Unpicking the tax lock

Party leaders should avoid pledging a tax lock which would rule out increases in the workhorse taxes of National Insurance, income tax and VAT, warns the Institute for Fiscal Studies’ Helen Miller.

It is perfectly reasonable that a political party would want to stand on a platform of not increasing taxes. It is also understandable why they would look for ways to show the electorate that they are credibly committed to their plans. However, the Conservatives’ 2015 manifesto pledge to not increase the rates of income tax or NICs or the rates or scope of VAT was a bad idea and should not be repeated in party manifestos.

The “tax lock” is a serious constraint on the government’s ability to raise revenues. This is because income tax, NICs and VAT are the workhorse taxes in our system, bringing in almost two-thirds of total tax revenue. Even if a party does not plan to raise taxes, the world can change in unexpected ways. Recessions can hit. The economy can grow in less tax-rich ways than forecast. Since the last general election, North Sea revenues have collapsed, the Office for Budget Responsibility has quantified the expected revenue loss from growing self-employment and incorporation (£4.5bn by 2020-21), and there has been pressure to support adult social care.

Unexpected events can force difficult choices between increasing borrowing, increasing taxes or cutting spending. Politicians do the electorate a disservice if they pretend that such decisions don’t exist. Ruling out increases to the UK’s three most important taxes takes an important policy lever off the table before knowing which problems will need fixing.

Arguably, the tax lock has led to poor policy choices because the Conservative government has needed to rely on a host of smaller and new taxes – including insurance premium tax, an apprenticeship levy and a soft drinks tax – to offset revenue falls elsewhere. These policy changes have tended to be made in an ad hoc fashion with insufficient attention to tax design.

A tax lock can also prevent desirable tax policy reforms, as we have seen in relation to the taxation of the self-employed. In the March 2017 budget, Philip Hammond tried to increase the rate of self-employed (Class 4) NICs in response to new evidence of the public finances hole that growth in self-employment is creating. The current tax treatment of different ways of working is complex, inefficient and unfair. Increasing NICs would have been a very small step towards levelling the playing field for employees and the self-employed.

Mr Hammond U-turned on the NICs increase because it breached the manifesto tax lock. Yet, he has clearly stated that he “continues to believe” that reducing the tax difference between employees and the self-employed “is the right approach”.

All parties enter this election knowing about the problems related to lower taxes on the self-employed. If the next government rules out increases in NICs, they will be unable to meet the challenge associated with growing self-employment by directly fixing an important part of the tax system. It is also worth remembering that this issue materialised during the parliament and other, as yet unforeseen, issues could materialise in coming years.

Finally, we should be wary of parties that say they don’t plan to increase taxes. They will probably do so anyway. In the 12 months following the five general elections of 1992, 1997, 2001, 2005 and 2010, significant net tax-raising measures (averaging £7.5bn) were announced despite these measures typically not featuring in the winning party’s general election manifesto. The 2015 general election followed this trend: policies announced in the subsequent 12 months boosted revenues by £3.5bn.

So, if a party pledges not to increase income tax, NICs or VAT, you may want to ask them which taxes they do plan to increase or, at least, which they would rely on if an unexpected revenue shortfall turns up.

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