

Better or Worse off?
More or less heavily taxed?
An assessment of manifesto claims

ELECTION BRIEFING 2005

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1. Introduction

This Election Briefing Note assesses the main parties' manifesto claims about living standards, poverty and taxation. First, Box 1 contains a summary of IFS analysis on how average incomes have changed since 1997, how tax and benefit reforms have affected average income, and what has happened to tax revenues over Labour's time in government.

Box 1. Incomes, taxes, and tax and benefit reforms

- Mean household disposable income has risen in real terms by around 19% since 1996–97, or 2.5% on an annualised basis. Median income increased by 17%, or 2.3% when annualised. See IFS Election Briefing Note no. 9 for more details.^a
- Looking just at the effects of tax, benefit, and tax credit reforms implemented by the past two Labour governments on household incomes, IFS analysis suggests that they have resulted in a small net giveaway. In total, fiscal reforms have raised mean household disposable income by £1.69 a week or 0.4%. Taking into account above-inflation increases in council tax since 1997 leaves households overall £2.85 a week (or 0.6%) worse off on average (the mean). See IFS Election Briefing Note no. 1 for more details.^b
- Tax revenues have gone up considerably: total current receipts increased from 37.0% of GDP in 1996–97 to 39.3% in 2005–06. This is the equivalent of an increase in tax payments of approximately £1,150 per household in 2005–06 prices. Around two-thirds of this increase is due to discretionary reforms to taxes and benefits, with the rest due to changes in the economy. See IFS Election Briefing Note no. 4 for more details.^c

^a M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Living Standards, Inequality and Poverty*, IFS Election Briefing Note no. 9, 2005 (<http://www.ifs.org.uk/bns/05ebn9.pdf>).

^b S. Adam, M. Brewer and M. Wakefield, *Tax and Benefit Changes: Winners and Losers*, IFS Election Briefing Note no. 1, 2005 (<http://www.ifs.org.uk/bns/05ebn1.pdf>).

^c C. Emmerson, C. Frayne and G. Tetlow, *Taxation*, IFS Election Briefing Note No. 4, London: Institute for Fiscal Studies, 2005 (<http://www.ifs.org.uk/bns/05ebn4.pdf>).

2. Average income growth

Labour's manifesto

Since 1997, average incomes have increased by 19 per cent and the income of a typical family has increased by 17 per cent ...

Page 11 of Labour, *Britain Forward Not Back: Labour Party Manifesto 2005*¹

Living standards in Britain have been rising, on average, by 2.5 per cent per year since 1997 – a total increase of nearly 20 per cent.

Page 17 of Labour, *op. cit.*

These statements are both based on the Households Below Average Income (HBAI) statistics, published by the Department for Work and Pensions.² We provide a fuller assessment of these statistics in IFS Election Briefing Note no. 9³ and in Brewer et al.⁴ Mean household weekly take-home income measured before housing costs have been deducted rose by 19% in real terms between 1996–97 and 2003–04 (2.5% per year on average). Median income (the income of the individual in the middle of the distribution) rose by 17% (2.3% per year) in real terms over the same period.

Setting these figures in context, the average rate of growth achieved under Blair is higher than that while Major was Prime Minister (0.8% annualised, both mean and median) and roughly comparable to that under Thatcher (2.9% mean, 2.1% median). But these growth rates relate to periods covering different parts of the economic cycle, and income growth rates are very sensitive to this.

As an aside, describing the median individual as belonging to a 'typical' family is not necessarily accurate, since there is nothing guaranteeing that the median individual's family will, in any sense, be representative of the rest of the population (if indeed it is possible for a single family to represent the rest of the population, or for there to exist a 'typical family').

Conservatives' manifesto

Last year, average living standards fell for the first time in over a decade ...

Page 3 of Conservatives, *It's Time for Action: Conservative Election Manifesto 2005*⁵

This statement is based on HBAI statistics showing a change in mean income between 2002–03 and 2003–04 of –0.2%, or about £1 per week. The last time mean income fell year-on-year was between 1991 and 1992, when the decline was 1.3%.

It is important to remember, however, that mean income is calculated from a sample of households (rather than the whole population), so we cannot be absolutely sure where its true value lies. Mean income growth between 2002–03 and 2003–04 could in fact have been slightly positive, or indeed could have been more negative. Similarly, HBAI statistics suggest

¹ http://www.labour.org.uk/fileadmin/manifesto_13042005_a3/pdf/manifesto.pdf.

² Department for Work and Pensions, *Households Below Average Income 1994/95–2003/04*, Corporate Document Services, Leeds, 2005.

³ M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Living Standards, Inequality and Poverty*, IFS Election Briefing Note no. 9, 2005 (<http://www.ifs.org.uk/bns/05ebn9.pdf>).

⁴ M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2005*, Commentary no. 99, Institute for Fiscal Studies, London, 2005 (<http://www.ifs.org.uk/comms/comm99.pdf>).

⁵ <http://www.conservatives.com/tile.do?def=manifesto.index.page>.

that median income grew by 0.5% between 2002–03 and 2003–04, but the true value of median income growth could have been slightly negative or more positive.⁶

As we show in Brewer et al.,⁷ incomes rose for all quintiles except the richest quintile in 2003–04 compared with 2002–03; it is only the income of the top quintile that was lower in 2003–04 than in 2002–03.

It is also worth noting that these figures from the Conservative manifesto are based on the same data source (HBAI) as those quoted above from Labour’s manifesto. Each party has chosen a different time period over which to measure growth in mean household income to make its own point.

3. Income growth across the whole population

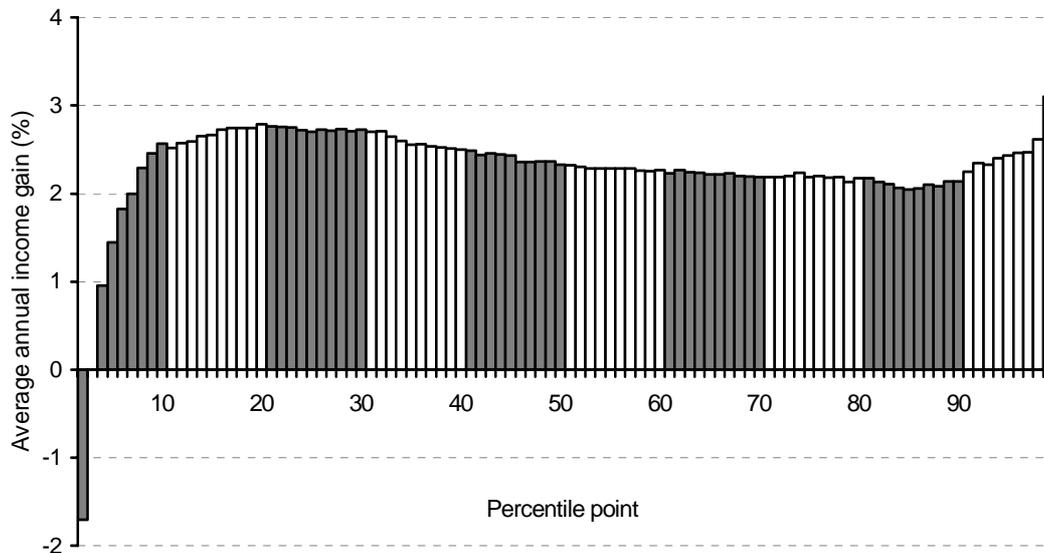
Labour’s manifesto

... living standards [have been] rising in double digits for every part of the income spectrum.

Page 11 of Labour, op. cit.

HBAI statistics show that average before-housing-costs (BHC) income has increased by more than 10% in real terms since 1996–97 for all 10 decile groups, when the average for each

Figure 1. Real income growth by percentile point, 1996–97 to 2003–04



Notes: The change in income at the 1st percentile is not shown on this graph in order to maintain a reasonable scale. However, at -16%, it is certainly very different from anything observed elsewhere in the distribution. However, it is important to realise that incomes are very unreliably measured at the very bottom of the income distribution, and so the changes here are likely to be very imprecisely measured.

Incomes have been measured before housing costs have been deducted.

Source: Authors’ calculations using Family Expenditure Survey and Family Resources Survey, various years.

⁶ For the confidence intervals for mean and median income growth, see M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Living Standards, Inequality and Poverty*, IFS Election Briefing Note no. 9, 2005 (<http://www.ifs.org.uk/bns/05ebn9.pdf>).

⁷ M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2005*, Commentary no. 99, Institute for Fiscal Studies, London, 2005 (<http://www.ifs.org.uk/comms/comm99.pdf>).

decile group corresponds to the midpoint, i.e. the 5th, 15th, 25th, 35th, 45th, 55th, 65th, 75th, 85th and 95th percentile points of the income distribution. Whether this can be described as double-digit rises in living standards ‘for every part of the income spectrum’ is open to question: HBAI statistics show income has grown by less than 10% in real terms since 1996–97 for the bottom four percentiles, and may indeed have fallen for the bottom three. However, incomes towards the bottom of the distribution are unreliably measured, so we cannot draw firm conclusions about this. Figure 1, taken from Brewer et al.,⁸ shows average annual real changes in income since 1996–97 for each percentile of the income distribution. An average real change of 1.4% or more per year would correspond to a double-digit increase over seven years.

Conservatives’ manifesto

Last year ... the poorest 10 per cent of Britons became poorer.

Page 3 of Conservatives, op. cit.

Average BHC income for the poorest decile fell by just three pence between 2002–03 and 2003–04 according to the HBAI data (measured by the change at the 5th percentile). This change is so small that we cannot be sure that incomes fell at all. Measured AHC, the decline was larger, but it is still unlikely to be statistically significant. There are concerns over how accurately incomes are measured at the bottom of the distribution, so we cannot be certain what has happened.

4. Taxation and income

Labour’s manifesto

As a result of personal tax and benefit measures introduced since 1997, by October 2005 families with children will be on average £1,400 a year better off in real terms.

Page 17 of Labour, op. cit.

Thanks to our reforms pensioner households are on average £1,500 a year better off, rising to £2,000 for the poorest third.

Page 12 of Labour, op. cit.

These statements were first made in Budget 2005 (paragraphs 1.35, 5.12 and 5.69). Both measure how much better off certain groups have become on average since 1997 as a result of changes to personal taxes, social security benefits and tax credits. Neither includes the impact of changes to indirect taxes, changes to council tax or changes to taxes levied on businesses, such as employer National Insurance contributions or corporation tax.

In IFS Election Briefing Note no. 1,⁹ we analyse the distributional impact of *all* tax and benefit changes since 1997 on households’ disposable income, having made assumptions about how tax changes that are levied on businesses are passed on to households. We estimate that non-pensioner households with children are £561 a year better off, and that pensioner households are £1,044 a year better off, through all of the tax and benefit changes since 1997

⁸ M. Brewer, A. Goodman, J. Shaw and A. Shephard, *Poverty and Inequality in Britain: 2005*, Commentary no. 99, Institute for Fiscal Studies, London, 2005 (<http://www.ifs.org.uk/comms/comm99.pdf>).

⁹ S. Adam, M. Brewer and M. Wakefield, *Tax and Benefit Changes: Winners and Losers*, IFS Election Briefing Note no. 1, 2005 (<http://www.ifs.org.uk/bns/05ebn1.pdf>).

excluding real changes in council tax. The difference between these estimates and those in the Labour Party manifesto arises because there has been a net increase in indirect taxes and changes to taxes that are levied on businesses.

When the above-inflation increase in council tax since 1997 is also included, non-pensioner households with children are, on average, £299 a year better off and pensioner households are, on average, £863 a year better off than they would have been had the (suitably indexed) 1997 tax and benefit system still been in place.

Labour's tax and benefit changes have usually benefited households with children or pensioners. Non-pensioner households without children have lost by an average of £688 a year through tax and benefit changes since 1997 excluding council tax changes, and by an average of £937 a year through tax and benefit changes since 1997 including council tax changes.

Conservatives' manifesto

Hard-working families have suffered from Labour's tax raids on mortgages and marriage, pensions and petrol, buying a home and having a job.

Page 3 of Conservatives, op. cit.

Table 1 in IFS Election Briefing Note no. 1¹⁰ shows the revenue effects in 2005–06 of changes in taxes and benefits since 1997. These are based on HMT published estimates that have been uprated to 2005–06 prices by growth in money GDP.

- Labour's abolition of mortgage interest relief at source has affected the cost of having a mortgage, and changes to stamp duty are very likely to have affected home-owners. The first of these measures raised £3.8 billion in 2005–06, and changes to stamp duty have increased revenues from residential properties by an extra £1.5 million (this figure does not include the extra stamp duty that has been raised because some of the thresholds have been frozen rather than being increased in line with inflation or house-price inflation).
- The removal of the married couple's allowance was worth £3.7 billion to the exchequer in 2005–06. But for those adults with dependent children, the married couple's allowance and associated additional personal allowance were succeeded by tax credits which are now worth more to families with dependent children with joint incomes of less than around £50,000.
- Repayable dividend tax credits were abolished, raising £7.3 billion in 2005–06, and analysis suggests that a large part of this is likely to represent an increase in the cost of providing private pensions (see the IFS Election Briefing Note on pensions and saving).
- Changes to road fuel duties in Labour's first term, as Labour extended the duty escalator introduced by the previous Conservative government, increased revenues by £4 billion in 2005–06. Freezes in fuel duty during Labour's second term have cost the exchequer £0.8 billion, though.
- The rise in National Insurance contributions, which are only paid by those people with sufficiently high earnings, in April 2003 raised £8.2 billion in 2005–06, but other changes

¹⁰ S. Adam, M. Brewer and M. Wakefield, *Tax and Benefit Changes: Winners and Losers*, IFS Election Briefing Note no. 1, 2005 (<http://www.ifs.org.uk/bns/05ebn1.pdf>).

to National Insurance and changes to income tax (other than changes to the dividend tax credit) have cost the government £4.6 billion in that year. Changes to personal tax credits, some of which have helped low-income workers, have cost the government £10.5 billion in 2005–06.

However, this is still a partial picture. Overall, central government tax and benefit changes since 1997 will have a net cost to the exchequer of around £2.2 billion in 2005–06. If the impact of council tax rises is also included, then central and local government tax and benefit changes since 1997 leave families slightly worse off, on average, than they would have been in the absence of tax and benefit changes.

Rising council tax bills, which are up by 76 per cent since Labour came to power, have hit pensioners particularly hard.

Page 4 of Conservatives, op. cit.

In real terms, council tax bills have increased by less than this quote suggests: on average, they rose by an average of 4.6% a year, or 44% overall, between April 1997 and April 2005.

But pensioner families do pay a higher proportion of their income in council tax than non-pensioner families. We estimate that in 2002–03 (the last year for which data are available on take-up of council tax benefit), net council tax as a proportion of disposable income, excluding council tax and council tax benefit, was 4.3% for single pensioners, 4.1% for pensioner couples, 2.3% for lone parents, 3.0% for couples with children, 3.2% for couples without children and 2.4% for single people without children. This suggests that, on average, the above-inflation increase in council tax since 1997 has hit pensioners harder than other families, although there is wide variation within pensioner families: those pensioners who receive the pension credit guarantee and who claim council tax benefit will pay no council tax and will have been unaffected by the rise in council tax, for example.

Liberal Democrats' manifesto

At present, people on low incomes or in old age have to pay a higher proportion of their income in taxes and government charges than those who are much better off. That cannot be right. Today, under Labour, the poorest 20 per cent of the population pay 38 per cent of their income in tax, compared with just 35 per cent for the richest 20 per cent. That is unfair.

Page 2 of Liberal Democrats, *The Real Alternative: General Election Manifesto for England*¹¹

These figures are derived from table 3 of Lakin,¹² which shows taxes (direct and indirect) as a percentage of gross income by quintile group in 2002–03, where gross income is defined as private incomes before tax plus social security benefits. It is more sensible to look at the overall impact of the tax and benefit system on people's incomes, rather than looking at the impact of taxes alone. For example, almost 60% of the poorest quintile group's gross income is in the form of cash benefits. This means that there is a large net transfer from the

¹¹ <http://www.libdems.org.uk/media/documents/policies/manifesto2005.pdf>.

¹² C. Lakin, 'The effects of taxes and benefits on household income, 2002–03', in *Economic Trends*, June 2004, no. 607, pp. 39–84 (http://www.statistics.gov.uk/downloads/theme_economy/ET607.pdf).

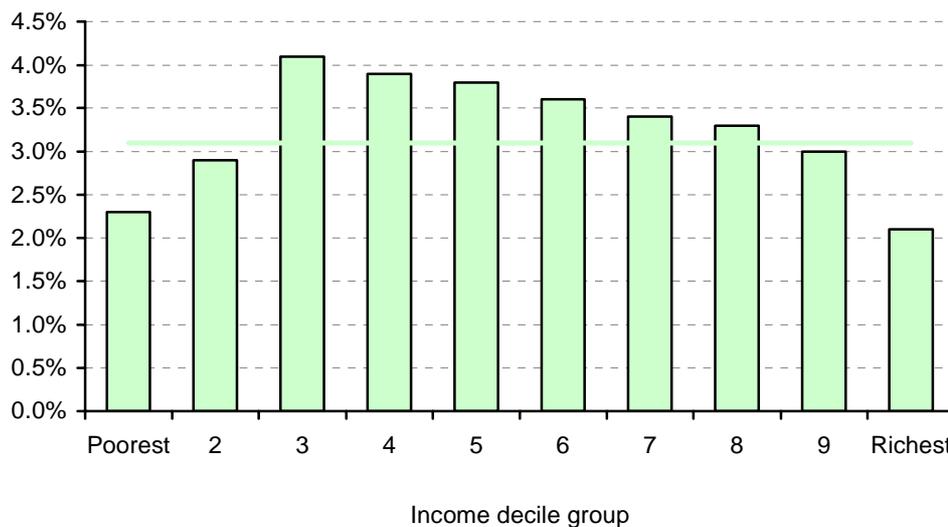
government to the poorest quintile group, and that there is a large net transfer to the government from the richest quintile group.

The Council Tax penalises pensioners and people on low incomes, who pay a far higher proportion of their income in Council Tax than the very rich.

Page 13 of Liberal Democrats, op. cit.

Council tax considered in isolation is a regressive tax: on average, poor households pay a higher fraction of their income in council tax than rich households. But the impact of council tax on low-income households' incomes is partially offset by council tax benefit: some families on a very low income who claim council tax benefit will effectively pay no council tax. The interaction of council tax and council tax benefit – net council tax – is regressive between the third income decile and the top income decile, but the bottom two deciles pay a relatively small proportion of their income in net council tax (see Figure 2). On average, families pay 3.1% of their disposable income in council tax. It is also important to realise that, in general, it is more meaningful to consider the effects of the tax and benefit system as a whole, rather than individual elements of it; however, this argument is stronger for national taxes than for those that can be varied locally.

Figure 2. Net council tax as a proportion of income, 2002–03



Notes: Assumes full take-up of council tax benefit and omits incidence of council tax on second homes. The horizontal line shows the average across all families.

Source: IFS tax and benefit model, TAXBEN, run on data from the 2002–03 Family Resources Survey.

5. Poverty

Labour's manifesto

There are two million fewer children and nearly two million fewer pensioners living in absolute poverty.

Page 11 of Labour, op. cit.

This statement uses an 'absolute' measure of poverty, rather than a 'relative' measure of poverty (the number of people living in households with income below 60% of 1996–97

median after housing costs (AHC) income). It is known as an absolute poverty measure because the poverty line is fixed in real terms. The statement is based on the fact that child poverty under this measure fell by 2.1 million between 1996–97 and 2003–04, and the number of pensioners living below the same income threshold fell by 1.9 million.

But it is not common to use an absolute measure to assess poverty in the UK. Indeed, in the Labour government's first term in office, it discussed poverty almost exclusively in terms of a relative measure: the most common example was to count people as poor if they had less than 60% of the median income in that year. This is known as a relative measure because whether someone is poor depends not just on their income but also on their income relative to the median. A fall in relative poverty requires the income of poor individuals to grow faster than that of those in the middle of the income distribution. The Labour government has a target for child poverty in 2004–05 to have fallen by at least a quarter from its 1998–99 levels, assessed using the relative measure of poverty.

With the poverty line set at 60% of median income AHC, 700,000 children and 800,000 pensioners have been moved out of relative poverty since 1996–97.

The Tories are the party of pensioner poverty. When they left office in 1997, one in four pensioners was living in poverty ...

Page 73 of Labour, *op. cit.*

This statement is based on the relative measure of poverty. In 1996–97, the proportion of pensioners in households with income below 60% of median 1996–97 AHC income was 27.9% (measured BHC, the figure was 22.1%).

In fact, pensioner poverty on this measure was no higher when the Conservatives left office than when they arrived in 1979: the rate of pensioner poverty in 1979 was 30.3% on the AHC measure and 29.6% on the BHC measure. However, poverty rates for pensioners have tended to fluctuate widely, increasing rapidly during booms – particularly in the mid- to late-1980s – and falling during recessions (this is because pensioners' incomes tend to be more stable over the economic cycle than the incomes of non-pensioners). The achievement of the Labour government in this area is that pensioner poverty has fallen since 1996–97 despite fairly rapid economic growth.

Using an absolute measure, pensioner poverty fell rapidly under the past Conservative government, from 2.7 million to 800,000 between 1979 and 1996–97 using a poverty line set at 60% of the 1979 median income AHC, or from 3.7 million to 2.3 million between 1990 and 1996–97 using a poverty line set at 60% of the 1990 median income AHC.