Pointmaker

THE COST OF LABOUR

ESTIMATING THE EMPLOYMENT EFFECTS OF LABOUR'S TAX POLICIES

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SUMMARY

- The Labour Party has announced a number of tax policies it intends to implement if it wins the next election.
- In this paper the employment effects of Labour's tax policy programme, including eight tax rises and two tax cuts, are estimated.
- Between 2015/16 and 2018/19, Labour's tax policies could lead to 300,000 fewer jobs than currently forecast by the OBR.
- Between 2015/16 and 2018/19, Labour's tax policies could lead to a fall in nominal GDP of £18.8 billion relative to the OBR's forecast.
- Over the entire Parliament, Labour's tax programme could lead to 375,000 fewer jobs and over £25 billion reduced GDP.
- Including a specific design of a Financial Transactions Tax, the fall in jobs could be 700,000 by 2018/19.

1. INTRODUCTION

Since the 2010 General Election, the Labour Party has announced a number of tax policy proposals which it intends to enact if it wins the next General Election in 2015. This paper estimates the potential impact on GDP and employment that this programme of tax policies could have in the next Parliament if they were implemented.

It is assumed that these tax policies are immediately enacted in an emergency Budget in the event of a Labour victory in the General Election in May 2015 (unless otherwise stated). This paper does not consider the impact of the use of any net tax revenue which is generated.

Labour's programme includes ten major tax policies of which eight are tax rises and two tax cuts. The tax rises are:

1. Increasing the Corporation Tax rate from 20% to 21%.[1]
2. Increasing the top rate of Income Tax from 45% to 50%.[2]
3. Reintroducing a 50% payroll tax on bank bonuses.[3]
4. Increasing the levy on bank balance sheets.[4]
5. Introducing a tax on houses worth above £2 million.[5]
6. Imposing a levy on the profits of payday lenders.[6]
7. Reintroducing Stamp Duty Reserve Tax.[7]
8. Introducing a Financial Transactions Tax.[8]

The tax cuts under consideration are:

9. Introducing a new 10% Income Tax rate.[9]
10. Cutting and freezing Business Rates.[10]

Between 2015/16 and 2018/19, the OBR expects employment to rise by 1.03 million. This paper finds that if Labour implements its programme of tax policies, all other things being equal, the job creation over the same time will be 723,500. Table 1 shows how this implies a loss of 306,500 jobs over the first four years of the next Parliament.

[1] http://labourlist.org/2013/09/transcript-ed-milibands-2013-conference-speech/

[2] http://www.bbc.co.uk/news/uk-25894312

[3] http://www.ft.com/cms/s/0/8dbfc2aa-a867-11e3-a946-00144feab7de.html#axzz3DDEtlJUF

[4] http://blogs.spectator.co.uk/coffeehouse/2013/09/labour-conference-ed-balls-speech-full-text-and-audio/

[5] http://www.standard.co.uk/comment/ed-balls-a-mansion-tax-will-make-the-housing-market-fair-for-all-9556524.html

[6] http://www.theguardian.com/money/2013/oct/17/labour-new-tax-payday-lenders

[7] http://press.labour.org.uk/post/61771352534/we-will-scrap-david-camerons-bedroom-tax-by-closing

[8] http://www.moneymarketing.co.uk/miliband-gives-support-on-financial-transaction-tax/1039021.article

[9] http://www.theguardian.com/politics/2013/feb/14/ed-miliband-10p-tax-band

[10] http://labourlist.org/2013/09/transcript-ed-milibands-2013-conference-speech/

TABLE ONE: COMPARISON OF OBR FORECASTS AND IMPACT OF LABOUR'S TAX POLICIES

No. of jobs created	2015/16	2016/17	2017/18	2018/19
OBR Forecast	250,000	250,000	260,000	270,000
Labour's Policies	183,000	146,500	192,500	201,500
Difference	67,000	103,500	67,500	68,500

Over the course of the entire Parliament, it is possible that approximately 435,000 jobs will be lost as a result of the implementation of Labour's tax programme.

Due to the considerable uncertainties over the design of a Financial Transactions Tax, the employment effects of this policy have not been considered. However, under a particular design of the FTT, the loss of employment could reach 700,000.

2. GENERAL FRAMEWORK

GDP is defined as the sum of Total Domestic Demand and Net Exports alongside the Statistical Discrepancy which is unchanged from the OBR's forecast outlined in its Economic and Fiscal Outlook[11] published in March 2014. Total Domestic Demand is in turn, the sum of Private Consumption, Private Investment, Government Consumption, Government Investment, Net Acquisition of Valuables and the Change in Inventories.

Government Consumption, Government Investment, Net Acquisition of Valuables and the Change in Inventories are all assumed to be unchanged from the OBR's forecast.

The key mechanisms by which these tax policies will impact GDP are household incomes and company profitability. The change in household income is modelled as a proportion of the net tax change. Private Consumption in turn will change as a proportion of the change in household income. Private Investment is modelled as a proportion of the net tax change to business profits.

Exports are assumed to be the same proportion of GDP as in the OBR's central forecast. Imports are also assumed to be the same proportion of Total Domestic Demand as in the OBR's forecasts.

The employment effect is calculated by estimating the impact of the taxes on company profits. Profits are used to pay for workers, dividends and investment. The share of profits which goes to pay for workers multiplied by the change in profits is the total change in funds available to hire workers. This number can then be divided by the average cost of hiring a worker to get an estimate of the change in employment as a result of each tax policy.

The total employment effect is the cumulative deviation in total employment from the OBR's central forecast after the implementation of Labour's tax policy programme.

This programme of tax policies may have a significant effect on underlying productivity growth by altering the level of investment and capital accumulation as well as more intangible effects on entrepreneurialism. However, given that this paper only estimates the GDP and employment effects of the programme over the next Parliament, these longer term effects are not included in the model.

It should be emphasised that this provides an estimation which tries to provide a more sophisticated guide to the impact on GDP and employment rather than being a prediction.

3. INCREASING THE CORPORATION TAX RATE FROM 20% TO 21%

The Coalition has cut the main Corporation Tax rate from 28% to 21%. This rate applies when company profits exceed £1.5 million and will be cut from 21% to 20% in April 2015. This means that the Small Profits Rate which is currently set at 20% will be merged with the Main Corporation Tax rate. Labour has proposed

[11] http://budgetresponsibility.org.uk/economic-fiscal-outlook-march-2014/

increasing the main rate to 21% if it wins the election.

The 2014 Budget[12] provided an update on the fiscal impact of reducing the main rate of corporation tax to 20%. The policy will reduce tax revenue in 2015/16 by £510 million, in 2016/17 by £995 million, in 2017/18 by £1,065 million and in 2018/19 by £1,090 million.

These amounts are the tax savings to businesses given the cut to 20%. It is assumed that these amounts also represent the reduction in retained profits implied by Labour's proposal to increase the rate to 21%.

Higher corporation tax rates discourage businesses from expanding and investing. By reducing the funds available to buy new equipment, take on new staff and pay shareholders, the higher tax holds back business growth.

A fall in retained profits from higher corporation tax will therefore have a negative impact on wages, investment and dividends, which then leads to a fall in the level of GDP. Different time lags will apply to each of these channels.

To estimate the share of profits which go to investment, employment costs and dividends, OBR data from 2009 to 2013 can be analysed.

From the low point to high point over this period, the increase in profits (private surpluses) of £6.2 billion was matched by an increase of £5.8 billion. Hence a £1 tax saving on profits is related to a £0.94 rise in profits.

Over the same period, after excluding the total compensation which would represent wage rises for existing employees, a £1 tax saving is related to £0.568 in wages for new workers.

Looking at the period 2009 to 2013, dividends as a percentage of profits is an average of 31.6%. This would suggest a £1 tax saving on profits would be related to a £0.316 rise in dividends.

Each element of investment, employment costs and dividends can be reduced rateably to ensure that £1 change in profits is matched by no more than a £1 cumulative change in investment, employment costs and dividends.

It is therefore assumed that every £1 reduction in profits resulting from the tax rise will lead to:

- Reduced dividend payments of £0.174.
- Reduced employment compensation of £0.312.
- Reduced investment of £0.514.

Businesses react to tax rises gradually; it is therefore assumed that there is a time lag between the tax rise and the reduced payments. The time lags are assumed to be one quarter for dividends, two quarters for wages and three quarters for investment.

The change in total compensation is calculated by multiplying the employment compensation share (0.312) with the tax rise in that quarter. The quarterly tax rise is assumed to rise evenly such that the annual tax rise is the same as that forecasted by the OBR. The new compensation is the sum of the existing OBR forecast for total compensation and the change in compensation. This change in compensation can then be used to derive the employment effect as discussed.

The change in private investment is the multiple of the investment share (0.514) with the tax rise in that quarter. The new private

[12] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293759/37630_Budget_2014_Web_Accessible.pdf

investment is the sum of this change and the existing OBR forecast for private investment.

The new GDP is therefore the sum of the new Total Domestic Demand, the new Net Exports and the Statistical Discrepancy.

	Employment	Dividend	Investment	Other
Profit Share	0.312	0.174	0.514	0

	2015/16	2016/17	2017/18	2018/19
Change in Profit	-£0.51bn	-£1.00bn	-£1.07bn	-£1.09bn
Change in Jobs	-10,200	-29,300	-38,600	-39,100

4. INCREASING THE TOP RATE OF INCOME TAX FROM 45% TO 50%

Changes in personal income tax rates are often used as a policy instrument by governments to raise revenue and redistribute wealth. In April 2010 the Labour Government increased the tax on earnings above £150,000 from 40% to 50%. The reduction in the top rate of income tax to 45% was announced in the 2012 Budget and came into force in April 2013. Labour proposes to increase this top rate back to 50%.

Increases in income tax rates are associated with two broad behavioural changes; labour supply effects and changes in tax planning.

Economic theory and empirical evidence show that people work fewer hours and exert less effort under a higher tax rate as the monetary reward for work is reduced and entrepreneurial spirits are dampened. Some people work may also harder in order to compensate for their loss of earnings under a higher rate of tax.

A higher rate of tax is also likely to influence retirement decisions and migration decisions and collectively, these would reduce the UK labour market force. Higher income earners tend to be older and therefore retirement could be a realistic prospect for them. They are also highly mobile and more able to migrate in response to higher tax rates. Higher tax rates are thus likely to lead to a reduction in total taxable income and thus a reduction in consumption.

An increase in the rate of tax is also associated with an increase in tax planning, avoidance and evasion. People subject to a higher personal income tax rate may make more use of tax relief, artificial avoidance schemes or engage in forestalling by bringing income forward to prevent it being subject to the higher tax rate. As a result, these have implications for the total taxable income, consumption, GDP and unemployment.

The labour supply effect would lead to an actual fall an income whilst the changes to tax planning would lead to an observed fall in income.

The impact on total taxable income can be determined using a framework previously used by HMRC[13] in *The Exchequer effect of the 50 per cent additional rate of income tax*. Total taxable income is total income minus deductions, reliefs and the personal allowance.

From the HMRC Survey of Personal Incomes for 2011/12[14], the total taxable income for those earning above £150,000 can be derived. Total income was £100,500 million, deductions and reliefs were £6,530 million and personal

[13] http://www.hmrc.gov.uk/budget2012/excheq-income-tax-2042.pdf

[14] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/341406/NS_Table_3.5_revised.pdf

allowances were £56 million. This means that total taxable income was £93,914 million in 2011/12.

In 2014/15, it is estimated that those paying the top rate of income tax will contribute 29.5% of total income tax.[15] If this stays constant throughout the next Parliament, then they are forecast to contribute £52.13 billion in 2015/16, £55.78 billion in 2016/17, £59.41 billion in 2017/18 and £62.86 billion in 2018/19.

In 2014/15, total income tax is estimated to be 17.5% of total income. Assuming this remains the same, then total income in 2015/16 will be £1,010 billion, in 2016/17 will be £1,081 billion, in 2017/18 will be £1,151 billion and in 2018/19 will be £1,218 billion.

In 2014/15, the total income of those earning above £150,000 is forecast to be 13.7% of total income. If this continues in the next Parliament, then their total income in 2015/16 will be £138 billion, in 2016/17 will be £148 billion, in 2017/18 will be £158 billion and in 2018/19 will be £167 billion.

In 2011/12, total taxable income of those earning above £150,000 was 93.5% of their total income. Assuming this remains the same in the next Parliament, then their total taxable income in 2015/16 will be £129 billion, in 2016/17 will be £138 billion, in 2017/18 will be £147 billion and in 2018/19 will be £156 billion.

The proportion of each additional pound earned received by the individual after tax is the marginal retention rate (MRR).

$$\text{MRR} = 1 - \frac{\text{income tax rate} + \text{employee NIC rate} + \text{employer NIC rate}}{1 + \text{employer NIC rate}}$$

The MRR for those earning above £150,000 falls from 46.6% to 42.2% after the increase in the income tax rate to 50%. This means that they should expect to receive 9.4% less after tax for each additional pound they earn.

In order to calculate the reduction in total taxable income, the "taxable income elasticity" (TIE) must be known. This is a measure of the overall responsiveness of total taxable income to changes in the marginal tax rate i.e. the percentage change in total taxable income in response to a one per cent change in the net-of-tax rate. Therefore, this measure captures all the behavioural responses as a result of a change in tax. HMRC assumes that the TIE is 0.45.

The percentage reduction in total taxable income is therefore the multiple of 9.4% and 0.45 which is 4.25%. Therefore, the reduction in total taxable income in 2015/16 will be £5.5 billion, in 2016/17 will be £5.9 billion, in 2017/18 will be £6.3 billion and in 2018/19 will be £6.6 billion.

HMRC suggests that between one-third and one-half of the behavioural response to the 50% income tax rate reflected a labour supply response and thus an actual fall in incomes.[16] Using the lower estimate, this would suggest that income in 2015/16 will fall by £1.83 billion, in 2016/17 it will fall by £1.96 billion, in 2017/18 it will fall by £2.01 billion and in 2018/19 it will fall by £2.13 billion.

Analysis of OBR data from 2009 to 2013 can give insight into the relationship between income and consumption. Private consumption as a percentage of household disposable income was an average of 96.4% every quarter. This matches almost exactly with the changes in household disposable income and

[15] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/306818/Income_Tax_Liabilities_Statistics_-_April_2014.pdf

[16] http://www.hmrc.gov.uk/budget2012/excheq-income-tax-2042.pdf

consumption from low point to high point over the same period with a one quarter time lag.

This suggests that a decrease in post-tax worker income of £1 will lead to reduced consumption of £0.964 in the following quarter.

Profits are an average of 30.4% of consumption over the period. This suggests that a £1 fall in consumption is related to a £0.304 fall in profits. The employment effect can thus be estimated.

	Employment	Dividend	Investment	Other
Profit Share	0.312	0.174	0.514	0

	2015/16	2016/17	2017/18	2018/19
Change in Profit	-£0.40bn	-£0.57bn	-£0.60bn	-£0.64bn
Change in Jobs	-5,400	-21,300	-21,900	-22,500

5. INTRODUCING A TAX ON HOUSES WORTH ABOVE £2 MILLION

Labour has committed itself to introducing a "mansion tax" if it wins the next election. Its initial proposal appeared to be identical to the Liberal Democrat proposal for a levy worth 1% of the value of houses worth over £2 million. However, given that such a tax would require regular revaluations, the administration costs would be very high.

Instead, Labour intends to categorise homes into value bands which will then be charged an annual amount depending on the band. This would eliminate the need for regular revaluations. Labour hopes to raise between £1.5 billion and £2 billion from this policy.

As of April 2013, there has been a tax on new properties bought by companies or non-natural persons. It is assumed that Labour will adopt the same bands and charges for all ownership of high value homes. Properties between £2 million and £5 million face an annual charge of £15,000; properties between £5 million and £10 million face an annual charge of £35,000; properties between £10 million and £20 million face an annual charge of £70,000 and properties worth over £20 million face an annual charge of £140,000.

Part of the justification for the introduction of a mansion tax is the perception that the owners of high value property do not make an adequate contribution to the exchequer. Such a perception is largely based on the distribution of council tax receipts. However, such properties are already charged more than simply council tax.[17] In fact, the UK has the highest tax on property as a percentage of GDP of any developed economy. For example, in 2011-2012, the Stamp Duty Land Tax (SDLT) on houses sold over £1 million amounted to £1.11 billion. This accounted for 26.3% of the total £4.22 billion SDLT collected, whilst only making up 2.7% of all housing.[18] This percentage is likely to be even higher now, given that SDLT on houses over £2 million has recently been increased to 7%.

High value property also makes up a significant proportion of inheritance tax. In 2011-12, there were 1,053 properties taxed over £2 million out of a total of 15,967. These 1,053 homes contributed £1.011 billion out of the £2.651 billion total.[19] This amounted to 38% of all inheritance tax.

[17] http://www.cps.org.uk/files/reports/original/120301155110-taxingmansions.pdf

[18] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/249656/stamp-tax-sep13.pdf

[19] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/338970/140729Table12-3DUChecked.pdf

HMRC's figures for identified personal wealth[20] indicate that there are approximately 90,000 residential properties worth over £2 million. This figure may have increased since the publication of that data. An examination of UK property transactions shows that between 2010 and 2013, 0.4% of transactions were of homes of value greater than £2 million[21]. If this is proportional to the number of houses worth over £2 million, that would suggest that there are approximately 100,000 such houses.

It is difficult to establish the wealth of those who own the houses which would be subject to this tax. One concern is that because 32% of homeowners are over 65, the tax will unfairly penalise those who are asset rich and cash poor, such as pensioners.

Rising property prices, particularly in London, are also an issue. The Office of National Statistics figures show that since 1994, property prices have risen 386% and that London has seen a rise of 486%.[22] There are therefore a large number of people who will have seen their house value soar, through no fault of their own and be subject to a tax that they may struggle to pay. Persistent house price growth will drag more and more people into the tax.

The Shadow Chancellor has announced that the threshold for each tax band will be raised each year in keeping with property inflation, but as this policy was first suggested in 2009, the threshold would now need to be increased to £2.2 million in order to keep pace with house price growth since then. The initial threshold of £2 million is thus completely arbitrary.

Nevertheless, it is fair to assume that the majority of those living in £2 million properties are among the highest earners; for example that the top 1% of earners largely occupy the most expensive 0.4% of homes. The average income of the top 1% is approximately £400,000 per year.[23]

In order to raise £1.5 billion annually, the average tax hit of the approximately 100,000 owners of affected houses property is £15,000.

It is assumed that a £1 decrease in income leads to a £0.964 decrease in consumption and that a £1 fall in consumption is related to a £0.304 fall in profits. The employment effect can thus be estimated.

	Employment	Dividend	Investment	Other
Profit Share	0.312	0.174	0.514	0

	2015/16	2016/17	2017/18	2018/19
Change in Profit	-£0.33bn	-£0.44bn	-£0.44bn	-£0.44bn
Change in Jobs	-4,400	-17,100	-16,500	-15,900

6. REINTRODUCING STAMP DUTY RESERVE TAX

The Coalition abolished the SDRT charge on unit trusts and open-ended investment companies (OEICs) in 2014. Labour has since proposed reintroducing the Stamp Duty

[20] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/270408/table_13-1.pdf

[21] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/323126/2014_AUKPTS_circ.pdf

[22] http://www.ons.gov.uk/ons/taxonomy/search/index.html?nscl=House+Price+Indices&nscl-orig=House+Price+Indices&content-type=Dataset&content-type=Reference+table&sortDirection=DESCENDING&sortBy=pubdate

[23] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/306831/Table_2.4.pdf

Reserve Tax (SDRT) charge from Part 2 of Schedule 19 of the Finance Act 1999.

Unit trusts and OEICs are professionally managed collective investment funds. Managers pool money from many investors and buy shares, bonds, property or cash assets and other investments.

SDRT is a tax for electronic 'paperless' share transactions and is payable on paperless transaction when buying shares in a UK company, shares in a foreign company which are registered in the UK and rights arising from shares already owned amongst other transactions. SDRT, unlike Stamp Duty, is payable when shares are bought electronically without a stock transfer form.

It is assumed that Labour will reintroduce SDRT in the same form as it was before its abolition. SDRT is set at 0.5% of the transaction value and for the majority of UK shares SDRT is deducted automatically from chargeable trades. SDRT is not charged when buying units from a fund manager, however the fund manager is charged when units are surrendered.

The investment management industry accounted for about 1% of the UK's GDP in 2011 and a similar proportion of tax revenues. It manages £4.9 trillion of funds and is also a major source of funding for the economy, accounting for over a third of all investment in UK equities.[24]

The size of the UK's fund management industry is generally measured by the value of Funds under Management (FUM) of Authorised investment funds (AIFs), £468 billion at 30 September 2007. This is a subset of the total £4.9 trillion assets under management in the UK.

Over the last ten years the UK has lost ground to both Luxembourg and Ireland as the leading location for European fund domicile. The UK is also under competitive pressure from jurisdictions outside the EU.

A report published by IMA and KPMG confirmed that taxation has a significant influence on the decision of participants to locate funds outside the UK. The main specific tax reasons for locating funds outside the UK are direct tax at the fund level and SDRT.[25]

Further research suggests that Schedule 19 SDRT accounted for approximately 16% of the total net investment costs in the relevant industries.[26] Reintroducing SDRT would therefore place the UK at a competitive disadvantage. This is especially the case given the growth in offshore funds; the amount of offshore funds under management in 2013 at £64.5 billion is three times higher than in 2007.

From the OBR's policy costings, it is assumed that the reintroduction of SDRT would be a tax rise of £160 million in 2015/16 and 2016/17, £165 million in 2017/18 and £170 million in 2018/19. Fund managers pay the SDRT directly to HMRC and it is assumed that 50% of this will be largely passed on to the unit holders through higher management fees i.e. higher prices.[27]

These higher prices will reduce returns to savings and affect GDP in the longer term

[24] http://www.investmentfunds.org.uk/fund-statistics/funds-under-management/?what=graph&show=3

[25] http://www.investmentfunds.org.uk/search-results/?AS_search=the+value+of+UK+domiciled+funds&sub=go

[26] http://www.investmentfunds.org.uk/search-results/?AS_search=fund+management+charges&sub=go

[27] http://www.hmrc.gov.uk/sdrt/intro/basics.htm

however we assume that the impact will not be felt in the time period considered in this paper.

However, the tax rise will also reduce the ability of UK funds to attract non-UK investors which will have an impact on the total fees and thus investment, dividends and employee compensation which the industry can generate. It is assumed therefore that the remainder of the tax rise is split in the same proportions as the corporation tax shares with 15.6%, 8.7% and 25.7% of the tax hike realised through reduced employee compensation, dividends and investment respectively.

	Employment	Dividend	Investment	Other
Profit Share	0.156	0.087	0.257	0.500

	2015/16	2016/17	2017/18	2018/19
Change in Profit	-£0.16bn	-£0.16bn	-£0.17bn	-£0.17bn
Change in Jobs	-1,600	-3,100	-3,000	-3,000

7. REINTRODUCING A 50% PAYROLL TAX ON BANK BONUSES

Labour has confirmed that it will implement a bank payroll tax (BPT) in 2015/16 of 50% on discretionary bonuses above £25,000 should it win the next general election. For example, on a bonus of £35,000, a bank employee would pay £5,000 in taxes in addition to the usual income tax and national insurance contributions.

The BPT was introduced as a one-off levy between the 9 December 2009 and 5 April 2010. The policy was only expected to raise £500 million however it surpassed expectations[28] and raised £3.4 billion in gross terms and £2.3 billion in net terms. The net yield was reduced because some bonuses were delayed or not paid which led to lower income tax and national insurance payments on those bonuses. Labour estimates that the reintroduction of this policy will raise up to £2 billion a year.[29]

The banking sector paid £20.6 billion in income tax, corporation tax and national insurance contributions in 2005/6. In 2010/11 it paid £24.4 billion with the introduction of the BPT and in 2012/13 it paid £21.7 billion.[30]

Given that the BPT was a one-off tax when it was initially introduced, the behavioural change was less significant than feared. However, if the tax is reintroduced, it may be that the behavioural change is more profound as banks suspect that it will become a permanent tax rise. These behavioural effects may manifest themselves in new ways to classify the bonuses such as through allowances or it may lead to more bonus deferrals and higher base pay.

Nevertheless, a slightly larger bonus pool may offset that behavioural change. It is therefore assumed that Labour does manage to raise the £2 billion net revenue.

It is assumed that this bonus tax is paid entirely out of bank profits as banks attempt to maintain take-home pay levels. For corporation tax the biggest impact of reduced bank profitability was experienced by investment followed by employment compensation and then dividends. However, it seems reasonable

[28] http://www.parliament.uk/business/publications/research/briefing-papers/SN05251/taxation-of-banking

[29] http://www.ft.com/intl/cms/s/0/8dbfc2aa-a867-11e3-a946-00144feab7de.html#axzz3B2DKHCL2

[30] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/258993/paye-ct-receipts-2013.pdf

that for banks the investment and dividends shares will be reversed. It is therefore assumed that every £1 of the bonus tax leads to reduced dividend payments of £0.514, reduced employment compensation of £0.312 and reduced investment of £0.174.

	Employment	Dividend	Investment	Other
Profit Share	0.312	0.514	0.174	0

	2015/16	2016/17	2017/18	2018/19
Change in Profit	-£2.0bn	0	0	0
Change in Jobs	-40,000	-39,700	0	0

8. INCREASING THE LEVY ON BANK BALANCE SHEETS

The bank levy was introduced under the Coalition as a way to recoup tax revenue from the banking sector within the context of the corporation tax cuts which applied across the economy.

The levy is a tax on the global balance sheets of UK banks and building societies as well as the UK subsidiaries of foreign banks operating in the UK and on UK banks and the UK branches of foreign banks in non-banking groups.[31] The levy includes a £20 billion allowance as well as discounts for High Quality Liquid Assets so that in effect only the larger banks are subject to the levy. The tax penalises the greater size of a bank and thus the greater systemic risk which that implies.

In 2011/12 and 2012/13, the bank levy raised £1.6 billion compared to an annual target of £2.5 billion. In 2013/14, the levy is projected to have collected £2.3bn and in 2014/15 it is forecast to raise £2.7 billion. In the following four years, the OBR forecasts that it will raise £2.9 billion annually.

The bank levy rate has been increased seven times since its introduction and is currently at 0.156% for short term liabilities and 0.078% for long term liabilities[32]. Shrinking balance sheets (which have been accompanied by reduced profitability) appears to have been the primary reason for the lower than expected tax yield.

Whilst approximately 30 banks are subject to the bank levy, the big five UK banks are contributing three quarters of the revenue which it is generating according to KPMG analysis.[33] Furthermore, the effective tax rate on the profits of the big five UK banks – i.e. corporation tax and the bank levy – was 71% in 2013

Labour proposes to add a further £800m to the bank levy annually and it is assumed that it will retain the current structure of the levy. This means that Labour intends to raise £3.7 billion from the bank levy annually from 2015/16 to 2018/19.

It is assumed that the bank levy is paid entirely out of bank profits. As with the bonus tax, it seems reasonable that for banks the investment and dividends shares will be reversed. It is therefore assumed that every £1 extra in bank levy leads to reduced dividend payments of £0.514, reduced employment compensation of £0.312 and reduced investment of £0.174.

[31] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210738/130704_Bank_Levy_Review_Consultation_Document.pdf

[32] http://www.ukbudget.com/2014-measures/bank-levy.aspx

[33] http://www.kpmg.com/uk/en/issuesandinsights/articlespublications/newsreleases/pages/uk-bank-levy-increases-top-five-uk-banks-tax-rate-to-71.aspx

	Employment	Dividend	Investment	Other
Profit Share	0.312	0.514	0.174	0

	2015/16	2016/17	2017/18	2018/19
Change in Profit	-£0.8bn	-£0.8bn	-£0.8bn	-£0.8bn
Change in Jobs	-16,000	-31,300	-30,000	-29,000

9. IMPOSING A LEVY ON THE PROFITS OF PAYDAY LENDERS

Labour has announced plans to impose a £13 million levy on the profits of payday lenders. Payday loans are short-tem, unsecured credit products with an average loan size of £260. Payday lenders offer a variety of products which include 'traditional' payday loans repayable in a single instalment within one month or less and longer-term loans which are repayable in a number of instalments over several months. The average duration of a payday loan is three weeks.[34]

In 2012/13 total payday loan revenue was around £1.1 billion. Payday lenders issued approximately 10.2 million payday loans which were worth £2.8 billion and this was a sharp rise on the year before. The Competition and Markets Authority (CMA) estimates that there were around 1.8 million customers of payday lenders each taking out an average of six loans over the year.

A study from the Department of Business, Innovation and Skills[35] estimates that based an Office of Fair Trading measure of vulnerability using for example age, employment status and income, three-quarters of home credit and pawn broking customers were classified as vulnerable. 60% of retail payday and 37% of online payday loan customers were also classified as vulnerable.

Whilst the profits of the payday lenders are not extraordinary,[36] it is unlikely that a £13 million levy, which is designed to double the funding for credit unions, will have a great impact on UK employment and GDP. Nevertheless, a reduction in retained profits will still lead to some depletion of investment, dividends and employee compensation.

However, given the highly price inelastic nature of demand for payday loans, it also seems reasonable that some of the tax burden is placed on customers through higher interest rates. It is assumed therefore that 50% of the tax burden goes to higher prices with no short term impact on GDP. It is assumed that the remainder of the tax rise is split in the same proportions as the corporation tax shares with 15.6%, 8.7% and 25.7% of the tax hike realised through reduced employee compensation, dividends and investment respectively.

	Employment	Dividend	Investment	Other
Profit Share	0.156	0.087	0.257	0.500

	2015/16	2016/17	2017/18	2018/19
Change in Profit	-£0.013b	-£0.013b	-£0.013b	-£0.013b
Change in Jobs	-100	-300	-200	-200

[34] https://assets.digital.cabinet-office.gov.uk/media/5397ef3c40f0b6101d000003/Summary_of_provisional_findings_report.pdf

[35] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/136548/13-702-the-impact-on-business-and-consumers-of-a-cap-on-the-total-cost-of-credit.pdf

[36] http://www.thebureauinvestigates.com/2013/09/05/payday-loans-companies-charging-up-to-7000-experience-huge-growth/

10. INTRODUCING A NEW 10% INCOME TAX RATE

The 10% rate of income tax existed between 1999 until its abolition in 2007. Labour has proposed reintroducing this 10% rate of income tax which would benefit approximately 25 million basic rate taxpayers.

Whilst there is a lack of detail on the precise size of this tax cut, it has been suggested by Catherine McKinnell that this might apply to the first £1,000 of income above the personal allowance threshold.[37] Given that the personal allowance threshold will rise to £10,500 it is assumed that the 10% rate will apply on incomes between £10,500 and £11,500 leading to a maximum £100 income tax cut. The IFS estimates that this would lead to a tax saving of approximately £2 billion.[38]

Analysis of OBR data suggests that a decrease in post-tax worker income of £1 will lead to reduced consumption of £0.964 in the following quarter. Furthermore, the OBR has highlighted the fact that it assumes a Taxable Income Elasticity of zero for personal allowance changes and just 0.03 for higher rate changes. This suggests that there is likely to be little to no behavioural change as a result of the introduction of this 10% income tax rate. This does not seem an unreasonable assumption given the positive correlation between income levels and the likelihood of changing behaviour in the light of tax changes

The channel through which this tax cut will boost GDP is therefore a flat £2 billion in worker income. It is assumed that a £1 rise in income leads to a £0.964 rise in consumption and that a £1 rise in consumption leads to a £0.304 rise in profits. The employment effect can thus be estimated.

	Employment	Dividend	Investment	Other
Profit Share	0.312	0.174	0.514	0

	2015/16	2016/17	2017/18	2018/19
Change in Profit	+£0.44bn	+£0.59bn	+£0.59bn	+£0.59bn
Change in Jobs	+5,900	+22,900	+22,000	+21,200

11. CUTTING AND FREEZING BUSINESS RATES

Labour has promised to cut business rates in 2015/16 and then freeze them in 2016/17 for small and medium sized businesses. Effectively this means freezing the business rates multipliers in 2015/16 and 2016/17 for properties with rateable value of less than £50,000. This would encompass almost 90% of properties.

Labour estimates that this would lead to a tax saving of £250 million in 2015/16 and £550 million for each following year.[39] The OBR forecasts that business rates revenue will be £28.7 billion in 2015/16, £30 billion in 2016/17, £30.8 billion in 2017/18 and £32.3 billion in 2018/19.

Business rates are commonly cited by businesses and their representative organisations as one of the biggest impediments to their growth.[40] Smaller

[37] http://www.publications.parliament.uk/pa/cm201314/cmpublic/financeno2/130613/am/130613s01.htm

[38] http://www.ifs.org.uk/publications/6606

[39] http://www.ifs.org.uk/budgets/gb2014/gb2014_ch11.pdf

[40] http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/11098107/More-than-100-companies-call-for-overhaul-of-business-rates.html

businesses in particular appear to view business rates as damaging.[41]

It seems likely that this tax saving will be reflected in higher profits. However, there is strong evidence that the reduction in business rates will eventually be offset by higher rental payments and thus higher rental income for property owners.[42] This is a point with which the IFS agrees.[43] Nevertheless, it is assumed that this is a longer term effect which does not occur during the time period under consideration in this paper.

It seems reasonable to assume that the tax saving will be shared out to investment, wages and dividends in a similar fashion to that experienced with corporation tax. However, given that the business rates savings will be largely experienced by smaller businesses, the tax saving may also go to pay back loans, that is deleveraging. This will have no short term impact on GDP.

Every £1 saved will therefore be shared out as £0.174 in extra dividends, £0.312 in extra employee compensation, £0.257 in extra investment and £0.257 in deleveraging.

	Employment	Dividend	Investment	Other
Profit Share	0.312	0.174	0.257	0.257

	2015/16	2016/17	2017/18	2018/19
Change in Profit	+£0.25bn	+£0.55bn	+£0.55bn	+£0.55bn
Change in Jobs	+5,000	+15,500	+20,600	+19,900

12. INTRODUCING A FINANCIAL TRANSACTIONS TAX

Labour has announced its support for a Financial Transactions Tax (FTT). In 2011, Ed Miliband stated that implementing an FTT "is a hard thing to do but I think it is the necessary, important and right thing to do. You have got to do it globally though for it to work, or at the very least in Europe."[44] At later points, the Labour leader has reaffirmed his support for an FTT. It is therefore assumed that if Labour wins the election, it will introduce an FTT from 2016/17 in line with the proposals from the European Commission (EC).

The EC has proposed a tax on all transactions between a party in the EU or using an EU institution of 0.1% applied to all shares and bond trades alongside a 0.01% tax on all derivative trades. The EC hopes to raise €57bn annually for the entire EU, with €19.4bn from taxation of transactions in securities and about €37.7bn from taxation of derivatives.[45]

One of the major risks of an FTT is that that the elements of the financial sector will relocate, taking their wealth and investment with them. Such a fear is not unfounded given the Swedish experience. However, the EC has taken robust measures to mitigate this risk. For example, if any party to the transaction is established in the 'FTT-zone', the transaction is taxed, regardless of where in the world it takes place. Also, a financial product issued in the 11 member states will be taxed when traded, even if those trading them are not established within the FTT zone. Thus, the only way to avoid the FTT is if financial institutions relocated, gave up their client base in

[41] http://www.fsb.org.uk/News.aspx?loc=pressroom&rec=8127

[42] http://www.hmrc.gov.uk/research/report42.pdf

[43] http://www.ifs.org.uk/budgets/gb2014/gb2014_ch11.pdf

[44] http://www.moneymarketing.co.uk/miliband-gives-support-on-financial-transaction-tax/1039021.article

[45] http://ec.europa.eu/taxation_customs/resources/documents/taxation/swd_2013_28_en.pdf

the FTT jurisdiction and no longer traded financial products issued there.[46] As the current 11 participating member states make up a large proportion of EU GDP and London is a well-established financial centre, it is unlikely this will happen to a significant extent.

Numerous studies of the impact of an FTT suggest that in fact the incidence of the tax will fall heaviest on the consumers of financial services rather than financial services providers themselves.[47]

It is certain however, that cascading effects will lead to the profitability of many ventures being diminished.[48] For example the FTT will likely be passed on to pensioners, as the costs are borne by the fund rather than the fund manager. Moreover, it could be felt in other ways for example by reducing the profits of exporters who will find it more expensive to hedge currencies and commodities as well as take out short term debts. This of course will lead to reduced investment, wages and dividends. Therefore the two main channels through which the FTT will impact the economy is on savings and the cost of capital.

A drop in household savings also leads to a reduction in consumption in the long run. ECB and IMF research that estimates for every 10% drop in household savings there is a 1% drop in consumption.[49] However, it is assumed that the economic impact of this reduction in saving is not felt within the time period under consideration in this paper.

It is assumed that the annual tax burden of the FTT would be £8.4 billion based on the estimates of European Commissioners.[50] It is assumed that there are no knock-on effects on the UK of the FTT applied in other countries.

It is also assumed that 50% of this tax would be felt through reduced household saving with the remainder of the rise in the cost of capital being split in the same proportions as under corporation tax with 15.6%, 8.7% and 25.7% of the tax hike realised through reduced employee compensation, dividends and investment respectively.

There are significant uncertainties over the precise revenue which would be raised and the incidence of the tax. Nevertheless, the academic literature is clear that an FTT applied in the UK would have a serious negative impact on GDP and consequently employment.

	Employment	Dividend	Investment	Other
Profit Share	0.156	0.087	0.257	0.500

	2015/16	2016/17	2017/18	2018/19
Change in Profit	0	-£8.4bn	-£8.4bn	£8.4bn
Change in Jobs	0	-80,900	-157,500	-152,200

13. CONCLUSION

It is clear that Labour plans to increase the tax burden significantly should it win the next

[46] http://europa.eu/rapid/press-release_MEMO-13-98_en.htm

[47] http://www.cbi.org.uk/media/2482473/FTT__impacts__and__arguments.pdf

[48] http://www.oxera.com/Oxera/media/Oxera/downloads/reports/The-economic-impact-of-the-proposed-FTT.pdf?ext=.pdf

[49] https://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/Research-2014/Effects-of-a-financial-transaction-tax-on-european-households-savings.pdf

[50] http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9087264/Financial-transaction-tax-would-raise-10bn.html

General Election. Whilst there may be reasons to increase taxes, perhaps to improve the fiscal balance or for redistributive purposes, the consequences for GDP and employment will be negative. Even if an FTT is not considered, the implementation of Labour's tax policies could lead to the loss of 300,000 jobs and £18.8 billion lower GDP over the first four years of the next Parliament. This could potentially reach 375,000 jobs lost and over £25 billion less GDP over the entire Parliament.

THE AUTHOR

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