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LABOUR'S PROPOSALS

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Labour's proposals

Election Briefing Note 5 shows how households have been affected by Labour's tax and benefit reforms. This Election Briefing Note discusses further tax–benefit reform that Labour proposes to introduce if re-elected. The first section discusses three 'credits' the government is proposing to introduce – the integrated child credit, the pension credit and the employment tax credit. We analyse their likely effect on household incomes and how much each would cost to introduce.

The new credits represent developments of tax–benefit reforms implemented in the last Parliament, but Labour's manifesto also contains proposals for 'asset-based' welfare, which would represent more of a new departure. In particular, the party plans to introduce two new policies – the Child Trust Fund and the Saving Gateway. Both are targeted towards low-income households and provide financial assistance in the form of assets. This method of asset-based welfare delivery contrasts with (and is intended to complement) the traditional approach of providing social security benefits as income supplements. Section 2 considers some of the arguments for and against the proposed new approach.

Finally, we consider Labour's approach to income tax.

The analysis of these proposed reforms is not directly comparable to the analysis of the tax and benefit reforms that the other parties have proposed, in part because Labour has not yet budgeted for their introduction. In addition, a number of details of how these policies will operate remain undetermined.

1. Three new credits

The Labour manifesto repeats recent government proposals to introduce three new credits in 2003–04: an integrated child credit, an employment tax credit and a pension credit. The manifesto contains very little detail on how these would work, so the analysis below is based upon previous government documents.[1] Neither main opposition party is committed to the introduction of these credits, so we consider them as specifically Labour proposals.

The integrated child credit for families with children would bring together the child-related payments in income support, the working families' tax credit (WFTC) and the children's tax credit.[2] It would be paid direct to the main

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[1] See HM Treasury, *Tackling Poverty and Making Work Pay: Tax Credits for the 21st Century*, The Modernisation of Britain's Tax and Benefit System no. 6, HM Treasury, London, 2000, for the integrated child credit and the employment tax credit, and Department of Social Security, *The Pension Credit: A Consultation Paper*, DSS, London, November 2000, for the pension credit.

[2] See M. Brewer, M. Myck and H. Reed, *Financial Support for Families with Children: Options for the New Integrated Child Credit*, Commentary no. 82, IFS, London, 2001 (http://www.ifs.org.uk/taxben/icc.shtml), for more detailed consideration.

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carer (usually the mother) alongside child benefit. The credit would be means-tested upon the joint income of a couple. Around 80% of the 7 million families with children in the UK would be eligible for some integrated child credit, with the poorest families receiving £36 a week for the first child and £26 for subsequent children. It is intended for introduction in April 2003, and it would cost around £1bn to ensure that no families on means-tested benefits lost out during the transition. It is possible, depending on the precise details of implementation, that some dual-earning higher-income families with children could lose out.

The employment tax credit would extend the principle of the WFTC to around 500,000 low-income working families without children.[3] Eligibility would probably be restricted to adults over 24 working full-time, and it could be worth up to £59 a week for a couple (perhaps less for a single person). Like the integrated child credit, it would be means-tested upon the joint income of a couple. It would cost around £0.5bn.

The pension credit is designed to allow pensioners to benefit from modest private incomes.[4] It is planned that this would be introduced at the same time as increases in the minimum income guarantee (MIG) – of £100 per week (in 2003–04 prices) for a single pensioner, for example. The costs and distributional effects of this benefit increase were included in the analysis in Election Briefing Note 5, so this Election Briefing Note considers the accompanying structural reform in isolation from the increase. The most important element of such reform is the replacement of pound-for-pound withdrawal of MIG in respect of any income a pensioner has, with a 'taper', which would mean the pensioner would only lose 40p in benefit for each pound of private income they have secured in addition to their basic pension.[5] The benefit would be completely withdrawn for a single pensioner when net income before the credit reaches about £135 per week. It would cost around £900m to introduce, and around half of all pensioner households could be entitled to some pension credit.

These three new credits would blur further the distinction between the tax and benefit systems, and they might even achieve some genuine integration. The pension credit does not represent tax and benefit integration – it is really only an extension of the means-tested income support. But it might have a very different feel from income support as it would have an infrequent – perhaps annual – means test and no capital limits. The integrated child credit, though, represents a genuine integration of elements of the tax and benefit systems, as it would combine the child-related elements of means-tested benefits (income support and WFTC) and the Pay-As-You-Earn income tax system (the children's tax credit) to create a transfer that operates in the same way for all families with children in the UK.

[3] See Chapter 7 of A. Dilnot, C. Emmerson and H. Simpson (eds), *The IFS Green Budget: January 2001*, Commentary no. 83, IFS, London, 2001 (http://www.ifs.org.uk/gbfiles/gb2001.shtml).

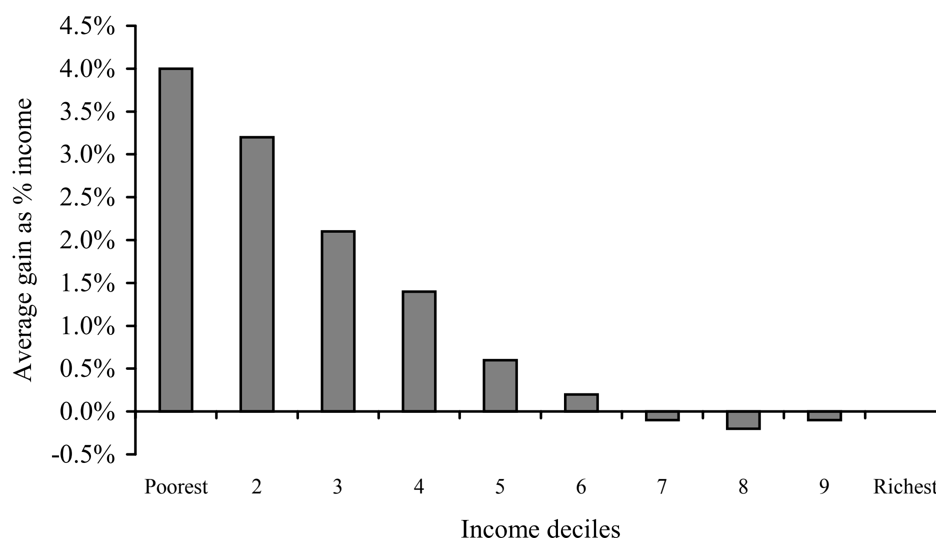
[4] See T. Clark, *Recent Pensions Policy and the Pension Credit*, Briefing Note no. 17, IFS, London, 2001 (http://www.ifs.org.uk/pensions/bn17.pdf), for more detailed consideration.

[5] Interaction with other means-tested benefits could mean that, in practice, significantly more than 40p in benefit is forgone for each pound of private income.

Distributional effects

We now turn to consider the distributional effect of all these credits, under particular assumptions regarding the details of how the credits will operate.[6] Granting these, we estimate that, taken together, the credits could cost around £2.5bn a year. Figure 1 shows the average change in household disposable income that would be felt in each income decile.

Figure 1. Gains from Labour's proposed new credits



Note: Assumes full take-up of the new credits and reflects a number of assumptions on how the credits will work.
Source: The IFS tax and benefit model, TAXBEN, run on 1996–98 Family Resources Survey data.

The credits are roughly progressive, with the gains concentrated in the lower deciles, and higher deciles losing slightly (as we have assumed that some families who are receiving the children's tax credit would not receive the integrated child credit). The gains are also progressive in cash terms, with the poorest two deciles gaining around £6 a week and the top three deciles losing under a pound a week. The progressive tenor of these reforms is consistent with the direction of many of the tax–benefit reforms introduced by the Labour government during the last Parliament.

Table 1 presents the average gains by family type. Families are presented in three sub-groups: families with children, pensioners and others. Of families with children, it is the two-earner couples who do least well, actually losing out under our assumptions about the operation of the integrated child credit.

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[6] Alternative ways in which each of the credits could operate are discussed respectively in M. Brewer, M. Myck and H. Reed, *Financial Support for Families with Children: Options for the New Integrated Child Credit*, Commentary no. 82, IFS, London, 2001 (http://www.ifs.org.uk/taxben/icc.shtml), Chapter 7 of A. Dilnot, C. Emmerson and H. Simpson (eds), *The IFS Green Budget: January 2001*, Commentary no. 83, IFS, London, 2001 (http://www.ifs.org.uk/gbfiles/gb2001.shtml) and T. Clark, *Recent Pensions Policy and the Pension Credit*, Briefing Note no. 17, IFS, London, 2001 (http://www.ifs.org.uk/pensions/bn17.pdf)

On average, all other classes of families with children gain, and it is workless couples and single parents (many of whom are without work) who fare best. The pension credit should produce comparable weekly gains in the household budgets of single and couple pensioners, each of whom will gain on average over £3 a week. Under our assumptions, childless families of working age will make more modest gains, despite the employment tax credit. In this respect, the introduction of the three credits would mirror Labour's fiscal reform during this Parliament, which, as seen in Election Briefing Note 5, has also principally helped pensioners and families with children.

Table 1. Average weekly gains from three new credits by family type

Family type	Average weekly gain
Families with children	
Single-parent family	£6.63
No-earner couple with children	£9.05
Single-earner couple with children	£3.95
Two-earner couple with children	–£1.18
Pensioners	
Single pensioner	£3.18
Pensioner couple	£3.24
Others	
Single, not employed	None
Single, employed	£0.97
No-earner couple without children	None
Single-earner couple without children	£1.45
Two-earner couple without children	£0.51

Note and source: As Figure 1.

The proposed new credits may all treat claimants with savings more generously than have traditional social security benefits, which have typically had stiff capital limits. The pension credit, in particular, is motivated by an explicit desire to reward saving. These policies show that the government is concerned to encourage low-income families to build up financial capital. The next section considers its new proposals to secure this goal more directly.

2. Asset-based welfare

Proposals for consultation

Labour is proposing two new asset-based welfare policies – the Child Trust Fund and the Saving Gateway. These had previously been discussed in the consultation document, *Saving and Assets for All*, where it was proposed that there should be further consultation about these policies in the autumn.[7] This section outlines what, at this early stage of the consultation process, we do and do not know about the form that these policies would take.

[7] HM Treasury, *Saving and Assets for All*, The Modernisation of Britain's Tax and Benefit System no. 8, HM Treasury, London, 2001.

The Child Trust Fund

This would be a savings account opened at birth for all children. It seems certain that the fund would have the following features:

- the government would pay an initial contribution into the account, (this element of the policy explains why it has become popularly known as the 'baby bond');
- the size of the initial contribution would vary inversely with household income, but all households would receive something;
- the assets would become available to the child when he or she reached early adulthood, possibly at age 18;
- family and friends would be given incentives to make supplementary contributions to the accounts.

There are many features of the scheme that remain unspecified:

- How generous would the initial payment be?
- Would it be supplemented by further state contributions later in the child's life?
- Would supplementary contributions receive tax relief, or would incentives to make these payments be provided by some other means?
- How active a role should families and/or children have in deciding how the funds are invested?
- What would be the best way to build financial education into the scheme?
- At what age should children get access to the funds, and should there be any restrictions controlling how the funds can be spent?

The 'illustrative examples' discussed in the final chapter of *Saving and Assets for All* give us a stronger hint about the form that the Child Trust Fund might take. These examples envisage a scheme that would pay an initial contribution of £500 to the poorest families, with further contributions of £100 when the child reaches ages five, 11 and 16. Richer households would get half these amounts. Assuming that the funds accumulated at a 5% real interest rate, the maximum state contributions would be worth approximately £1,640 when the child reached the age of 18.[8] Assuming that the scheme was set up in such a way that half the recipients would receive £500 and half would receive £250, and that children that have already been born would not be eligible for the age-triggered payments, the policy would cost approximately £300m in its first year.[9] The annual cost would rise somewhat as children reach the ages to qualify for the supplementary payments.

[8] It is assumed here that the interest is added annually and that the supplementary £100 contributions are uprated in such a way as to maintain their real value.

[9] This assumes 720,000 births in the year, which is approximately the number of births per year in the UK. See Office for National Statistics, *Annual Abstract of Statistics*.

The Saving Gateway

This would be a new type of savings account that would almost certainly have the following characteristics:

- only households with low income would be eligible to open an account;
- eligible households would be given strong incentives to divert some of their current income or assets into the account;
- incentives would be provided by the state paying money into the account to match a household's contributions, up to some maximum amount, thus hugely increasing the effective return received on these matched savings.

As with the Child Trust Fund, there are many features of the Saving Gateway that remain unspecified:

- What would be the eligibility criteria for the accounts?
- If eligibility is determined by an income test, would this involve household or individual income?
- Would changes in circumstances be taken into account when deciding on eligibility, and, if so, how?
- At what rate would matching occur?
- For how long would households be able to keep their accounts open?
- Would households be allowed to open second and subsequent accounts if they continue to satisfy the income criteria for eligibility after closing a first account?
- Would savers be allowed complete freedom to decide what they would do with their asset at the end of the 'gateway period'?
- If households are to be able to transfer their savings from these accounts into instruments such as individual savings accounts (ISAs) or stakeholder pensions, what implications does this have for the tax treatment of the accounts (and the other instruments)?
- Would savers be allowed access to their funds during the 'gateway period'?
- What would be the method for delivering financial education in conjunction with the Saving Gateway?

The illustrative examples in *Saving and Assets for All* are calculated assuming that: eligibility for the scheme would be determined according to some income test; the accounts would run for three years; contributions would be matched on a pound-for-pound basis up to a maximum of £50 per month. Without any more specific proposals, it is not possible to estimate how much the scheme would cost the exchequer. Furthermore, even with specific proposals, it would be difficult to cost a scheme that is intended to induce households to change their behaviour.

A rationale for asset-based welfare?

The Saving Gateway and the Child Trust Fund are two distinct policies. None the less, they share the common form of being 'asset-based' welfare policies: they both provide financial assistance to low-income households in the form of assets. We have highlighted above the fact that many things about the form of the proposed policies remain unresolved. This in part reflects the fact that the precise purpose of the policies – the failure that they are intended to correct – also remains vague. The proposed extended consultation period should help to clarify the rationale for the policies, which would in turn inform decisions as to their form. This section considers some possible justifications for asset-based welfare and comments on their validity.

The proponent of asset-based welfare must explain why it is a good idea to provide financial support to low-income households in the form of assets, rather than providing income and allowing families to choose whether or not to save. In a world where individuals rationally distribute lifetime income between consumption in each period, and in which everyone has access to credit markets, it is hard to see any advantage of asset-based welfare over income supplements. Families who were able to borrow against any asset that they were given, or save from their income, would choose to do so if this were the best way to allocate their resources, and so would be indifferent between receiving assets and receiving income. If opportunities to borrow are more restricted than opportunities to save, or if borrowing incurs a punitive interest rate, then households would prefer to receive income. A justification of an asset-based policy must depend on some feature of the world that is not adequately captured in this description and that would result in gains from increasing the asset holdings of poor people that outweigh the costs of the scheme.

Support for the proposed asset-based policies could be based on a view that it is equitable to extend incentives to save lower down the income distribution. Non-taxpayers do not benefit from existing tax breaks on savings instruments, and the capital limits for benefit eligibility make saving unattractive to those at the bottom of the income distribution. However, these points do not explain why it is good to have low-income households holding and accumulating assets.

If the policies are seen as a means of redistributing wealth, then support for them could be founded on the value judgement that a more even distribution of lifetime wealth between individuals is intrinsically good.[10] The government has not tended to take this line, but has argued that asset holding can help people to improve the outcomes that they achieve. This argument draws on evidence that asset holding has an 'independent effect on individuals' life chances'[11] in terms of outcomes such as health, education and employment

[10] A snapshot view certainly shows that current personal wealth is very unevenly distributed between individuals in the UK. See Box 2.3 in Chapter 2 of HM Treasury, *Saving and Assets for All*, The Modernisation of Britain's Tax and Benefit System no. 8, HM Treasury, London, 2001.

[11] Speech by David Blunkett to the Institute for Public Policy Research, 7 June 2000.

status, over and above that of income.[12] We now consider some reasons why such a link between asset holding and outcomes might exist, and what implications this has for the potential effectiveness and preferred form of asset-based welfare policies.

Learning to plan for life

One reason why people who hold assets might achieve relatively good outcomes is that they tend to be people who plan ahead. It is possible that this kind of attitude causes both asset holding and the achievement of good outcomes. This means that it is difficult to interpret evidence that asset holding is positively correlated with good outcomes as meaning that the former causes the latter. Furthermore, if the attitude of forward planning is crucial, then asset-based policies would not help to improve the outcomes achieved by the asset recipients any more than would income-based policies, unless they help to teach people to adopt a forward-looking outlook. Evidence is required to support the claim that giving people assets can teach them to plan ahead, but it is possible that giving assets to those who would not otherwise have had them could at least help to break down barriers such as lack of knowledge and trust of financial assets. If saving is a habit-forming activity, then this provides another route by which incentive schemes that get people to begin saving might induce them to continue to engage in this forward-looking activity.

It also seems plausible to argue that the policy is more likely to affect participants' attitudes if financial education is a part of the schemes. Initial evidence from experiments with matched savings in individual development accounts (IDAs) in the US suggests that moderate amounts of financial education (six to 12 hours) increase the amount that participants save;[13] other evidence suggests that regular financial education is needed in order to have a significant impact on saving behaviour.[14] It can also be argued that, whilst financial education is an important part of the overall package, giving this education in isolation would be ineffective because people would not take the advice seriously if they were not active savers. The government's initial consultation document suggests that there would be an element of financial education in any asset-based policies that are enacted.

[12] J. Bynner and S. Despotidou, *Effect of Assets on Life Chances*, Centre for Longitudinal Studies, Institute of Education, London, 2001, is cited as UK evidence in support of this claim. G. Kelly and R. Lissauer, *Ownership for All*, Institute for Public Policy Research, London, 2000, summarises some other evidence, including US evidence, to support this claim. We comment further on this evidence below.

[13] See M. Schreiner et al., *Saving and Asset Accumulation in Individual Development Accounts: Downpayments on the American Dream Policy Demonstration: A National Demonstration of Individual Development Accounts*, Centre for Social Development, George Brown Warren School of Social Work, Washington University, St Louis, 2001.

[14] See B. D. Bernheim, D. M. Garrett and D. M. Maki, 'Education and saving: the long-term effects of high school financial curriculum mandates', *Journal of Public Economics*, vol. 80, pp. 435–66, 2001, and B. D. Bernheim and D. M. Garrett, 'The determinants and consequences of financial education in the workplace: evidence from a survey of employees', Stanford University, Working Paper no. 96-007, 1996.

Intergenerational mobility

By intergenerational mobility, we mean the opportunity for individuals to move to a different part of the income (or wealth) distribution from that which their parents occupied. With respect to the policies under consideration in this section, the hope would be that the Child Trust Fund might help youngsters from families near the bottom of the income distribution to achieve high incomes relative to those of their parents. This kind of effect might be deemed particularly desirable, given evidence that children from low-income households find it difficult to move up the income distribution.[15] Whether or not one thinks that the policies proposed might be effective in this regard depends on whether or not one thinks that asset-based policies are the best way of providing youngsters from disadvantaged households with opportunities that they would not otherwise have.

Tackling credit constraints

One reason why those who hold assets might achieve better outcomes than those who do not is that the wealth can be used to fund large expenditures more cheaply than is possible for individuals who are forced to borrow. Giving assets to the poor might help to equalise this disparity. An 18-year-old who gains access to their Child Trust Fund could (ignoring possible restrictions on how the fund can be used) use the money to help fund further education or training, for travelling in a 'gap year', for property purchase or to start a new business, for example. Giving all youngsters more equal access to these opportunities might be valued on grounds of equity.

Even if one accepts such an argument, it is not clear that the Child Trust Fund is the best way to provide the opportunities. More direct interventions such as subsidised loans or grants are also possible. Additionally, the amounts involved in the current proposal would represent a small contribution to the cost of a year in education or that of a property purchase. This suggests that the case for the Child Trust Fund must rest not only on the expenditure opportunities that it opens up to young people from less wealthy backgrounds, but also on the other benefits of making young people asset holders, which are discussed elsewhere in this section.

Enabling people to cope with 'unforeseen' circumstances

The government cites the fact that assets can act as a 'cushion for families if they are hit by unemployment or other unexpected adversity'[16] in support of its proposals. It is true that savings provide this kind of buffer, but it is not clear that this justifies the cost of giving people assets rather than providing help through a social safety net. The safety net is a better-targeted way of providing assistance since it will only pay out to individuals who suffer a particular contingency. The extra cost of providing assets might be justified if there is evidence that individuals benefit from the knowledge that they are

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[15] See P. Johnson and H. Reed, 'Intergenerational mobility among the rich and poor: results from the National Child Development Survey', *Oxford Review of Economic Policy*, vol. 12, no. 1, pp. 127–42, 1996.

[16] Paragraph 1.4 of HM Treasury, *Saving and Assets for All*, The Modernisation of Britain's Tax and Benefit System no. 8, HM Treasury, London, 2001.

likely to be able to cope with future contingencies without becoming financially dependent on the state.

On the other hand, such peace of mind might in itself increase the cost of the policy if it makes people less averse to the risk of unemployment and so less inclined to work hard to avoid becoming unemployed or to search hard for new work. The means test for the policy might also give people an incentive to reduce their labour supply in order to reduce their income and qualify to receive the (largest available amounts of) assets. So, whilst providing people with assets might provide some insurance against unexpected adversity, the policy must be carefully designed to take into account any behavioural incentives that might increase the likelihood of unemployment.

Some problems with the policies

Can new saving be created?

One motive for introducing the Child Trust Fund and the Saving Gateway would be to encourage low-income households to save more and to turn some families who would not otherwise have saved into asset holders.[17] Although the Saving Gateway in particular would provide strong financial incentives to low-income households to save, it is not necessarily true that the policies would lead to all eligible households increasing the amount that they save. Both policies have a positive impact on the wealth of the households affected. Suppose that some of these households aim at a certain level of asset stock to provide for their children or to provide insurance against unforeseen contingencies. This level of asset holding could be achieved with less saving out of current income after the asset-based policies have been enacted, and so the households might be induced to save less, not more, out of current income. The problem is likely to be particularly acute with the Saving Gateway. Households that would have saved a little without encouragement are the most likely to choose to enrol on the scheme, and at least some of their saving would be accounted for by transfers out of other assets, not new saving.

These problems could be largely circumvented by careful targeting of the policies towards low-income households that would save little or nothing without encouragement. Some new savings would also be created if the matching element of the policy were generous enough to ensure that the incentives created would outweigh the wealth and asset-switching effects discussed above. On the other hand, very generous matching might induce some households to borrow (either from financial intermediaries or from family or friends) in order to save at a profitable effective rate of return. There might be some concern if this odd portfolio allocation were observed. Qualitative evidence from experiments with matched savings in the US suggests that at least some of the saving in IDAs is non-borrowed new saving.[18]

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[17] Paragraphs 1.5 and 1.6 of HM Treasury, *Saving and Assets for All*, The Modernisation of Britain's Tax and Benefit System no. 8, HM Treasury, London, 2001.

[18] See A. Moore et al., *Saving, IDA Programs and the Effects of IDAs: A Survey of Participants*, Research Report, Center for Social Development, Washington University, St Louis, 2001 (http://gwbweb.wustl.edu/users/csd/).

Should people on low incomes be saving?

We argued above that targeting the Saving Gateway at low-income households is one way to ensure that it generates new saving and savers. However, it is not obviously desirable to encourage this income group to forgo current consumption. The total amount of consumption that they can fund is small and hence these households might have good reason to think that they cannot afford to save. The problem would be compounded if saving incentives were to be integrated into the Child Trust Fund, thus encouraging families to forgo current consumption at a time when needs are increasing with family size. These considerations perhaps explain why the traditional approach favours giving welfare assistance via income supplements that can be spent immediately. They also suggest that policies encouraging saving out of current income might be best directed towards the working poor rather than towards the poorest recipients of welfare benefits.

The issue is further complicated by the fact that, whereas savings are held for forward-looking reasons, an eligibility test based on current income does not take future circumstances into account. This might result in some households with high lifetime income being assessed to be eligible to receive assets because current income is low, and, conversely, some households with low lifetime income but high current income being assessed to be ineligible. Leaving this issue aside, we can also ask how low current income might be related to expected future income and so to the desire to save. Households with low current income might expect their circumstances to improve. It might not be optimal for such households to be saving from current income, and indeed they might even be wise to borrow against future income.

Controlling the use of funds

If part of the aim of the Child Trust Fund is to encourage spending on certain things, such as further education or training, then it may be decided that there should be restrictions placed on how the funds can be spent. From a practical point of view, this might be difficult to do if youngsters can substitute between expenditure from this part of their budget and expenditure out of current income. The problem would be small if the largest funds were given to youngsters who would otherwise have spent very little on the designated purposes. On the other hand, if the reason for their low spending is that they gain little from such expenditures, then having such restrictions would reduce the benefits of the policy. It would seem necessary to allow some flexibility in how the funds can be spent in order to ensure that children from low-income backgrounds really do benefit.

3. Labour policy on income tax

The Labour manifesto makes two main pledges on income tax:

- to extend the 10p tax band;
- not to raise the basic or top rate of income tax.

The pledge to widen the 10% band is not by any specific amount, so it might be regarded as an ‘aspiration’, like the Liberal Democrat aim of abolishing the

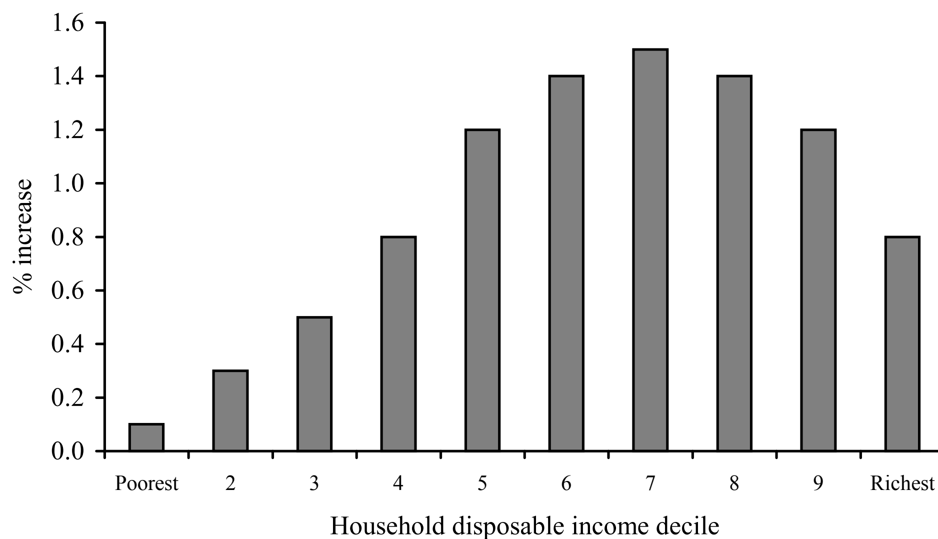
10% band and the Conservatives' longer-term target of raising the higher-rate threshold.

Labour could double the width of the 10p starting-rate band of income tax to £3,760 at a cost of about £4.9bn. If this occurred, the typical gross income required before the basic rate was payable would increase from £6,415 to £8,295.[19] Figure 2 shows the effect across the household income distribution. The poorest 30% of households would gain little, as most do not have sufficient income to pay income tax and so cannot gain from its reduction.

To gain in full from this reform, an individual must have an income of £8,295 or more – for only in this case do they possess the full range of income on which the marginal tax rate has been reduced. There are more such individuals in higher income deciles than lower, so, in cash terms, it is the top two income deciles that gain most – families in both stand to gain over £7 a week each, compared with average cash gains of £1 a week in decile 3 and £5 a week in decile 6. The more the 10p band is widened, the higher the income required to gain from it in full. This means widening the 10p band grows steadily less progressive.

In proportional terms, though, the tax cut brings most benefit to families in the upper-middle of the income distribution. This is because every individual in receipt of an income in excess of £8,295 receives a flat-rate cash gain of about £4.35 a week. Proportionately, this is worth more to those with incomes only modestly above this level, rather than those at the top of the income distribution. So Figure 2 shows that proportional gains peak at 1.5% in decile 7 before falling back to 0.8% for the top decile.

Figure 2. Distributional effects of doubling the width of the 10% starting-rate band of income tax to £3,760



Source: The IFS tax and benefit model, TAXBEN, run on 1998–99 Family Resources Survey.

[19] Throughout the discussion, we assume a childless individual born after 1935 with no special tax allowances or credits.

The pledge not to raise the higher or basic rate of income tax is repeated from the 1997 manifesto. Of course, it does not preclude increases in other taxes, but it does not even rule out rises in income tax itself. Income tax can be increased by cutting back on tax allowances (as the married couple's allowance was abolished in this Parliament), by extending the income tax base or by reducing the income at which particular rates are payable. Reducing the threshold at which the basic rate begins to be charged is incompatible with the proposal to widen the 10p band, but the higher-rate threshold could theoretically be cut.

But these alternative means by which to raise income tax grow more difficult to find as they are increasingly exploited. Many tax allowances are already less generous than they used to be, and the attraction of reducing the higher-rate threshold might be judged to be reduced by the large growth in the number of higher-rate taxpayers that the last two decades have already witnessed. Policies that increased the marginal rates faced by some without altering the formal level of income tax rates – for example, through restricting the personal allowance – might be judged to go against the spirit of the income tax pledge. Similar charges might be levelled against policies that could be used to raise money in a manner that mimicked the effects of increasing income tax rates – for example, raising National Insurance rates.

During the last 20 years, when resources have been available for tax cuts, they have very frequently been delivered by cuts in income tax rates. At the same time, tax increases have been implemented in alternative ways. This asymmetry risks making alternative means of increasing tax less attractive. In doing so, it makes a pledge to avoid higher income tax rates an increasingly significant constraint on tax policy.

4. Conclusions

In the first section of this Election Briefing Note, we discussed three credits that the Labour Party intends to introduce if re-elected – the integrated child credit, the pension credit and the employment tax credit. We saw that the introduction of these credits would be consistent with the direction of many of the reforms to taxes and benefits that have been introduced by the Labour government during the last Parliament. They would be progressive and also continue the shifts towards joint assessment, integration of (or at least a blurring of the distinction between) taxes and benefits, and the use of means-tested benefits.

Like the credits, the Child Trust Fund and Saving Gateway proposals would show certain continuities with much of the tax–benefit reform introduced in the last Parliament: the policies would increase state support for children, low-income children in particular. The 'asset-based' means of delivery, however, is new. We have highlighted the need for careful thought about precisely why it might be better to provide people with assets rather than income. If the motivation is to encourage forward planning amongst young people and to aid intergenerational mobility, then maybe carefully designed policies could achieve some success. However, the policies involve a financial cost and, in assessing them, we must be careful to consider whether this money could be

better used. Traditional income benefits are not the only alternative. Another is providing direct subsidies to those undertaking education or training. Yet another would be provision of financial education. Education and training might represent a good way to help youngsters from poor backgrounds to achieve higher incomes than their parents; financial education might be a good way to encourage forward planning.

Asset-based welfare has many potential aims, some of which constitute more convincing rationales for the approach than others. Should Labour win the election, before more detailed policies are settled it will be important to specify more precise objectives. Once these are known, consultation will be important in determining the exact shape the policy should take.