatives have proposed a reform to the Climate Change Levy which would, in the context of the European Emissions Trading System, have the effect of putting a floor price on carbon – but still only where the generation is for business use. This has the advantage of providing greater certainty over the carbon price and giving firms an incentive to use less carbon intensive fossil fuels. But it could lead to more uncertainty in government revenue.
- The Conservatives would also consult on a 'fair fuel stabiliser' that would stabilise after tax fuel prices. This would help stabilise the prices paid by consumers, but is likely to be difficult to implement and could lead to unstable revenues. Environmental benefits are unlikely.
- The Conservatives have promised to increase the share of environmental taxes in total tax revenues, but have not explained how they will do so. The current government has overseen a reduction in environmental tax revenues as a proportion of the total. Reversing this trend would likely require large increases in fuel duties.
- The Liberal Democrats would replace air passenger duty (APD) with a per plane duty. This would target the external costs of flying from greenhouse gas emissions more effectively.
- The Liberal Democrats also seem to be the most enthusiastic advocates of road pricing, suggesting that it would be introduced 'in a second parliament'. In the mean time they propose a fuel discount for people living in rural areas.

Election Briefing Note No. 15
Families and children

Taxes, benefits and tax credits

- The government's last Budget announced a small rise in the child tax credit for poorer families with children aged 1 or 2, and the Labour Party has proposed a less generous tax treatment of childcare vouchers for higher-rate taxpayers. The Conservatives and Liberal Democrats have proposed cuts to child tax credit for richer families and the Child Trust Fund. In both cases, the Liberal Democrats' proposed cuts would be larger than the Conservative Party's. The Conservative Party has proposed a partially-transferable personal allowance for some married couples, restricted to basic-rate taxpayers, which would benefit around 4 million couples, around 1.5 million of whom would have children.

- These policies would have very small impacts on couple penalties and premiums in the tax and benefit system. The fraction of couples facing a couple penalty in the tax and benefit system would not change under Labour Party plans, and would fall very slightly under Conservative and Liberal Democrat plans (by 1 and 2 percentage points respectively). The average penalty would fall very slightly (by 0.2%) under the Conservative plans, rise very slightly (by 0.4%) under Labour's plans, and rise by a little more (by 3.1%) under the Liberal Democrats' plans.
- It is not clear what the Conservative Party means by its desire to "end the couple penalty for all couples in the tax credit system". A literal interpretation of this ambition would require assessing tax credits on an individual's own income, and cost at least £18 billion a year. It may be that the Conservative Party want to increase the working tax credit for couples with children. This would reduce couple penalties for couples with children, but would introduce new couple premiums, and would leave the vast majority of couples with children facing a couple penalty in the tax and benefit system.

Parental leave, pay and flexible working

- The Labour Party is proposing doubling paternity pay to 4 weeks, but has dropped its previous ambitions to extend maternity pay from 9 to 12 months. The Conservatives and the Liberal Democrats propose to make all 12 months of maternity leave transferable from mother to father, as opposed to the Government's plan to make only 6 months of it transferable. The Conservatives and the Liberal Democrats want to extend employees' right to request flexible working from families with children to other workers.

Childcare, Early Years and Education

- The Labour Party proposes a very modest expansion of the current pilot providing free nursery education to deprived two-year-olds, a considerably less expensive policy than that announced by Gordon Brown last autumn. The Conservative Party has proposed reforms to Sure Start to alter its focus and its priorities. The Liberal Democrats aspire to extend free nursery provision, but when the nation's finances allow.
- Overall, there is a conspicuous absence of policy pledges with large price tags attached, presumably because of the deep spending cuts that will have to be made over the next Parliaments.

Election Briefing Note No. 16
Pensions and retirement policy

- All three main UK parties have promised to increase the Basic State Pension (BSP) at least in line with earnings. The Liberal Democrats have said they would do this from April 2011, Labour from April 2012 and the Conservatives at some point in the next Parliament.
- Labour and the Liberal Democrats plan to start increasing the State Pension Age (SPA) to 66 for men and women from 2024. The Conservatives have said they might bring this forward to 2016 for men and 2020 for women. If implemented, this would adversely affect men born between 1951 and 1959 and women born between 1955 and 1959.
- All would restrict the tax relief received by some on their pension contributions. Labour and the Conservatives would do this for 300,000 individuals with incomes above £130,000, while the Liberal Democrats propose doing this for all 3.1 million higher rate taxpayers. It is unfair to restrict tax relief on pension contributions without similarly restricting the tax paid on pension income. Such policies introduce considerable complexity and compliance costs.

- The Conservatives and the Liberal Democrats have both pledged to get rid of the requirement to annuitise all private pension pots before the age of 75. This reform risks worsening the operation of the annuities market and higher prices for some. The current system does not actually force individuals to annuitise retirement savings, as they are free to save for retirement in non-pension products.
- The Conservatives and the Liberal Democrats have both said they would review the current pension arrangements for public sector workers. Public sector pensions are more generous on average than private sector ones, but this is not itself a justification for cuts. Any future review should consider whether the remuneration packages being offered provide the appropriate incentives to recruit and retain staff at the lowest cost to taxpayers. The Conservative proposal to cap public sector pensions at £50,000 a year would not be a sensible reform.
- All three parties want to remove employers' right to make individuals retire at age 65. Employment legislation should contain provisions for employers to be able to assess their employees' abilities to carry out their roles and terminate their employment if they cannot perform their duties even with reasonable adjustments. But allowing age as a proxy for physical and mental capability does not seem desirable.