



# PERSPECTIVE

## CENTRE FOR POLICY STUDIES

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### *The tax double whammy: More tax costs more than you think*

**CHARLIE ELPHICKE**

- By the time of the next election, the tax burden will have gone up 4.2% of GDP compared with 1996/97.
- Since 1996/97, the tax burden has increased by the equivalent of £6,182 a year in real terms for every household in the UK (or by £9,098 in cash terms).
- Between 1996/97 and 2009/10 (the time of the next general election), the tax burden is forecast to rise by the equivalent of £8,153 a year for every household in the UK (or by £12,881 in cash terms),
- This additional tax burden has an effect on growth. Latest estimates suggest that the increased tax burden will reduce the UK's annual economic growth by between 0.3% and 0.5% a year.
- Over 10 years, the loss of growth could be as much as the equivalent of 6% of GDP. 6% of today's GDP is £77bn – the equivalent of £3,143 per household.
- 1% rise in tax/GDP ratio can reduce per capita output levels by 0.3% to 0.7% a year;<sup>1</sup>
- each 1% GDP rise in distortionary taxation can reduce economic growth by 0.2% to 0.4% a year;<sup>2</sup>
- a 2.5% GDP/tax increase can reduce GDP growth by between 0.2% and 0.3% a year.<sup>3</sup>

The tax burden since 1996/97 will, by next year, have increased by over four percentage points. Taking these figures together, this suggests that higher taxes could reduce growth by between 0.3% and 0.5% a year.

A United Kingdom specific study argues that if the tax burden continues to move towards the 40% mark, long-term GDP growth in the UK is expected to fall by 0.3% to 0.5% per year.<sup>4</sup> If trend growth is around 2.5% a year, the increase in tax burden may reduce this towards 2.0% a year. Over 10 years, 0.5% of lost growth a year will amount to the equivalent of 6% less growth in GDP. In 2006/06, this is the equivalent of £77 billion – or a further £3,143 per household.

The table overleaf sets out the household tax burden on the basis that all tax is eventually visited on UK households. While it is true that not all UK tax is paid by UK taxpayers, this figure indicates both how the tax burden has moved and the amount by which taxes have risen relative to each household.

The cost of higher taxes is higher than people think. It is a double whammy – less money in people's pockets today, and even less tomorrow thanks to lower economic growth. The evidence for this includes the following:

<sup>1</sup> A Bassanini, and S Scarpetta, *The driving forces of economic growth*, OECD, 2001.

<sup>2</sup> L Barton and J Hawksworth, *The relationship between tax, public spending and economic growth*, PricewaterhouseCoopers, 2003.

<sup>3</sup> E M Engen and J Skinner, *Taxation and Economic Growth*, NBER Working Papers 5826, National Bureau of Economic Research, 1996.

<sup>4</sup> G Leach, *The Negative Impact of Taxation on Economic Growth*, Reform, 2003.

## CALCULATION OF INCREASE IN HOUSEHOLD TAX BURDEN

	1996/97	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11
GDP (£bn)	773	1,177	1,224	1,284	1,360	1,438	1,513	1,592
GDP (£bn at 2006/7 base year)	978	1,231	1,254	1,284	1,325	1,364	1,398	1,432
Net taxes and NICs (as % GDP)	34.8	36.2	37.5	38	38.5	38.7	38.7	38.7
Add back tax credits (% GDP)	n/a	0.4	0.4	0.4	0.4	0.3	0.3	0.3
Total taxes and NICs (% GDP)	34.8	36.6	37.9	38.4	38.9	39	39	39
Cumulative increase in taxes and NIC (as % of GD, since 96/97)	n/a	1.8	3.1	3.6	4.1	4.2	4.2	4.2
Tax Burden (£bn)	269	431	464	492	526	557	585	614
Tax Burden (£bn at 2006/7 base)	340	451	485	492	513	528	540	552
Cumulative increase in receipts in nominal terms (from 1996/97) (£bn)	n/a	162	195	223	257	288	316	344
Cumulative increase in receipts in real terms (from 1996/97) (GDP deflator adjusted, £bn)	n/a	110	145	151	172	188	200	211
Tax burden of average household (£, nominal terms)	10,980	17,596	18,935	20,078	21,482	22,731	23,861	25,041
Tax burden of average household (£, real terms)	13,896	18,405	19,806	20,078	20,922	21,556	22,048	22,522
Tax burden increase per household (£, nominal, since 96/97)	n/a	6,616	7,955	9,098	10,502	11,751	12,881	14,061
Tax burden increase per household (£, real terms, since 96/97)	n/a	4,510	5,910	6,182	7,026	7,660	8,153	8,626
GDP Deflator 2006/7 base year	79	96	98	100	103	105	108	111
GDP deflator Treasury	82.7	100.0	102.1	104.6	107.4	110.3	113.2	116.3

### SOURCES

Money GDP latest figures as at 29 March 2006. See [www.hm-treasury.gov.uk/media/463/5D/gdpdeflators\\_290306.xls](http://www.hm-treasury.gov.uk/media/463/5D/gdpdeflators_290306.xls)

GDP Deflator from [www.hm-treasury.gov.uk/media/463/5D/gdpdeflators\\_290306.xls](http://www.hm-treasury.gov.uk/media/463/5D/gdpdeflators_290306.xls)

Net taxes and NICs for 1996/97 from Table C25 of Budget Red Book, HM Treasury, 2006, p286. Net taxes and NICs for 2004-05 (outturn) and 2005-06 onwards (estimates) from Table C10 of Budget Red Book, HM Treasury, 2006, p267.

Tax credits as % GDP drawn from Table C9 of Budget Red Book, HM Treasury, 2006, p266.

Real terms calculations for households determined according to the GDP deflator.

The number of households has been assumed at 24.5m for all years. In 1997-98 there were 24,556,000 (*The effect of taxes and benefits on household income* (ONS) 1997-98, Economic Trends No 545, Table 2A, p16) and in 2004/05 there were 24,431,000 (*The effect of taxes and benefits on household income 2004/05* Table 14, p20). Future figures are unknown, although expected to increase slightly: hence the assumption at 24.5m.



# PERSPECTIVE

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