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Proposed Tax and Benefit Changes
Winners and losers in the next term

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Proposed tax and benefit changes: winners and losers in the next term

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Summary

- The government has announced a number of tax and benefit changes due to take effect between May 2005 and April 2009, and the opposition parties have said they would implement these policies if elected. The changes would raise £0.5 billion for the government. The lowest-income 30% of households would gain from these changes on average, with richer households losing on average. Families with children are more likely to gain than those without. Pensioners would lose on average, primarily because the value of winter payments is due to fall in Winter 2006.
- In addition to these changes, the Conservatives are proposing tax cuts and benefit increases worth £4.7 billion in 2009–10 (in 2005–06 prices). The gains are distributed relatively equally across the income distribution, but pensioner households would gain more, on average, than non-pensioners. The poorest non-pensioners, though, would see little gain from these changes.
- The Liberal Democrats are proposing tax and benefit changes that are roughly revenue-neutral. Low-income households would gain and high-income households would lose on average, although much of the loss is concentrated on a very small number of households in which someone has an income over £100,000 a year. Pensioner households would gain much more, on average, than non-pensioner households.
- On average, the highest-income three decile groups would gain most under the Conservatives, while the remaining seven decile groups would gain most under the Liberal Democrats. The highest-income two decile groups as a whole would fare worst under the Liberal Democrats, while the remaining eight decile groups would fare worst under Labour. All decile groups gain on average under the Conservatives, the bottom seven do under the Liberal Democrats and the bottom three do under Labour.
- Both the Conservatives and the Liberal Democrats are proposing more progressive packages than they did in the 2001 election. This is despite Labour introducing a more progressive package of reforms in its second parliament than in its first.

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1. Introduction

This Election Briefing Note shows how the tax and benefit reforms proposed by the three main UK parties would affect government revenues and the incomes of different groups in the population. It also shows how the changes to taxes and benefits already announced by the government and due to come into effect between May 2005 and April 2009 will affect household incomes.

2. What are we doing?

This Note compares the effect of the current tax and benefit system on household incomes with what its effect might be under each of the three main UK parties by the time of the next General Election (taken to be in four years' time, shortly after the April 2009 tax and benefit system comes into force), if each party implemented everything to which it has committed itself and introduced no other reforms.

We consider only changes to taxes, benefits and tax credits; we do not attempt to allocate spending on public services to particular households. These changes can be divided into two categories:

- those already announced by the government but that have not yet come into effect (discussed in Section 3). The costs or revenue yields of these measures have already been included in the government's public finance forecasts. The Conservatives and Liberal Democrats take these forecasts as the starting point for their proposals, implying that they would implement these policies unless they have explicitly stated otherwise.
- those proposed by the main parties (discussed in Sections 4 and 5). In fact, the Labour Party's manifesto does not propose any changes that have not already been mentioned in government documents and included in the public finance forecasts, so we analyse only the Conservatives' and Liberal Democrats' proposals (though see Box 1 on changes to paid maternity leave).

The starting point is to simulate what the April 2009 tax and benefit system would look like now if there were no policy reforms between now and April 2009, and to compare that with the likely April 2009 system given the reforms that have already been announced by the government.

We then use the IFS tax and benefit microsimulation model, TAXBEN, to calculate taxes due and entitlements to benefits on the same data on incomes, expenditures and demographic characteristics of households at a given point in time. Box 2 discusses how we deal with the fact that not every family receives the benefits and tax credits to which they are entitled.

However, there are a number of measures due to take effect between 2005 and 2009 that we cannot allocate to specific households in this way. These are predominantly certain taxes levied on businesses and on non-labour income, which are hard to allocate to particular households because patterns of stock ownership through institutions such as unit trusts and pension funds make it very difficult to know how share ownership and dividend incomes are

Box 1. Increasing paid maternity leave

The length of paid maternity leave is due to rise from six to nine months in April 2007, and all three parties have proposals to increase further the generosity of paid leave (see IFS Election Briefing Note no. 7;[a] the Liberal Democrats and the Conservatives have costed proposals for implementation in 2007, but the Labour Party has only an uncosted goal to be achieved by the end of the Parliament).

Data do not exist to enable us to model accurately the distributional impacts of the parties' proposals for paid maternity leave. The extent to which women would gain depends on their decisions on when to go back to work and their earnings before the period of maternity leave. We have therefore omitted the effect of increased paid maternity leave from our analysis of the parties' proposals.

However, as explained in IFS Election Briefing Note no. 7,[b] each reform would lead to a small number of winners, each gaining by a relatively large amount. No women on maternity leave would be worse off.

[a] M. Brewer, C. Crawford and L. Dearden, *Helping Families: Childcare, Early Education and Work–Life Balance*, IFS Election Briefing Note no. 7, 2005 (http://www.ifs.org.uk/bns/05ebn7.pdf).
[b] Ibid.

distributed across the population, and therefore to whom we should allocate such taxes. But simply excluding any reforms to these taxes from our assessment of the distributional effects of the government's pre-announced tax and benefit reforms could create a misleading impression: all taxes are ultimately paid by individual households. As a crude solution, therefore, we assume that the tax and benefit changes not modelled in TAXBEN have an impact proportional to household income.

We then take as a new starting point the likely April 2009 system given the reforms that have already been announced by the government, and we compare this with systems that reflect the policies proposed by the Conservatives and by the Liberal Democrats. As discussed in Box 1, data do not exist to enable us to model the distributional impacts of the parties' proposals for paid maternity leave. In some cases, the extent to which women would gain depends on their decisions on when to go back to work and their earnings before the period of maternity leave, which we cannot easily model, so we have omitted the effect of the proposals for paid maternity leave from our analysis.

Three key aspects of our methodology are worth stressing:[1]

- In simulating the April 2009 tax and benefit system, we take our 'no change in policy' baseline to be the default uprating assumptions made in the public finance forecasts. Alternative baselines that could be chosen are discussed in chapter 7 of the 2005 IFS Green Budget;[2] one implication of our choice is that the fiscal drag which all parties are relying on to increase tax revenues is not counted as a reform.

[1] Chapter 7 of R. Chote, C. Emmerson, D. Miles and Z. Oldfield (eds), *The IFS Green Budget: January 2005*, IFS, London, 2005 (http://www.ifs.org.uk/budgets/gb2005/05chap7.pdf) gives more detail of the methodology.

[2] Ibid.

- Our comparison is between alternative tax and benefit systems that could exist in 2009–10 (although we express all costings and incomes in 2005–06 prices unless otherwise specified).[3] This comparison tells us what the cumulative effect of the different parties' proposals would be on households in 2009–10. It does not, therefore, measure the gains and losses households experience *during* the period: we take no account, for example, of whether measures would be introduced early or late in the parliament, and therefore for how many years households would have benefited/lost from them.
- Because we model the effects of all the different proposals on the same data on household incomes, expenditures and demographic characteristics, we ignore any changes in

Box 2. Non-take-up of benefits and tax credits

A combination of lack of information and the time, effort and stigma costs of making applications means that many people do not claim means-tested benefits and tax credits to which they are entitled.

TAXBEN models households' entitlement to programmes, not their actual receipt. However, in this Note we have attempted to allow for the fact that some people do not claim the benefits to which they are entitled. This is a more desirable approach than that used in IFS Election Briefing Note no. 1,[a] which assumed full take-up and calibrated the final results to compensate. Given that the opposition parties are proposing to reform benefits for pensioners, who are less likely to claim means-tested benefits than non-pensioners, it is particularly important to consider the impact of non-take-up.

Our approach uses official estimates of the take-up rates of council tax benefit and of income support amongst pensioners in 2002–03[b] and early evidence on take-up of pension credit[c] to predict take-up rates for council tax benefit and the pension credit in 2009–10.

We allow take-up rates to vary by broad family types. Within each family type, we assume that the likelihood that someone who is entitled actually claims a means-tested benefit is unrelated to the amount to which they are entitled, with the exception that people who are entitled to the pension credit guarantee are assumed to be around twice as likely to claim the pension credit as people who are entitled only to the pension credit savings credit.

We continue to assume full take-up of all other means-tested benefits and tax credits, although this assumption has relatively little impact on the analysis in this Note.

[a] 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).

[b] Department for Work and Pensions, *Income Related Benefits Estimates of Take-Up in 2002/2003*, 2005 (http://www.dwp.gov.uk/asd/income_analysis/final0203btense.pdf).

[c] House of Commons Work and Pensions Committee, *Pension Credit*, Third Report of Session 2004–05, HC43-I (http://www.publications.parliament.uk/pa/cm200405/cmselect/cmworpen/43/43.pdf).

[3] The fact that we model the effect of the policies in 2009–10 and then deflate to 2005–06 prices largely explains why our costings do not always match those given by the parties.

households' behaviour (quantities purchased, labour supplied, etc.) that might occur because of differences between the tax and benefit systems. In practice, such behavioural responses are an important part of costing and evaluating the parties' proposals. For example, the Conservatives have costed their proposal to increase support for employee contributions to pension schemes at £1.7 billion (in 2007–08), but at only £1.0 billion if there is no behavioural response to the reform; we use the latter figure. The Liberal Democrats have costed their tax policies assuming that they induce no behavioural response, although they have left a contingency reserve to cater for such eventualities; previous IFS analysis has expressed doubt as to whether such an assumption is plausible (see http://www.ifs.org.uk/pr/libdem_tax.pdf), but in this Note we too assume no behavioural response (and therefore that their contingency reserve is unused).

3. Changes that have already been announced

Changes to the tax and benefit system that have already been announced and are due to be implemented between May 2005 and April 2009 will raise a net £0.5 billion (in 2005–06 prices) for the exchequer in 2009–10 compared with what the government's budgetary position would be if the current system were simply uprated in line with the conventional public finance assumptions.

The main changes that directly increase household incomes are the following:

- The pension credit guarantee will rise in line with average earnings in April 2006 and April 2007. Cost: £0.4 billion.
- The child element of the child tax credit will rise in line with average earnings in April 2006 and April 2007. Cost: £0.5 billion.
- The inheritance tax threshold will increase more quickly than inflation in April 2006 and April 2007. Cost: £0.1 billion.
- Paid maternity leave will be extended from six months to nine months in April 2007. Cost: £0.3 billion.
- The proportion of childcare costs that are reimbursed by the childcare element of the working tax credit will rise from 70% to 80% in April 2006. Cost: £0.1 billion.
- Child-related benefits and tax credits will be extended to cover 16- to 19-year-olds in training from April 2006. Cost: £0.2 billion.
- The current ISA limits will be extended until April 2010. Cost: £0.1 billion.
- Capital limits in means-tested benefits are set to rise. Cost: £0.0 billion.

The main changes that directly reduce household incomes are the following:

- The winter fuel allowance is due to fall to £150 from Winter 2006, from a level of £200 (or £300 for those aged 80 or over) in Winter 2005 (see Table 1). The additional 'one-off' payments for Winter 2005 announced in the last Budget and Pre-Budget Report will also disappear in Winter 2006. Revenue raised: £1.7 billion.

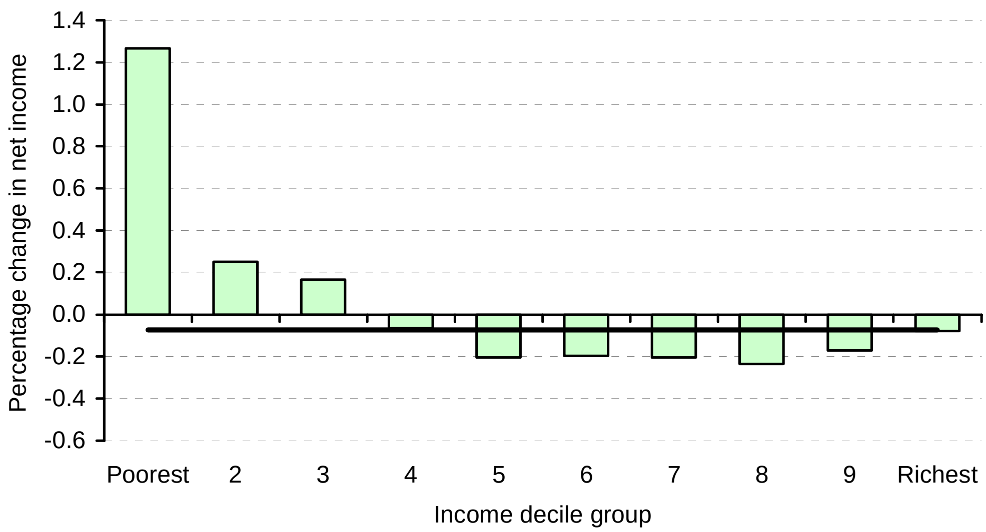
- Fuel duties will rise in September 2005.[4] Revenue raised: £0.2 billion.

In aggregate, these measures (and smaller ones not listed) will raise around £0.1 billion for the government in 2009–10. But there are also a set of changes that directly affect businesses (but will ultimately, of course, be passed on to households in some form) and some anti-avoidance measures which will, in aggregate, raise a further £0.4 billion.

Table 1. Rates of winter fuel allowance and associated payments

1997, 1998	£20 (£50 if on means-tested benefits)
1999	£100
2000–02	£200 (NB: PBR 2000 announced 'one-off' £200 for Winter 2000)
2003	£200 for those aged 60–79, £300 for those aged 80+
2004	£200 for those aged 60–79, £300 for those aged 80+ Plus 'one-off' £100 for those aged 70+
2005	£200 for those aged 60–79, £300 for those aged 80+ Plus 'one-off' £200 if 65+ and does not receive pension credit guarantee Plus 'one-off' £50 if 70+ and receives pension credit guarantee
Planned 2006	£150

Figure 1. Gains and losses across the income distribution from tax and benefit reforms due to take effect between May 2005 and April 2009



Note: Income decile groups are derived by dividing all households into 10 equal-sized groups according to net income adjusted for household size using the McClements equivalence scale. Decile group 1 contains the poorest tenth of the population, decile group 2 the 2nd poorest, and so on up to decile group 10, which contains the richest tenth.
Sources: IFS tax and benefit model, TAXBEN, run using uprated data from the 2003–04 Family Resources Survey and the 2001–02 Expenditure and Food Survey; authors' calculations using various Budgets and Pre-Budget Reports.

[4] This is the revalorisation that was due in April 2005 but was delayed until September. Since we are comparing the (uprated) May 2005 tax system with the likely April 2009 system, this counts as a real increase. Correspondingly, the delay counts as a real cut in 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), which analyses Labour's reforms from May 1997 to May 2005.

Figure 1 shows the estimated effect across the income distribution in 2009–10 of all these tax and benefit reforms. The net £0.5 billion fiscal tightening corresponds to an average loss of 36p per household per week,[5] or under 0.1% of household disposable income (the black line in Figure 1). This average effect is very small, but in fact the size of the change varies widely across the income distribution: the biggest gains are experienced by the poorest tenth of the population, who gain an average of £1.96 per week, or 1.3% of their net incomes, with smaller gains in the 2nd and 3rd poorest decile groups. The other seven decile groups lose, on average, with the biggest loss as a share of income experienced by the 8th income decile group, who lose on average £1.46 per week, or 0.2% of their incomes.

The large difference between the 1st and 2nd decile groups reflects our attempt to allow for the fact that many pensioner families do not claim the pension credit even though they are entitled. Because families that are entitled to the savings credit only are much less likely to claim the pension credit than those poorer pensioners who are entitled to the pension credit guarantee, a rise in the pension credit looks even more progressive than it would if we had assumed full take-up. Of course, if the take-up rate of the pension credit amongst pensioner

Table 2. Gains and losses for different household types from pre-announced fiscal reforms between May 2005 and April 2009

Household type	Percentage change in net income	Average change in net weekly income (£)	Proportion of population (%)
Single, not working	0.52	0.84	4.9
Single, working	-0.04	-0.15	10.3
Lone parent, not working	0.39	0.93	3.1
Lone parent, working	0.53	2.00	3.0
0-earner couple, no children	0.26	0.96	2.4
0-earner couple, children	0.40	1.32	1.3
1-earner couple, no children	-0.17	-0.85	4.9
1-earner couple, children	0.14	0.87	5.9
2-earner couple, no children	-0.08	-0.58	12.0
2-earner couple, children	-0.02	-0.11	10.7
Single pensioner	-0.49	-1.07	14.1
Couple pensioner	-0.52	-2.03	10.4
Multi-family household, no children	-0.10	-0.66	12.8
Multi-family household, children	0.06	0.57	4.4
All non-pensioners without children	-0.06	-0.31	47
All non-pensioners with children	0.11	0.60	28
All pensioners	-0.51	-1.48	25
All	–0.07	–0.36	100 (24.5 million)

Note: Multi-family households are treated as non-pensioners in the more aggregated groups.
Sources: See Figure 1.

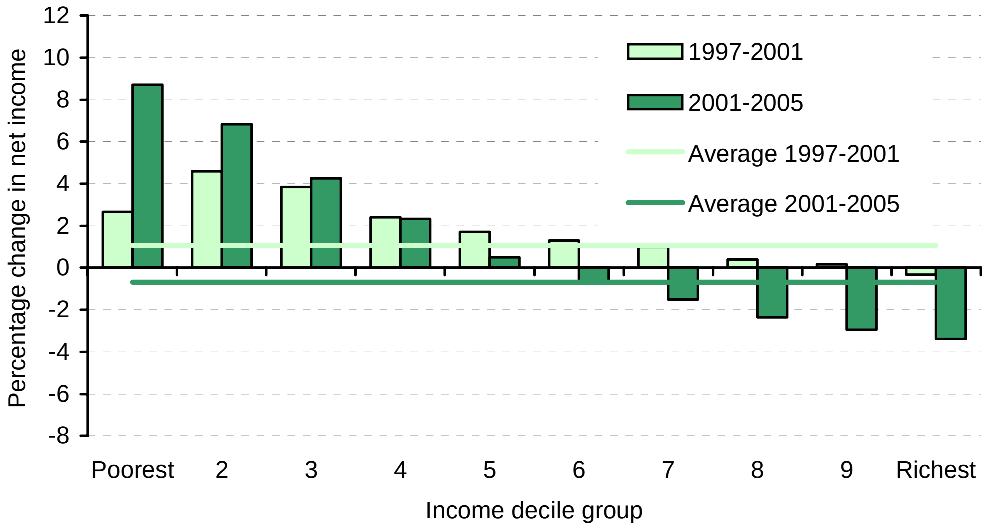
[5] Throughout this Note, 'average' refers to the mean.

families entitled only to the savings credit rises from its current level, then the gains in the 2nd and 3rd income decile groups would be higher.

In fact, the small changes among the bottom decile groups conceal a considerable variation between family types. Table 2 shows how the changes due after May 2005 affect different household types on average in 2009–10. Pensioner households lose on average, essentially because the money saved by cutting winter payments is more than that spent on increasing the pension credit. Families with children gain on average because of increases in the child element of the child tax credit. But all of the changes are small, amounting to average gains or losses of less than 1% of household income for all household types.

These tax and benefit changes are on a much smaller scale than those introduced by the Labour government in either of the previous two parliaments, shown in Figure 2: note that the vertical scale on Figure 1 is one-tenth of that on Figure 2 (see also table 1 of IFS Election Briefing Note no. 1[6]).

Figure 2. Gains and losses across the income distribution from fiscal reforms in the 1997 and 2001 parliaments (excluding impact of council tax changes)



Source: Figure 2 of 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).

4. The Conservatives' proposals

The Conservatives' plans involve implementing all the changes described in Section 3. In addition, they propose the following reforms:[7]

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[6] 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).

[7] As discussed in Box 1, we exclude the Conservatives' proposed reforms to paid maternity leave from the analysis. We also exclude their proposal to cut vehicle excise duty for new cars in the least-polluting categories, also because of a lack of data, but the Conservatives cost this proposal at only £60 million per year, so it should make little difference to the results.

- A 50% discount on the net council tax bills of pensioner households in England, capped at £500, where 'net council tax' means council tax less council tax benefit and a 'pensioner household' is one in which all members are aged 65 or over (from April 2006). Cost: £1.2 billion.[8]

- An increase in the threshold for stamp duty land tax, from £120,000 for residential properties and £150,000 for non-residential properties to £250,000 for both residential and non-residential properties (from April 2006). Cost: £0.8 billion.

Box 3. The impact of not implementing the planned council tax revaluation in England

Council tax in England is currently based on a property's estimated value in 1991. These values are currently being updated, so from April 2007 the council tax will be based on April 2005 house prices. The Conservatives have said that, if elected, they would not continue with this revaluation.

The aggregate amount of council tax that needs to be raised is determined by the amount that local councils spend minus the amount of grant that central government provides. The first-round effect of the council tax revaluation is not to change either of these factors, but instead to determine how the aggregate council tax bill is shared between different households.

Broadly speaking, cancelling the revaluation would mean redistributing from people whose property values have risen by less than the English average to those whose property values have risen by more than the English average. Estimating precisely which households would gain and which would lose from not carrying out the revaluation is complicated. This is because the change in a household's bill would depend both on whether their own council tax band changed as a result of the revaluation and on whether the overall council tax base of their local authority rose or fell relative to the rest of England.

On average, however, those who live in areas where house prices have risen the most since 1991 would gain the most under the Conservatives' policy of not proceeding with the revaluation. Figure 3 shows that, on average, those who live in London and the South-West would gain the most, while those in the North-West and Yorkshire and Humberside would lose the most.

More frequent preannounced revaluations would be more sensible than having ad hoc or no revaluations, for at least three reasons. First, it would seem more sensible to have a local tax in 2007 based on 2005 house prices than on 1991 house prices. Second, having regular revaluations means that changes in individual bills are likely to be less sharp. Third, having preannounced revaluations enables future council tax bills to be more easily taken into account by individuals who are buying homes.

[8] Here and elsewhere, we assume that council tax rates and local authority spending rise in line with inflation.

Box 3 continued

Figure 3. Relative increase in house prices, by region in England, 1991Q1 to 2005Q1

Sources: Authors' calculations using information from the Halifax Regional House Price Series (http://www.hbosplc.com/economy/HistoricalDataSpreadsheet.asp) and the ODPM website for information on the number of dwellings per region in 2005 (http://www.local.dtlr.gov.uk/finance/stats/data/dwellnew2.xls).

- An increase in support for individuals' contributions to funded pension schemes where these currently attract relief at the basic rate of income tax (from April 2006). Cost: £0.9 billion.[9]
- Increase the basic state pension in line with average earnings for the lifetime of the parliament (from April 2006). Cost: £1.4 billion.
- Introduce a flexible childcare payment (from April 2008). Cost: £0.5 billion.
- Cancel the planned revaluation of council tax in England. This would have no first-round net revenue effect (apart from possible administrative savings) and we do not model its distributional impact, but see Box 3 for a discussion.

These reforms would return a total of £4.7 billion to the household sector. The first three together cost an estimated £4 billion a year in 2007–08 (2007–08 prices) and form the

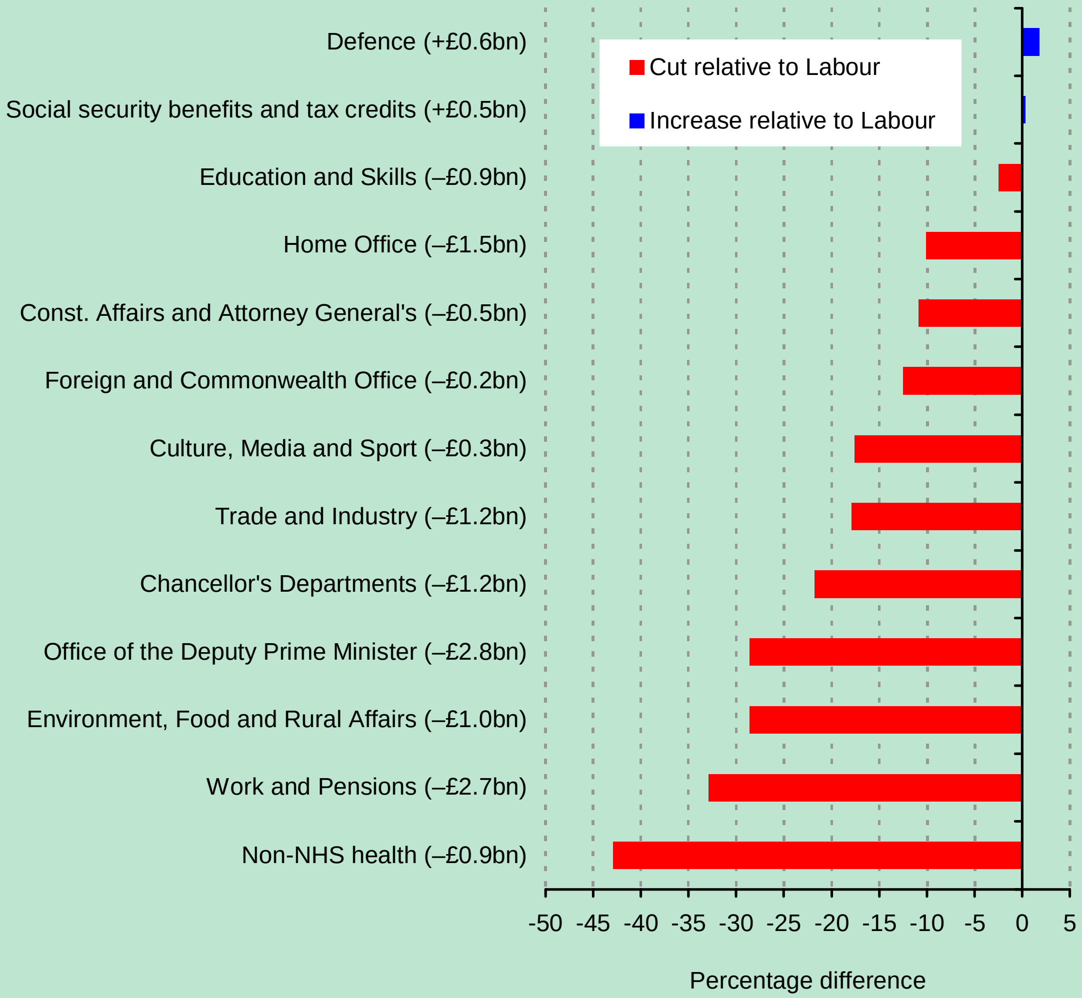
[9] As mentioned in Section 2, this is less than the cost assumed by the Conservatives, because we assume no change in behaviour while they allow for a large increase in pension contributions as a result of the policy. See the Appendix to C. Emmerson, G. Tetlow and M. Wakefield, *Pension and Saving Policy*, IFS Election Briefing Note no. 12, 2005 (http://www.ifs.org.uk/bns/05ebn12.pdf), for a fuller discussion.

Conservatives' three main tax cuts. These tax cuts, together with the increased spending on the basic state pension, are offset by cuts relative to Labour's plans in spending on public services in 2007–08. Box 4 looks at where the proposed spending cuts would fall, but this Note does not attempt to model the impact on households of the cuts in spending on public services.

Box 4. Where the Conservatives' £4 billion tax cut comes from

The analysis in this Note only looks at the parties' proposals that directly affect household incomes. The Conservatives are proposing to cut public spending, relative to Labour's plans, in 2007–08 by £12 billion. In terms of measures that directly affect household finances, they plan to increase spending by £0.5 billion; in addition, they plan a £0.8 billion increase in spending on defence and police, and a £13.3 billion reduction in spending on other public services, relative to Labour's plans. Figure 4 compares the Conservatives' spending plans for 2007–08 with those of Labour. For example, the Office of the Deputy Prime Minister would have a budget in 2007–08 that is £2.8 billion, or nearly 29%, lower under the Conservatives than under Labour.

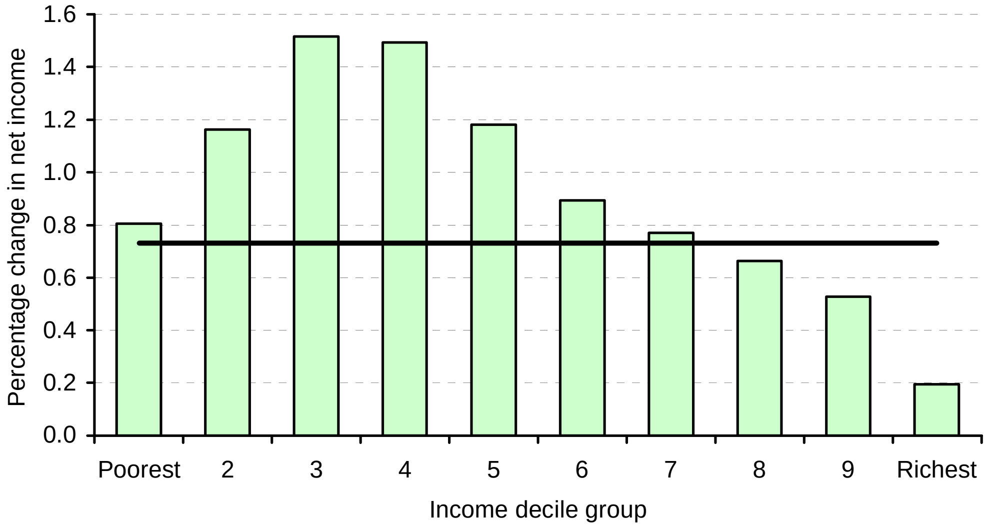
Figure 4. Conservatives' spending plans in 2007–08 relative to Labour's



Note: Lower spending on Home Office and Education and Skills by the Conservatives in 2007–08 relative to Labour to fall in areas other than spending on the police or spending on schools.
Source: C. Emmerson and C. Frayne, *The Public Finances: Election 2005*, IFS Press Briefing, 21 April 2005 (http://www.ifs.org.uk/election/tax_spend_public.ppt).

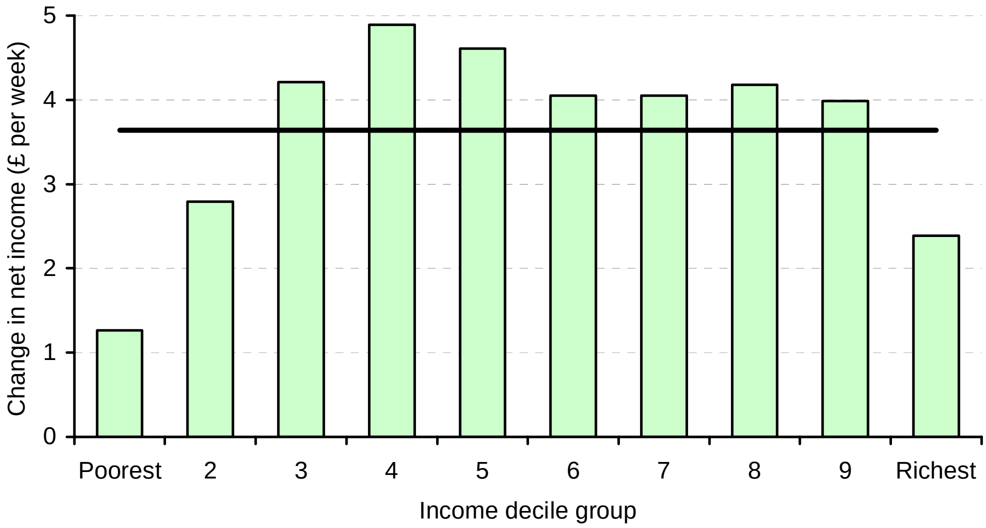
The Conservatives propose to introduce the flexible childcare payment in April 2008, at an estimated cost of £0.5 billion in 2009–10. This would presumably be matched by an offsetting cut in public spending, but, because 2008–09 and 2009–10 fall outside the period for which we have detailed public spending plans for either the government or the opposition parties, it is not possible to say where these cuts would fall.

Figure 5. Percentage change in net income across the income distribution from the Conservatives' tax and benefit proposals



Notes: See Figure 1. Excludes changes already announced by the government.
Sources: IFS tax and benefit model, TAXBEN, run using uprated data from the 2003–04 Family Resources Survey; authors' calculations using the British Household Panel Survey.

Figure 6. Average change in net income across the income distribution from the Conservatives' tax and benefit proposals



Notes: See Figure 5.
Sources: See Figure 5.

Table 3. Gains and losses for different household types from the Conservatives' tax and benefit proposals

Household type	Percentage change in net income	Average change in net weekly income (£)
Single, not working	0.2	0.30
Single, working	0.3	1.38
Lone parent, not working	0.1	0.13
Lone parent, working	1.7	6.14
0-earner couple, no children	0.4	1.57
0-earner couple, children	0.0	0.07
1-earner couple, no children	0.3	1.90
1-earner couple, children	0.2	1.12
2-earner couple, no children	0.4	2.52
2-earner couple, children	0.6	4.22
Single pensioner	2.4	5.20
Couple pensioner	2.7	10.88
Multi-family household, no children	0.4	2.80
Multi-family household, children	0.4	2.62
All non-pensioners without children	0.4	2.01
All non-pensioners with children	0.5	2.90
All pensioners	2.6	7.60
All	0.7	3.64

Notes: Excludes changes already announced by the government. Multi-family households are treated as non-pensioners in the more aggregated groups. For proportions of the population, see Table 2.
Sources: See Figure 5.

Figures 5 and 6 show the estimated effect across the income distribution in 2009–10 of the tax and benefit reforms proposed by the Conservatives over and above those already announced by the government. The Conservatives' proposals would increase household incomes by £4.7 billion, equivalent to £3.64 per household per week on average, or 0.7% of net incomes (the black lines in the graphs).

The changes proposed by the Conservatives would have the largest impact on incomes in the 3rd, 4th and 5th income decile groups. The smallest cash gain is in the bottom decile group, whose incomes rise by £1.26 per week on average, or 0.8%. The smallest percentage change is in the top income decile group, whose incomes rise by 0.2% on average, or £2.39 per week.

There are a number of reasons that households at the top and bottom of the income distribution are less likely to benefit than those in the middle:

- The cut in stamp duty is of benefit to those with houses worth between £120,000 and £250,000, who are unlikely to be at the extremes of the income distribution.[10]
- Private pension contributions from those in low-income families tend to be low (or zero), so they would benefit little from the increased support on offer; the measure is also not

[10] In common with past IFS work, we assume that the beneficiaries of a cut in stamp duty are existing home-owners, not home-buyers. This is likely to be the case except in so far as the cut in stamp duty leads to an increase in the available housing stock.

worth anything to higher-rate taxpayers (except in so far as their pension contributions exceed the excess of their income over the higher-rate income tax threshold).

- The flexible childcare payment benefits only households where all adults work, but the payment is means-tested away from those with high incomes.
- Many of the poorest pensioners are receiving full council tax benefit, and therefore cannot benefit from the halving of net council tax bills for some pensioner households. Similarly, those receiving pension credit guarantee would be unaffected by the increase in the basic state pension.

Table 3 shows how the proposed changes over and above those already announced by the government affect different household types on average. Pensioner households would be the largest gainers because of the council tax discount and the increase in the basic state pension, followed by working lone parents and two-earner couples with children, both of whom benefit from the flexible childcare payment. On average, non-working households gain by less than working households.

5. The Liberal Democrats' proposals

The Liberal Democrats' plans involve implementing all the changes described in Section 3. In addition, they propose the following reforms:[11]

- Abolish council tax and replace it with a local income tax (from April 2007). Cost: £2.3 billion.
- A new 49% rate of income tax on incomes above £100,000 a year (from June 2005). Revenue raised: £5.6 billion.
- A 'citizen's pension' replacing the basic state pension for those aged 75 and over, paid at a higher rate than the current basic state pension and increased in line with average earnings, and based on residency rather than past National Insurance contributions (from April 2006). Cost: £3.2 billion.
- A rise in the threshold of stamp duty land tax from £120,000 to £150,000 (to be implemented immediately after the election). Cost: £0.1 billion.

Together, these reforms are broadly revenue-neutral.[12] However, they have markedly different effects across the income distribution, as shown in Figures 7 and 8. The changes are strongly progressive, with gains inversely related to incomes. The largest proportionate gains are experienced by the bottom two decile groups, whose disposable income would rise by 5% on average, or £9.89 per week. On average, incomes in the first eight income decile groups rise, but, on average, incomes in the top two decile groups would fall, by 0.8% in the 9th decile group and by 4.6% in the top decile group.

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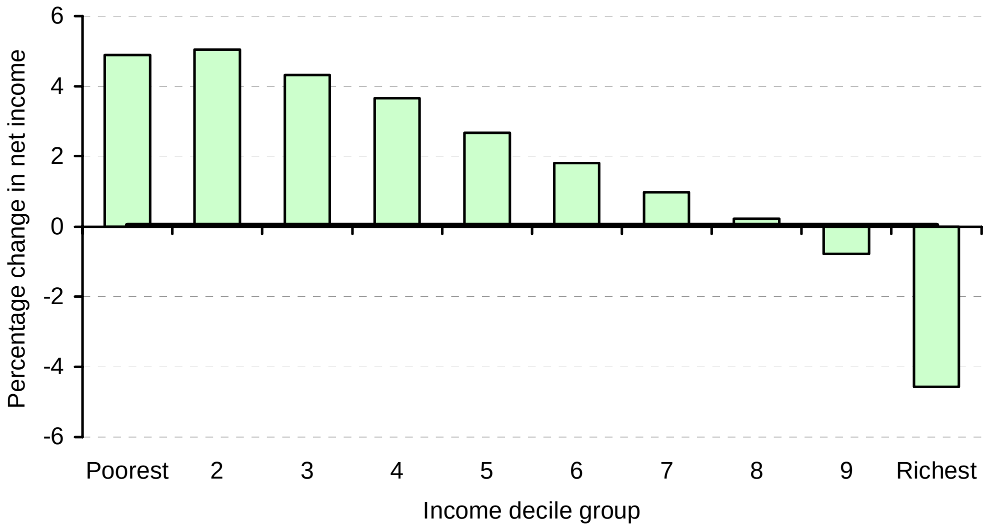
[11] As discussed in Box 1, we exclude the Liberal Democrats' proposed reforms to paid maternity leave from the analysis.

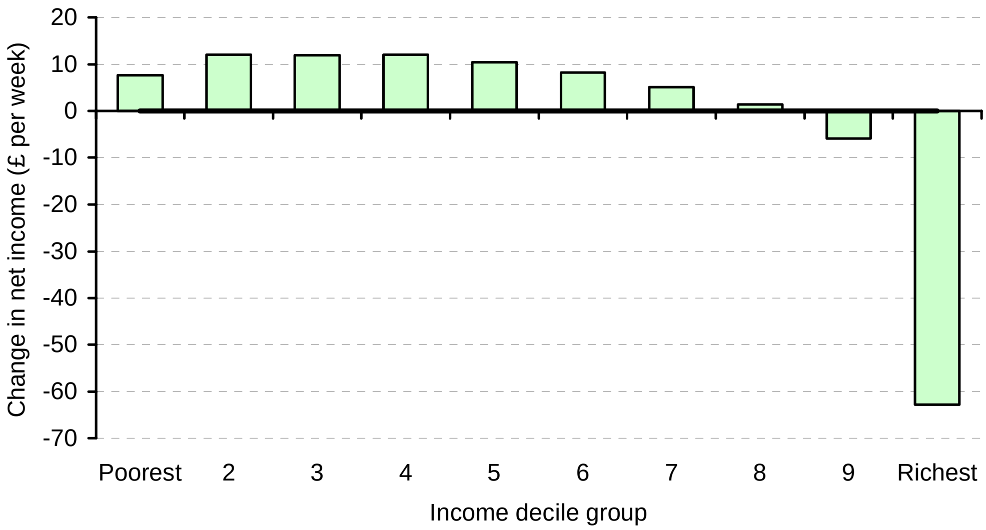
[12] The Liberal Democrats are proposing changes to public spending not analysed here that would also have a broadly neutral impact on public finances: see R. Chote, C. Emmerson and C. Frayne, *The Public Finances*, IFS Election Briefing Note no. 3, 2005 (http://www.ifs.org.uk/bns/05ebn3.pdf).

Figure 7. Percentage change in net income across the income distribution from the Liberal Democrats' tax and benefit proposals



Notes: See Figure 1. Excludes changes already announced by the government.
Sources: IFS tax and benefit model, TAXBEN, run using uprated data from the 2003–04 Family Resources Survey; authors' calculations using the British Household Panel Survey.

Figure 8. Average change in net income across the income distribution from the Liberal Democrats' tax and benefit proposals



Notes: See Figure 7.
Sources: See Figure 7.

The progressiveness of the reforms is partly explained by the fact that those aged 75 or over who would gain from the introduction of a citizen's pension are disproportionately to be found at the lower end of the income distribution. The gains are particularly marked amongst pensioners who are currently not claiming means-tested benefits to which they are entitled. Furthermore, because the Liberal Democrats are proposing to increase the citizen's pension in line with earnings for the lifetime of the next parliament, the citizen's pension would mean that even pensioners on the pension credit guarantee would be significantly better off from

April 2008, because the government has only committed to increasing the pension credit in line with earnings until April 2007.

A more important factor explaining the progressiveness of the reforms over the income distribution is the replacement of council tax by local income tax. Broadly speaking, this reform would benefit people with relatively low incomes and high property values at the expense of people with relatively high incomes and low property values. But while this means a local income tax looks more progressive than council tax over the distribution of current income, property values may capture aspects of ability to pay other than current income, such as wealth or expected lifetime income. The Liberal Democrats' proposals would therefore look less progressive over the distribution of lifetime income than over the distribution of current income shown in Figures 7 and 8.

The impact on the top decile group is, of course, dominated by the impact of the new 49% income tax rate on incomes over £100,000 a year: this policy alone costs the top decile group £42.13 per week. But the 49% tax rate does not affect all households in the top decile group

Table 4. Gains and losses for different household types from the Liberal Democrats' tax and benefit proposals

Household type	Liberal Democrats		Liberal Democrats, without 49% income tax rate	
	Percentage change in net income (%)	Average change in net weekly income (£)	Percentage change in net income (%)	Average change in net weekly income (£)
Single, not working	2.1	3.36	2.1	3.36
Single, working	–1.4	–6.23	–0.2	–0.76
Lone parent, not working	1.1	2.56	1.1	2.56
Lone parent, working	1.3	4.87	1.5	5.57
0-earner couple, no children	1.4	4.84	2.2	7.73
0-earner couple, children	2.8	9.05	2.8	9.05
1-earner couple, no children	–1.3	–8.96	0.6	3.66
1-earner couple, children	–1.8	–12.87	0.5	2.94
2-earner couple, no children	–1.4	–9.80	–0.7	–5.28
2-earner couple, children	–1.4	–10.88	–0.3	–2.35
Single pensioner	6.0	12.94	6.1	13.21
Couple pensioner	5.0	19.86	5.4	21.48
Multi-family household, no children	–0.2	–1.54	0.2	1.12
Multi-family household, children	–0.4	–3.25	0.1	0.92
All non-pensioners without children	–0.9	–4.60	–1.8	–0.09
All non-pensioners with children	–1.1	–6.07	0.2	1.15
All pensioners	5.4	15.87	5.7	16.71
All	0.0	0.01	0.9	4.38

Notes: Excludes changes already announced by the government. Multi-family households are treated as non-pensioners in the more aggregated groups. For proportions of the population, see Table 2.
Sources: See Figure 7.

equally: there are 2.5 million households in the top income decile group, but only 419,000 people in 2004–05 had incomes high enough to be affected by the new income tax rate; this is 0.9% of the UK adult population, 1.4% of those with incomes sufficiently high to pay income tax and around 17% of households in the top income decile group.[13] In the absence of this policy, the average change in the top decile group would be a loss of 1.7% of income (£20.67 on average), rather than 4.6% (£62.81 on average).

Pensioner households gain by more than non-pensioner households on average from the Liberal Democrats' proposals (see Table 4): as well as gaining from the citizen's pension, they tend to gain from the replacement of council tax by local income tax, since they have low incomes relative to their property values. Amongst non-pensioner households, the changes are dominated by this latter reform, which tends to lead to gains for low-income households and losses for higher-income households; accordingly, couples with at least one earner lose, on average, while lone parents and families with no workers gain, on average. Given that so few individuals have sufficiently high incomes to be affected by the 49% higher rate of income tax, Table 4 also shows the average changes omitting the impact of this policy. The figures change substantially for two-earner couples and for some other family types. Without the 49% income tax rate, the only household types to lose on average are single working individuals and two-earner couples, for whom bills under a local income tax would be larger, on average, than council tax bills.

6. Comparing the parties

The previous two sections have looked at the distributional effects of the Conservatives' and the Liberal Democrats' proposals over and above those already announced by the government, which the opposition parties have said they would implement. This section compares the likely changes in household incomes under all three main parties, relative to simply uprating the current tax and benefit system. As discussed earlier, both Labour and the Liberal Democrats plan a small fiscal tightening, while the Conservatives plan a rather larger giveaway, to be financed by cuts in public spending. Because the change from the preannounced reforms is much higher in the bottom income decile group than in the others, the combination of all tax and benefit changes that would take place under either a future Conservative or a future Liberal Democrat government would have a broadly progressive, income-inequality-reducing, effect, with the poorer income decile groups gaining more, on average, than the richer decile groups. The Liberal Democrats' proposals entail far more redistribution from high-income to low-income households than either of the other two parties', however – indeed, the pattern here is much more reminiscent of that under Labour to date (as shown in Figure 2) than are Labour's own proposals.

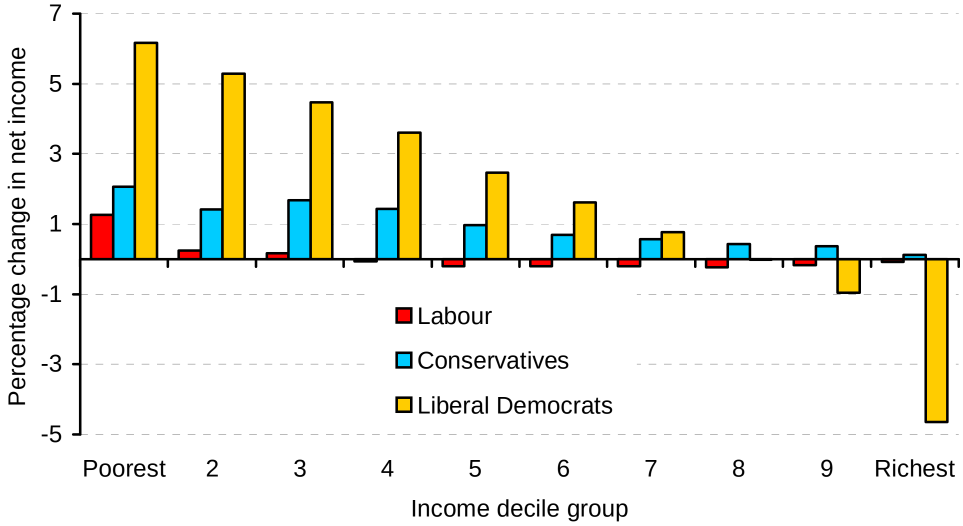
Figures 9 and 10 show that, on average, the highest-income three decile groups would gain most under the Conservatives, while the remaining seven decile groups would gain most under the Liberal Democrats. The highest-income two decile groups as a whole would fare worst under the Liberal Democrats, while the remaining eight decile groups would fare worst

[13] These numbers would be slightly higher by the end of the parliament, particularly because the Liberal Democrats have no plans to increase the £100,000 threshold even in line with inflation. But it would remain a very small proportion of the population and even of the top decile group.

under Labour. All decile groups gain on average under the Conservatives, the bottom seven do under the Liberal Democrats and the bottom three do under Labour.

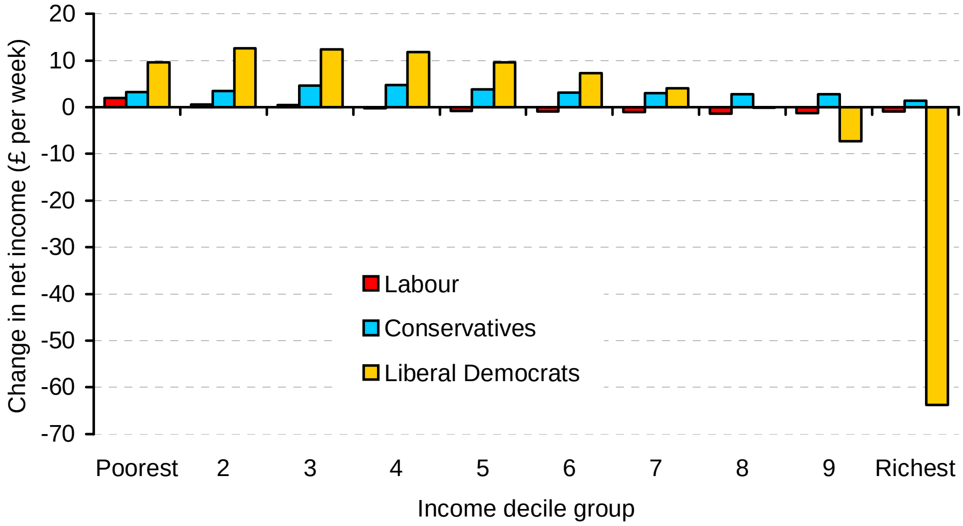
In a similar way, we can add the effects of the measures included in Tables 3 and 4 to those included in Table 2 to give the average changes from all tax and benefit changes due to take

Figure 9. Percentage change in net income across the income distribution from tax and benefit reforms proposed by the three main parties



Notes: See Figure 1. The average changes across all households are –0.1%, +0.7% and +0.0% under Labour, the Conservatives and the Liberal Democrats respectively.
Sources: IFS tax and benefit model, TAXBEN, run using uprated data from the 2003–04 Family Resources Survey and the 2001–02 Expenditure and Food Survey; authors' calculations using the British Household Panel Survey and various Budgets and Pre-Budget Reports.

Figure 10. Average change in net income across the income distribution from tax and benefit reforms proposed by the three main parties



Notes: See Figure 1. The average changes across all households are –£0.36, £3.28 and –£0.35 under Labour, the Conservatives and the Liberal Democrats respectively.
Sources: See Figure 9.

place under a future Conservative or a future Liberal Democrat government, and compare these with what would happen under a Labour government. This is done in Table 5, which shows the following:

- Households with children would gain on average from Labour's proposed changes, but they would gain by more on average from the Conservatives' proposed changes, and, unless they have an income over £100,000 a year, from the Liberal Democrats' proposed changes.
- Pensioner households would lose on average from Labour's proposed changes, but they would gain on average from the Conservatives' proposed changes, and they would gain substantially from the Liberal Democrat's proposed changes, unless they had an income over £100,000 a year.
- Non-pensioner households without children would lose slightly on average from Labour's proposed changes. They would lose by more on average from the Liberal Democrats' proposed changes, especially those with incomes over £100,000 a year. But they would gain on average from the Conservatives' proposed changes.

Table 5. Gains and losses for different household types from tax and benefit reforms proposed by the three main parties

Household type	**Average change in net weekly income (£)**			
	Labour	**Conservatives**	**Liberal Democrats**	**Liberal Democrats, without 49% income tax rate**
Single, not working	0.84	1.14	4.20	4.20
Single, working	-0.15	1.24	-6.38	-0.91
Lone parent, not working	0.93	1.06	3.49	3.49
Lone parent, working	2.00	8.13	6.86	7.57
0-earner couple, no children	0.96	2.54	5.81	8.69
0-earner couple, children	1.32	1.39	10.36	10.36
1-earner couple, no children	-0.85	1.05	-9.81	2.80
1-earner couple, children	0.87	1.99	-12.00	3.82
2-earner couple, no children	-0.58	1.93	-10.38	-5.87
2-earner couple, children	-0.11	4.11	-10.99	-2.46
Single pensioner	-1.07	4.13	11.88	12.14
Couple pensioner	-2.03	8.84	17.83	19.44
Multi-family household, no children	-0.66	2.14	-2.20	0.46
Multi-family household, children	0.57	3.19	-2.68	1.49
All non-pensioners without children	-0.31	1.69	-4.91	-0.41
All non-pensioners with children	0.60	3.50	-5.46	1.75
All pensioners	-1.48	6.13	14.40	15.24
All	-0.36	3.28	-0.35	4.03

Notes: Multi-family households are treated as non-pensioners in the more aggregated groups.
Sources: See Figure 9.

- Non-pensioner households in which no adults are in work would gain on average from all the parties' proposals, but they would benefit the most from the Liberal Democrats' proposals, because some of these households do not claim council tax benefit to which they are entitled and so would gain substantially from a local income tax.

It should be borne in mind that the IFS forecasts in the January 2005 Green Budget suggest that both Labour and the Liberal Democrats would need to tighten fiscal policy by 0.9% of national income (equivalent to £11 billion in 2005–06) in order to meet the fiscal rules to which they are committed with the same caution that the Chancellor was aiming for at Budget time, principally because we fear that the Treasury may be overoptimistic about future revenue flows. If this were to be the case – which both parties deny – then it would require a tax increase averaging 1.9% of income or £9.57.

7. A comparison with the changes proposed in the 2001 General Election

In their 2001 manifesto, the Conservatives promised to make £8 billion in tax cuts, to be funded by a net £8 billion cut in public spending. The Liberal Democrats were proposing increases in taxation and spending of a similar order of magnitude (just over £8 billion a year), but, because some of the increased public spending was on social security benefits, the change in net tax and social security benefits meant that household incomes would have fallen by around £4.4 billion. The Labour Party's manifesto contained uncosted pledges to introduce the child and working tax credits and the pension credit, which IFS estimated would together cost a minimum of £2.4 billion.[14] The IFS analysis of the 2001 election[15] considered the impact of reforms that had been announced but not yet implemented as part of the outgoing Labour government's record, rather than as part of the Labour party's proposals for the next term, as Section 3 of this Note does.

Figure 11 is a copy of the analysis produced by IFS during the previous General Election of how the changes proposed then would affect the 10 income decile groups, on the same scale as Figure 9. It shows the impact of the Conservatives' proposed tax cuts worth £8 billion (and also small benefit changes), an increase in net tax less social security benefits of around £2 billion from the Liberal Democrats' proposals (the Liberal Democrats proposed to raise £1.5 billion from capital gains tax, but this tax rise was not allocated to households in our old analysis), and the cut in net tax less social security benefits of £2.4 billion proposed by the Labour Party.

A number of points are clear when comparing Figure 11 with Figure 9:

- In 2001, the Conservatives were proposing tax cuts worth more to middle-to-high-income families than to low-income families. But in this election, partly because of their acceptance of Labour's proposed increases in spending on low-income families with children and pensioners, and partly because of the Conservatives' focus on pensioners,

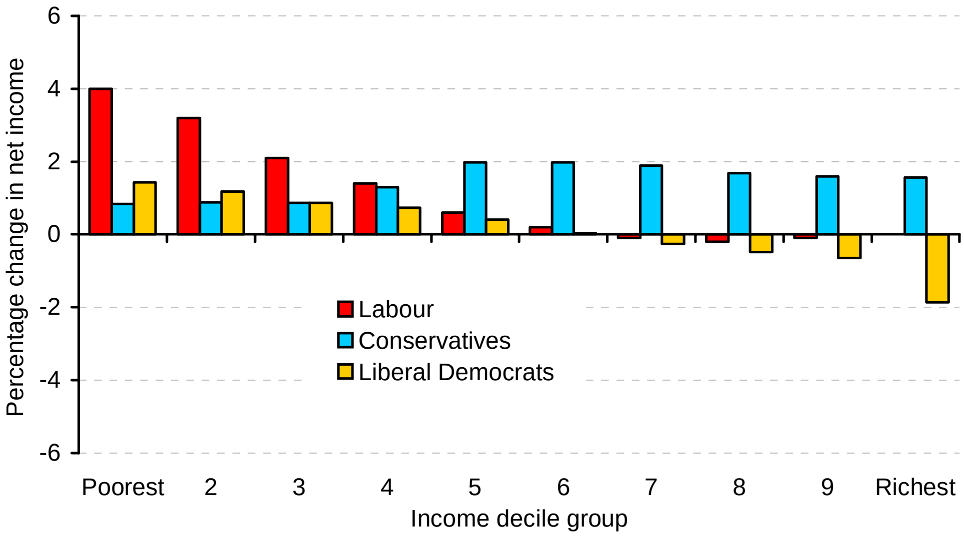
[14] These proved to be underestimates, because the government decided to increase the generosity of the credits when they were introduced.

[15] See http://www.ifs.org.uk/election/index01.php.

the gains from the tax cuts and benefit increases promised under a future Conservative government are worth more, on average, to low-income households than to better-off households.

- The policies proposed by the Liberal Democrats are more redistributive in 2005 than in 2001: low-income households would gain by more, on average, and high-income households lose by more, on average, from the changes proposed in the 2005 manifesto than those proposed in 2001.
- In 2001, the Labour Party proposed (albeit without costing) the introduction of benefits and tax credits that were worth considerable amounts to low-income pensioners and families with children. This is a much more expensive set of changes than those that it has already proposed for the period from May 2005 to April 2009.

Figure 11. Gains and losses across the income distribution from fiscal reforms proposed by the three main parties in the 2001 election manifestos



Note: Taken from T. Clark and A. Dilnot (eds), *Election Briefing 2001*, Commentary no. 84, IFS, London, 2001. Different methodologies mean that the analysis may not be fully comparable with that presented elsewhere in this Note.

8. Conclusion

The Conservatives and Liberal Democrats are offering bigger tax-and-benefit giveaways than Labour to households of most types and incomes. The Conservatives would achieve this by offering a net giveaway overall, financed by cuts in other forms of government spending. The Liberal Democrats would redistribute income from a relatively well-off minority of the population to other households.

For the Conservatives, it is uncertain whether the offsetting cuts in public spending can be achieved as quickly as the party hopes and with as little detrimental impact on the quality of public services. For the Liberal Democrats, it is uncertain whether their tax increases would raise as much money from the relatively well-off as they expect (although their plans include a reserve which would give them some margin for error). Like Labour, the Liberal Democrats also face the prospect of having to announce fresh tax increases or spending cuts to pay for their plans and to meet the fiscal rules to which all the parties have signed up if, as IFS researchers and other independent analysts fear, future tax revenues undershoot Treasury forecasts.

Labour to date has pursued an unambiguously redistributive policy, targeting extra resources on less-well-off pensioner households and families with children, while increasing the burden of tax on the better-off. Labour clearly signalled its desire to spend significantly more on low-income households in the run-up to the 2001 election, but on this occasion it has made its intentions much less stark.

Over the next couple of years, Labour has promised to increase means-tested support for its target groups in line with the living standards of people in work. But in recent years it has also targeted resources on different pensioner groups through a series of one-off payments. The problem with such an approach is that, at some point, either such payments have to stop being provided – in which case there will be losers – or the payments have to be made permanent and fresh spending commitments have to be accepted. Labour has not made such commitments to date, which helps explain why our analysis shows a net loss to households on average if Labour wins again.

If Labour were only to implement the measures it has promised to date in a third term, we would see a very different distributional pattern from the one we have seen under the party so far. If Labour wishes to continue providing extra resources to the least well-off, as has happened in recent years, it would need to raise the money from other households or reduce public spending.

This, in effect, is what the Liberal Democrats propose to do. The clearly redistributive pattern of their proposals is more in line with what we have seen from the government to date than Labour's own plans. The Liberal Democrats are, though, more willing than Labour has been to date to concentrate the pain on the very richest households.

The Conservatives' proposals offer a net giveaway to every decile of the income distribution, with the largest gains for the less-well-off rather than those on middle and higher incomes as was the case in their proposals at the last election.

Comparing the position of all three parties, therefore, it is interesting to observe that the proposals of the Liberal Democrats and the Conservatives are more progressive than their plans at the last election, while Labour's are less so.