# Labour is repeating the Tory mistake and boxing itself in

Answers to some questions involve more than a yes or no. So it is with the issue of tax. At the best of times discussion about tax can be complicated. This is particularly so during an election campaign, when complex statistics are interpreted in a variety of ways, possibly confusing the voter.

Tax has been the issue during the last week, following reports from the Council of Churches and the Institute for Fiscal Studies (IFS).

Taxes have risen since the last election, as Labour's posters continuously remind us. There have been 22 tax increases but there have also been 25 tax cuts. The most significant increases included a rise in National Insurance contributions from 9% to 10% for employees, the imposition of VAT on fuel at 8% and reductions to 15% in mortgage tax relief and the married couple's allowance. By contrast, major tax cuts have included an extension of the 20% tax band and two reductions in the basic rate of income tax, from 25% to 23%.

There is no definitive answer of how tax changes affect people, as personal circumstances differ and there is no representative example of the population. The IFS finds an average loss of £7 per week arising from tax and benefit changes, but as they report: "Only 56% of individuals live in households with an employee present."

It is important to stress that a household is not the same as a family. Single people and one-parent families are making up a larger proportion of households. Thus the growth in non-working households owes as much to social change as economics.

The largest losers from tax changes since the last election have been married couples, particularly those with children, who suffered from reductions in the married couple's allowance. This reduction always seemed strange, and now the Government wants to correct the damage, proposing transferable income tax allowances for married people.

But how well people do is not just determined by tax. As the economy has grown, so too have earnings. Under a progressive income-tax system, as earnings rise the average tax take increases. Hence changes in tax, benefits and earnings must be considered to see how people have fared. Despite being hard hit by tax, the net income of a married couple with one earner and two children has risen significantly during this parliament – up by £765.

Since the last year of the Labour Government in 1978/79 the total tax burden, as measured by taxes and National Insurance contributions, has risen from 34.25% of GDP to 35.75%. But it has fallen from 36.25% of GDP in the final year of the last parliament in 1991-92. The tax take fell for the first two years of this parliament, to 33.5% of GDP in 1993/94. Then it rose, following substantial tax increases in the March and November budgets of 1993.

The fact that taxes had to rise, despite promises made at the last election, highlights two lessons. First, governments should not commit themselves to policies that give little room for manoeuvre. No-one wishes to break promises but this may sometimes be the better option if the alternative of no change causes the economy greater problems. A government should always put the good of the country above a manifesto commitment. After sterling's ERM exit a rebalancing of policy was essential. Whilst the low pound and falling interest rates gave industry a boost and reduced the debt burden, taxes had to rise to curb domestic demand and reduce the budget deficit.

Second, the best policy now for the British economy is a tight fiscal stance and accommodating monetary policy. Just as devaluation and fiscal tightening were inevitable following the last election, whoever won, there could be a repeat performance this time. Not only is the pound too strong for the economy's own good but a further rebalancing of policy is inevitable at some stage, with upward pressure on taxes.

There is a danger that Labour is boxing itself in, having committed itself to the Government's tough spending plans and to no increases in income tax rates. Although spending plans can be exceeded this may be at the risk of upsetting the financial markets.

The Council for Churches' report saw things differently. They called for higher public spending, financed by taxation. This is a tax-and-spend policy that Old Labour would have been proud of. As the IFS report said, "we are a strikingly low-tax country" compared with Continental Europe. But tax increases cannot be seen in isolation from spending. And government spending here is also less than on the Continent.

Spending on the health service has risen by over two-thirds in real terms since 1979, and on education by one-third. Furthermore, social security costs each working person £15 per day.

Better public services have to be paid for. If economic growth remains buoyant, tax revenues will be healthy and problems will be avoided. Spending on public services will increase.

But the growth dividend may not be great. Then hard choices will have to be made. Taxes could rise or Labour may have to do the unthinkable and extend Peter Lilley's radical plans to privatise pensions. To put more money into education and health a Labour Government may have to privatise more of the welfare state. Labour's conversion to privatisation during the last week may be tame compared with some of the changes that could come.

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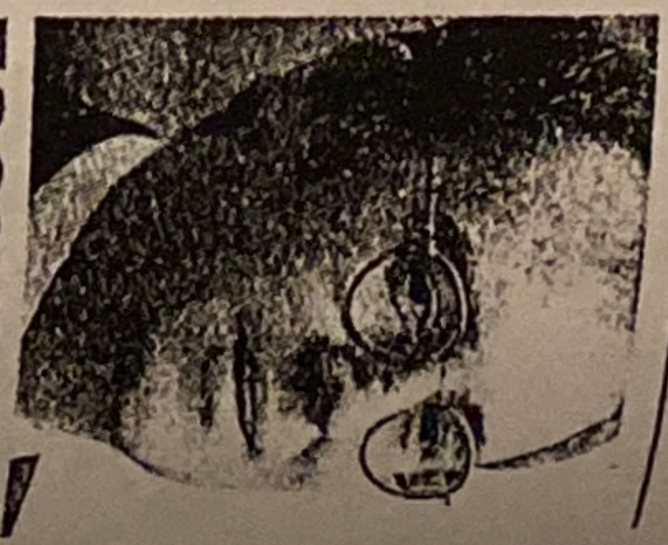

ECONOMICS WEEK

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