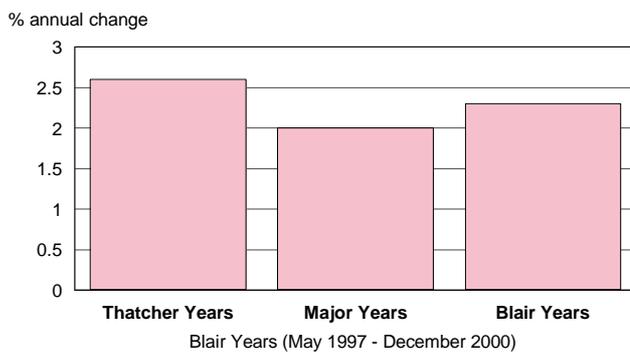


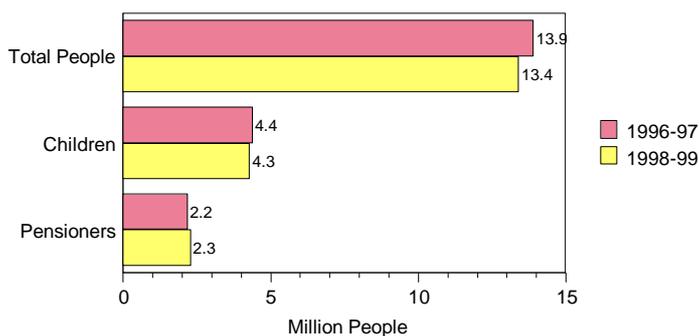
## Living Standards and Taxation Under Labour

### CHANGING REAL DISPOSABLE INCOME PER HEAD



### NUMBER OF PEOPLE WITH INCOMES BELOW POVERTY LINE

Incomes below 60% of contemporary median incomes



The end of Labour's first term in office is a natural moment to assess the extent to which their policies have brought about an end to widening income and wealth inequality, and whether or not average living standards in the United Kingdom have improved during the current Parliament.

Conditions for rising living standards have certainly been fortuitous with nine years of continuous economic growth, rising employment and a growth in average earnings for those in work that has outpaced price inflation.

These three factors have provided a platform for a general increase in prosperity - although the gains in real incomes have not been evenly spread across the income distribution and between and within the main regions of the UK. *Continued on page 2*

**Bank of England cuts interest rates to 5.25% in May—see page 4**

### ELECTION 2001 WEB SITES

**BBC NEWS ONLINE-VOTE 2001**  
<http://news.bbc.co.uk/vote2001/>

**FINANCIAL TIMES ELECTION 2001 COVERAGE**  
<http://specials.ft.com/ukelection2001/index.html>

**GUARDIAN ELECTION COVERAGE**  
<http://politics.guardian.co.uk/>

**Tutor2u Economics [www.tutor2u.net](http://www.tutor2u.net)**  
Tutor2u Economics is a resource for students and teachers. There are hundreds of pages of revision notes, links and a Discussion Forum.

### WEB SITES ON INEQUALITY

**JOSEPH ROWNTREE FOUNDATION**  
[www.jrf.org.uk/home.asp](http://www.jrf.org.uk/home.asp)

**INSTITUTE FOR FISCAL STUDIES**  
[www.ifs.org.uk/](http://www.ifs.org.uk/)

**CHILD POVERTY ACTION GROUP**  
[www.cpag.org.uk/](http://www.cpag.org.uk/)

## Living Standards under Labour

### AVERAGE INCOMES IN THE FIRST FOUR YEARS OF THE LABOUR GOVERNMENT

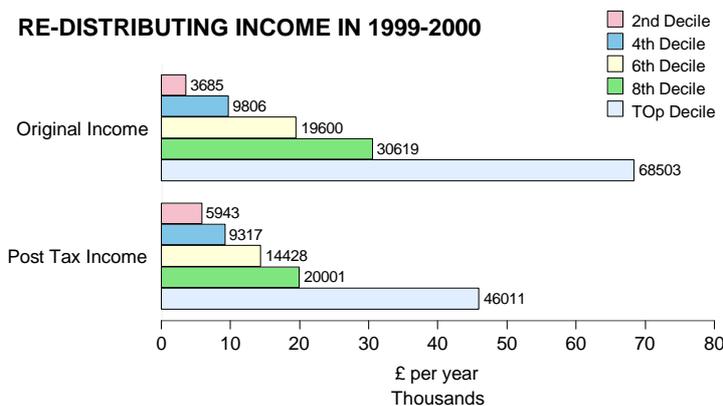
Research from the Institute of Fiscal Studies finds that real disposable income in the UK is 9% higher at the end of 2000 compared to the level when Labour swept to power in May 1997. This means that real disposable household income has grown by 2.3% per year - slightly higher than the 2% per annum achieved under Major's premiership (1991-1997) but smaller than the 2.6% annual average reached under Margaret Thatcher (1979-1990).

One might expect a faster pace of improvement in real post tax incomes. After all, pay has been rising faster than prices and by spring 2001, total employment in the UK was over two million higher than at the end of the last recession. The growth of real disposable income has been held in check by a rising tax burden (see page 3 of this Briefing). Two factors are worth highlighting. One is the impact of self-assessment - which has increased the number of people paying tax on at least two sources of earned income by several million in recent years. Another is the effects of fiscal drag - where tax payers see their tax payments rise quickly as they move into higher tax brackets and spend more on items carrying VAT @ 17.5% or with heavy excise duties.

The latest figures for income growth also exclude announcements made by Gordon Brown in his March 2001 Budget. These include a £5 per week increase in the basic state pension; a higher minimum income guarantee for pensioners, increased benefits for working families and an increase in the band on income on which the lower rate of income tax is paid. The most rapid gains in post tax income over the last four years have come towards the bottom end of the income scale. It becomes clearer with each budget statement that Gordon Brown is pursuing a co-ordinated strategy of income redistribution without changing the top rates of income tax.

During the Thatcher years, the average growth of net income for the poorest 10% of households was just 0.3%. Under Major, these groups saw their net income grow by 1.9% per year. In the first three years of the Blair government, this fell again to just 1.5% per year. But the combined effects of the most recent budget announcements together with the recent hike in the National Minimum Wage will provide a jump in disposable income for households at the bottom of the income ladder.

### RE-DISTRIBUTING INCOME IN 1999-2000



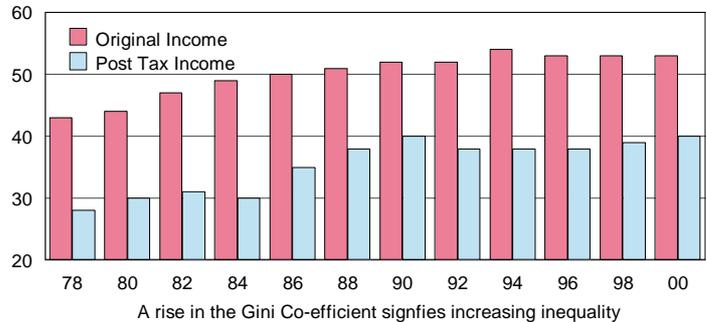
### INEQUALITY STILL RISING

Data released by the Office for National Statistics last month found that relative poverty has continued to worsen in the early years of the new Labour government. The most commonly used measure of income inequality is the Gini-coefficient. The higher the value of coefficient-coefficient, the wider the dispersion in pre or post tax incomes.

The Gini-coefficient increased from 0.31 in 1981 (perfect inequality gives a co-efficient of 1, complete inequality would have a value of zero) to 0.38 in 1997-98. Since then the figure has edged higher to 0.40 in 1999-2000.

### THE SCALE OF INCOME INEQUALITY HAS INCREASED

Gini Co-Efficient (max inequality = 100)



There is a long way to go before Labour can claim significant progress in halting the long term rise in inequality and perhaps reversing what appears to be a 20-30 year process.

The data also shows a small decline in the number of non-pensioners and children falling below the Government's chosen poverty line (i.e. annual income less than 60% of median after-housing costs income). But even allowing for this improvement, just under 24% of the population lie below the poverty threshold. Britain remains a rich country with one of the highest rates of child and pensioner poverty in the industrialised world.

Future trends in income inequality and relative poverty depend on the extent to which government policies can sustain recent falls in employment and attract more of the economically inactive back in the labour force. Brown's pledge this week to improve incentives to work for low income families is a reassertion of his long term strategy - Welfare to Work. The most effective route out of poverty for most households is to have at least one (preferably more) people in paid work.

## Taxation Under New Labour

### TAXATION UNDER NEW LABOUR

The General Election campaign has focused on the issue of the tax burden under the current Labour Government.

The Conservatives accuse Labour of having raised the burden of taxation through a series of stealth taxes. Labour responds by pointing out that it has kept to its 1997 manifesto commitment not to raise the basic or higher rates of income tax. And, it claims that its tax reforms have improved the incentives to work for millions of people towards the bottom end of the income scale.

So has the tax burden grown in the first four years of the Labour government? And if taxes are now substantially higher, can we blame a group of explicit tax increases made under Brown's time at the Treasury?

The latest evidence from the independent Institute for Fiscal Studies is fairly conclusive. Over the last four years, the annualised average real increase in total taxation under Labour has been 4.8%. This is more than double the annual growth in tax revenue under the Major government from April 1992-May 1997.

Because tax revenues have grown faster than real GDP, the share of GDP taken in tax has grown. The share of tax in the national economy has jumped from 37.6% in financial year 1996-97 to 40.5% in 2000-01. This rising share of tax in GDP is equivalent to £24.3 billion per year.

Labour claims that the Working Families Tax Credit should be treated as a form of negative taxation. This reduces the overall burden of tax to 37.7% in the current financial year.

### WHY HAVE TAXES GROWN SO STRONGLY

As is often the case with many economic trends - we must be careful to distinguish between cyclical and structural factors behind the rapid expansion of tax revenue.

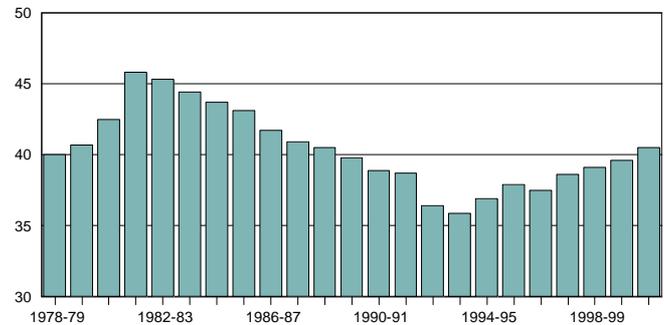
**Explicit increases in taxation:** For example the real terms increases in duty on fuel and tobacco; the introduction of the one-off Windfall tax on privatised utilities, higher taxes on pension funds, and an increase in national insurance contributions.

**Rising Prices and Incomes:** The economy has enjoyed nine years of sustained economic growth with incomes for most workers rising faster than prices. Higher employment and real incomes causes an effect known as fiscal drag - where people end up paying more in both direct and indirect taxes as they earn and spend more of their incomes. Company profits have also grown leading to a surge in revenue from corporation tax.

The basic rate of income tax has actually fallen during the first four years of the Labour Government - and there have been a series of targeted tax cuts aimed at lower income households. But their impact has not been sufficient to outweigh the effects of specific tax rises and fiscal drag.

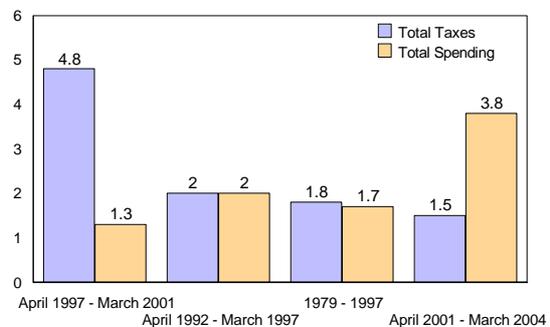
### THE UK TAX BURDEN HAS RISEN SINCE 1997

Total Tax Receipts as a % of GDP



### TAXATION AND SPENDING COMPARISONS

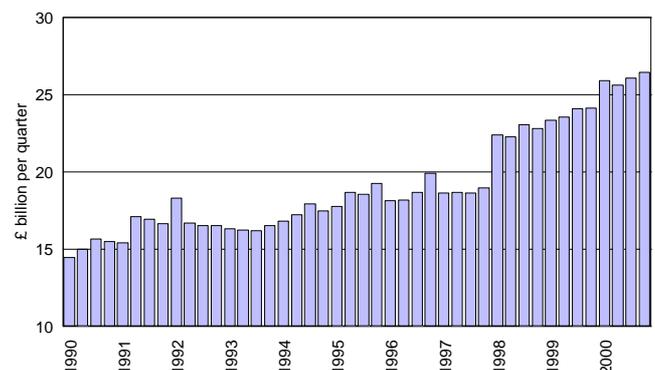
Annualised average real increase (%)



*Tax revenues under Labour have grown by nearly 5% per year in real terms. At the same time, the annual growth of total government spending has been substantially lower (just 1.3% per year). Little wonder that we have seen such a dramatic improvement in government finances since Labour came to power in May 1997.*

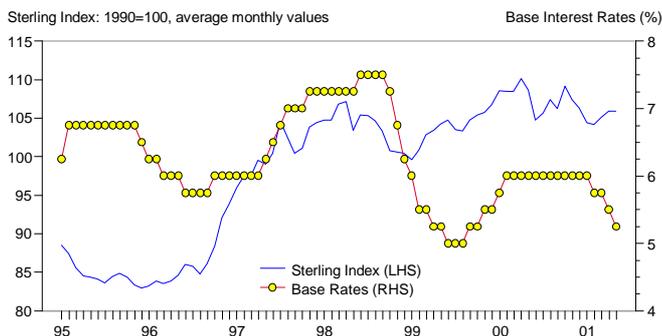
*The decision by Labour to stick to the previous Government's spending plans for their first two years in office is one reason for the gap between spending and tax revenue growth. Another is lower than expected inflation. A third (and important) factor is the strength of the economy leading to much lower unemployment and therefore cuts in the total spending bill for social security.*

### INCOME TAX PAID BY PERSONS

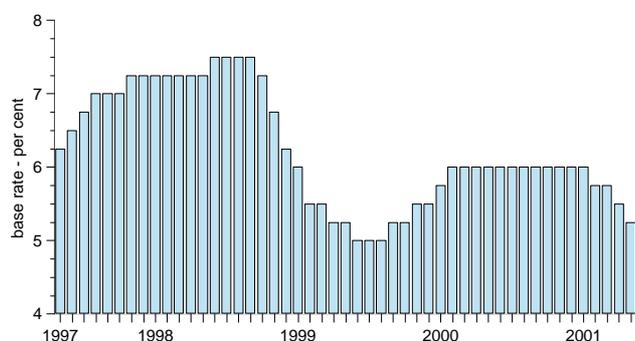


# THE WEEK IN REVIEW

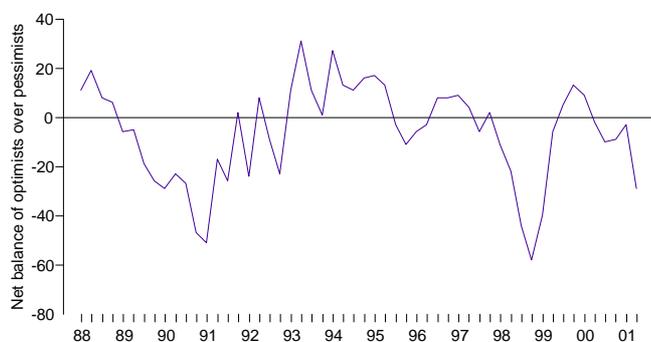
## STERLING EXCHANGE RATE INDEX AND BASE RATES



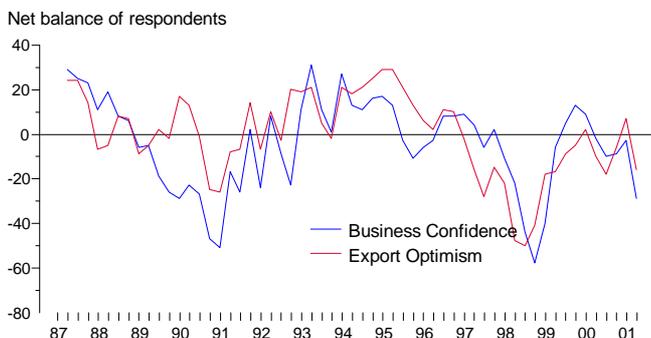
## UK INTEREST RATES SINCE BANK INDEPENDENCE



## CBI MANUFACTURING BUSINESS CONFIDENCE



## BUSINESS CONFIDENCE AND EXPORT OPTIMISM



## Interest Rates are Cut in the UK and the Euro Zone

*"The world economic prospect has on balance continued to weaken. The extent and duration of the slowdown remain uncertain."*

These words, taken from the MPC announcement of a further cut in UK base rates signify the Bank's desire and willingness to respond speedily to the risks of a sharper than expected UK economic slowdown.

The cut in interest rates was expected. Some economists felt that base rates might come down by a full 0.5% - but the Bank remains fairly committed to series of small rate changes as part of their strategy of matching demand growth with output potential in the economy. RPIX inflation has been below the official 2.5% target for over two years and most indicators of cost and price inflation remain subdued.

The European Central Bank also moved this week to cut interest rates for the twelve member nations of the Euro Zone from 4.75% to 4.5%. The ECB has been reluctant to ease monetary policy because of a greater risk of inflation than in the UK and the USA.

But the small cut (which came as a surprise to the currency markets) may not be universally welcomed! Currency traders caught on the hop by unexpected rate changes are unlikely to develop an enduring love for the Euro.

Is it in the best medium term interests for the ECB to develop a more predictable pattern of rate movements?

## SHARP FALL IN MANUFACTURING CONFIDENCE

The latest CBI Industrial Trends survey finds that confidence among UK manufacturers is at its lowest level for two years. In part the collapse in confidence shown in the April Survey may be due to the impact of foot and mouth disease - although most of the damaging effects of this crisis should be felt within agriculture and tourism.

Prospects for both domestic and export orders have fallen with manufacturing output flat and capacity utilisation falling. The growing uncertainty about the strength of demand in home and overseas markets continues to impact negatively on planned investment spending.

Consumer confidence is holding up better than optimism among producers and suppliers. This raises interesting questions. How much weight should we attach to survey evidence? Can we rely on the somewhat volatile nature of responses to questionnaires on the likely future trends in demand, output and employment?

And should we give a greater weight to consumer confidence indicators - since their spending decisions are likely to have the greatest impact on the overall level and growth of economic activity?