25 November 2009

TUC

A Socially Just Path to Economic Recovery

TUC Submission to 2009 Pre Budget Report

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Section one

Executive Summary

1.1 The UK and, indeed, the world economy have found themselves in the midst of the most significant economic downturn since the 1930s. While there are some signs that the economy has at least stabilised, the TUC remains cautious of any talk of recovery. Weak bank lending remains drag on the UK's recovery and although the rise in unemployment has been less than could have been expected, levels will almost certainly breach 2.5 million when the next figures are published.

1.2 The TUC wholeheartedly supports the fiscal stimulus that has been introduced by the British Government and other governments across the globe. To have done nothing would have been catastrophic and might have turned this recession into a 1930s-style depression.

1.3 Political discussion in recent months has focused on the size of the fiscal deficit and the urgency, or otherwise, of reducing it. Budget 09 forecast public sector net borrowing to peak at £175 billion in the fiscal year 2009-10 and included a pledge to halve the deficit within four years, meaning it would fall to 5.5 per cent of GDP, or £97 billion, by 2013-14. UK debt is expected to rise to 99.7 per cent of GDP in 2014, similar to other G7 economies. However, the UK has spent 180 of the last 260 years with the national debt at above 80 per cent, so this cannot be interpreted as a crisis.

1.4 Nevertheless, the TUC does recognise that while long-term public debt is not a serious cause for concern, the collapse in tax revenues brought about by the financial crisis and recession has created a rapidly rising annual deficit which is not sustainable or desirable in the longer term. The TUC completely rejects the notion that this is a national emergency requiring an urgent response. However, it is vital that Government identifies measures to reduce the deficit over the medium to long term. At the heart of such a strategy will be restoring economic growth and thus reviving tax revenues, but we also believe other measures have a key role to play.

1.5 The TUC sets out five principles to govern how any deficit reduction strategy should proceed. Any measures introduced by the Government must be:

- Effective: any measure must genuinely reduce the deficit;
- Progressive: the costs of any measure must fall to those most able to pay;
- Proportionate: measures must meet the reality of the challenge posed by the fiscal problems rather than any exaggerated claims;

- Limited in its economic consequences: any measure must not prolong the recession of threaten recovery;
- Just: the costs of any measure should not fall on those who bear no responsibility for the financial crisis and recession that has caused the fiscal problems.

1.6 No measure can meet all these tests absolutely but we believe that some suggestions currently being proposed perform particularly badly when judged against these criteria. Major spending, benefits and pensions cuts meet none of the principles. Increases in VAT would also fail most of these tests. Increases in income tax would, we believe perform better, but our argument here is that a series of different tax options come much closer to meeting these criteria.

1.7 The TUC has identified six tax options which could play a key role in deficit reduction. We do not believe that all of these options require implementation, but they do show the sorts of options available to Government, yet which are not currently being widely discussed. The six options, with estimates of the likely revenue that they could raise over the course of one year, are:

- A Major Financial Transaction Tax (£30 billion)
- A General Anti Avoidance Principle (£1 billion)
- A Tax Relief Cap (£10 billion)
- An Empty Property Tax (£5 billion)
- Collecting tax that is due by improving HMRC resources (£20 billion)
- Abolishing the Non-Domicile Rule (£3 billion)

1.8 In line with previous recessions, it is likely that unemployment will keep rising into 2010, but there are some signs that the steep rises in unemployment that we saw at the start of this year may be behind us. However, levels of long-term unemployment are likely to continue to increase even after overall unemployment levels begin to fall.

1.9 The Future Jobs Fund is strongly welcomed, but its operation must be monitored to ensure that disadvantaged young people are not left out and its funding must be kept under review. The Government should consider extending its scope as demand for jobs rises.

1.10 The TUC strongly opposes workfare schemes, which are ineffective as well as unjust. Rather than piloting a ‘work for your benefit’ scheme, we urge the Government to extend its demand side approach to provide a Job Guarantee for all adults who have been claiming JSA for over 12 months.

1.11 The TUC continues to support a short time working subsidy, a policy that unites employers, including the Federation of Small Businesses, the British Chamber of Commerce, the EEF, and the TUC.

Section two

The State of the Economy

2.1 Recent TUC Budget and Pre Budget Report submissions have focused on the fact that the UK and, indeed, the world economy have found themselves in the midst of the most significant economic downturn since the 1930s. However, recent months have seen some talk among commentators of the 'green shoots' of recovery. The TUC remains cautious.

2.2 Figures published on 23rd October 2009 showed a decrease in GDP of 0.4 per cent in the third quarter of the year. This compared with a decrease of 0.6 per cent in the second quarter. Analysts had expected growth to remain on a downward trajectory at this time, but the fall was steeper than economy-watchers had predicted. Expressing our disappointment, the TUC felt that the only silver lining might be that the figures would silence those worrying voices of complacency that have begun to emerge in recent months.

2.3 More generally, in its bi-annual World Economic Outlook, published in October 2009, the International Monetary Fund (IMF) reported that, whilst the global economy is expanding again and financial conditions have improved, it will take some time for employment to recover. The IMF argued that consumption would be particularly weak in advanced economies, especially those that experienced credit booms, housing bubbles and large current account deficits, such as the United States and the United Kingdom.[1]

2.4 There is particular concern among commentators that weak bank lending will be a drag on the UK's recovery. The Bank of England's Credit Conditions Survey[2] has confirmed these fears, finding that a small balance of lenders reported the reduced availability of secured credit to households in the three months to mid-September 2009, although some increase in overall credit availability was expected over the next three months. Access to corporate credit had increased, although the biggest increase was for larger firms.

2.5 The inflation picture remains worrying. The Consumer Prices Index (CPI), the Government's preferred measure of inflation, increased to 1.5 per cent in October, up from 1.1 per cent in September. The Retail Price Index (RPI), which includes housing costs and so is a more accurate measure of the costs that people bear, stood at -0.8 per cent, meaning that, on this measure, the UK economy is experiencing deflation. The Government's symmetrical CPI inflation target is two per cent and it is considered as important to avoid undershooting that target as it is overshooting it.

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[1] IMF (2009) 'World Economic Outlook: October 2009', Washington DC, IMF.
[2] Bank of England (2009) 'Credit Conditions Survey', 2009 Q3 London: Bank of England.

2.6 During the July-September quarter unemployment stood at 2.46 million. The number of unemployed people increased by 30,000 over the quarter and 629,000 over the year. Furthermore, as more and more people who lost their jobs earlier in the recession find themselves still unemployed, so the numbers who are long-term unemployed have risen steadily. 1,155,000 people have been unemployed for over six months.

2.7 Looking to the future, the Treasury's analysis of independent economic forecasts for October 2009 shows that the average of new forecasts is for the economy to shrink by 4.3 per cent in 2009 (unchanged from August and September) and to grow by 1.3 per cent in 2010 (an increase of 0.1 per cent on the previous month). The Budget 09 forecast negative growth of between 3.25 and 3.75 per cent in 2009 and positive growth of 1-1.5 per cent in 2010.

2.8 As is explained below the latest data on the labour market does suggest the very earliest signs of some stabilisation in the rate at which unemployment is increasing. Although, there is always the chance of a reverse, this may suggest that some of the very sudden spikes in unemployment seen earlier this year could be behind us. However, it is abundantly clear that the economic situation remains very fragile and will remain so for many months to come.

2.9 It is against this background that the Government presents its 2009 Pre Budget Report (PBR 09) and the TUC makes this submission. The TUC fully supported the fiscal stimulus introduced by the British Government and by other governments across the globe, in response to the economic downturn. It is impossible to prove a negative, but a broad body of opinion believes that to have done nothing would have been catastrophic and may have turned this economic recession into a 1930s-style depression.

2.10 The months to come will present policy makers with a delicate balancing act. They will need to consider when it is safe to draw an end to the type of fiscal support that has been given and when to begin paying off the deficit that has ensued. Getting this wrong could plunge the world economy back into recession. The TUC believes that caution is necessary and that there should be no attempt to begin paying off the deficit until it is clear that the economy can remain in positive growth while that happens. We discuss this further in the sections below.

2.11 Finally, whilst we recognise that we are entering into a period of spending restraint, we remind policy makers that the economic fundamentals required for the UK to succeed in the era of globalisation remain to be met. Writing in the Observer on 13th September 2009, Will Hutton describes the importance of taking advantage of the scientific and technological opportunities before us. He calls for a world-class infrastructure, from a high speed rail network to great schools and universities. He calls for a "high investment, fair capitalism", arguing that the "allegedly self-organising market is delivering far too low a level of business start-ups and far too few of these firms survive to become fully-fledged, medium-sized enterprises". The TUC agrees with this statement, which underpins the importance of the New Industry, New Jobs agenda introduced by Lord Mandelson.

2.12 In conclusion, this submission focuses on the response to the economic crisis, in the light of the political debate around meeting the costs of the deficit. But our vision of a high-skill, high-value, good work economy, which must form the cornerstone of the UK economic model of the twenty-first century, remains central and should not be forgotten by policy-makers.

Section three

The Public Deficit

Introduction

3.1 In recent months, public discussion of the state of the economy has been dominated by the size of the deficit and the urgency, or otherwise, of reducing it. Put simply, visualising the nation's economy in a similar way to a household economy, as pioneered by the Thatcher Government, has captured the public's, or at least the media's, consciousness. This means that the danger of "spending beyond the nation's means" has been at the forefront of many people's minds.

3.2 There are a number of problems with this approach. Most obviously, the state is regarded by lenders as a much safer debtor than the average householder. The willingness of lenders to keep lending to the state at affordable rates of interest is not infinite but it is clearly very high. It may not be desirable for the state to borrow large and expanding amounts, but it is not necessarily a profound and urgent problem when it does.

3.3 Furthermore, increased borrowing by the state is a clear way of ensuring that ordinary householders and businesses themselves do not face just the sort of financial crisis that many wrongly believe the state faces. By expanding its borrowing and spending capacity during a period of recession, the state acts as an investor just at the time that the private sector is no longer showing the willingness to invest. The state thus acts as an important financial safety valve which prevents the private sector spiralling into a worse situation.

3.4 In addition, unlike in the average household, cuts in spending by the state can result in very significant short and longer term costs to the state, most notably the extra direct and indirect costs of unemployment caused by redundancies resulting from cuts in public services and cancelled public procurement contracts.

3.5 For all these reasons, the underlying narrative of applying household budgeting rules to the state finances is not only deeply misleading, but is potentially highly damaging to the economy.

3.6 So let us state here that the committed action taken by the Government, in the form of fiscal stimulus, in the last two years has most certainly been the prudent thing to do. Indeed, without this stimulus, the state of the UK and indeed the world economy would be much, much worse. Writing in The Observer on 13th September 2009, Will Hutton describes the "breathtaking success of the most aggressively Keynesian economic stance taken since the war". Three days earlier, Times columnist Anatole Kaletsky chides the

Conservatives for wanting even faster fiscal tightening than announced in the 2009 Budget, arguing that macroeconomic stimulus programmes have "saved the global economy from a 1930s-style collapse".

3.7 Nevertheless, in the longer term, the deficit must be repaid. This is for three reasons.

- Firstly, running a public deficit of approximately 12% over the long term is not sustainable in the eyes of lenders. The TUC does not believe that the bond markets are suddenly about to push interest rates to high levels nor refuse to buy gilts. However, if the Government were to run a deficit of this size over the long term, with no clear plan for its reduction, then it is likely that interest rates would rise and some lenders may look to other places to invest.
- Secondly, it is clear that there are far better uses for public money than the servicing of interest payments on large debts. With ever expanding demands on public services and the need for public investment in areas such as green infrastructure, it is clearly right for government to reduce its debt commitments.
- Finally, no-one knows for sure what major demands on public finances there may be around the corner, but a government that is heavily committed to debt servicing has less freedom to respond appropriately and speedily to challenges such as natural disasters, security threats or rapid demographic shifts.

3.8 This section will now deal with such questions as the true level of the deficit and the timescale in which the TUC believes it should be repaid. The following section will set out some ideas for repayment, while this one will describe some ways in which the deficit most certainly should not be repaid if low and middle-income earners, and the wider UK economy, are not to suffer.

How high is the deficit?

3.9 In the 2009 Budget, the Treasury forecast that public sector net borrowing (the annual budget deficit) would peak at £175 billion (12.4 per cent of GDP) in the fiscal year 2009-2010[3]. At the time of the Budget, the Chancellor made the pledge to halve this deficit within four years, meaning it would fall to 5.5 per cent of GDP, or £97 billion, by 2013-14. Of course, this year's PBR 09 may update these figures.

3.10 At the same time, net debt for 2009-10 is predicted to be 55 per cent of GDP, rising from 43 per cent in 2008-09 and 36.5 per cent in 2007-08. This is projected to rise to over 76 per cent of GDP by 2013-14.

[3] *Budget 2009*, p.33 table 2.3

3.11 Despite the fact that some of the more hysterical media coverage has focussed on the size of the absolute debt, the real issue to be addressed is the deficit, as the Institute for Fiscal Studies made clear in its recent paper, 'Britain's Fiscal Squeeze'.[4] It is an ongoing structural deficit which would lead to an unsustainable rise in debt and so the deficit is of more concern than the debt.

International comparisons

3.12 The IMF has revised its debt projections, giving higher figures than the Treasury estimates, concluding that UK debt will be 68.6 per cent of GDP in 2009, rising to 99.7 per cent in 2014[5]. To give the UK situation some context, this sits alongside a prediction that, by 2014, debt to GDP ratios in all the G7 economies except Canada will exceed 90 per cent. The average for the G20 is 100.6 per cent in 2009 and a projected 119.7 per cent in 2014.

3.13 Turning to look at budget deficits, the IMF projects an average fiscal deficit in the advanced G20 countries of 10 per cent of GDP in 2009 and 8.5 per cent in 2010. By 2014, these averages are expected to be around or above 4.5 per cent of GDP.[6]

Historical precedent

3.14 Whilst these levels of debt and deficit are undeniably high given the relative financial stability of recent decades, it is worth bearing in mind that there is a significant historical precedent for far higher debt as a proportion of GDP. In his Observer article on 13th September, Will Hutton pointed out the long history of higher debts than we see now:

> "David Cameron and George Osborne ….. have decided that the national debt peaking at some 80 per cent of GDP constitutes a national emergency. Never mind that since 1750 the national debt has always been proportionally higher than this, except for two 40-year periods – one at the end of the 19th century and the other from the 1970s until now."

3.15 Samuel Brittan explored the same issue in the Financial Times on 2nd October 2009:

> "Debt ratios of this size are historically far from unprecedented. In the early Victorian period the ratio was nearly 200 per cent and almost reached that level again in the early 1920s. In 1956 it was just under

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4 http://www.ifs.org.uk/bns/bn87.pdf
5 http://www.imf.org/external/pubs/ft/spn/2009/spn0921.pdf
6 International Monetary Fund *Global Financial Stability Report,* October 2009 http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/text.pdf

> 150 per cent. Harold Macmillan, who was chancellor at the time, quoted the historian Lord Macaulay: 'At every stage in the growth of that debt it has been seriously asserted by wise men that bankruptcy and ruin were at hand; yet still the debt kept on growing, and still bankruptcy and ruin were as remote as ever.' In fact the debt was gradually reduced from the peaks mentioned above without any heroic gestures."[7]

3.16 Where does this get us? The TUC accepts that the deficit must be reduced over the medium to longer term. Below, we say more about the timescale for this reduction, before setting out some principles about how the deficit should be reduced. In our view, there are ways of reducing the deficit that have more or less of an impact on ordinary working people – the victims, not the instigators, of this economic crisis. However, it is essential that recent fiscal stimuli are allowed to run their course and that these are not cut while there remains any threat that such action would prolong the economic downturn.

The timescale for deficit reduction

3.17 Anatole Kaletsky, in his Times article of 10th September, argues: "It will only be when the global economy has convincingly recovered and other governments are cutting back their deficits that pressure in financial markets will build for Britain to move into line. In terms of timing, therefore, the Tories are over-hasty and the Chancellor [has] got it broadly right – major reductions in public borrowing should be planned now, but they should be implemented in 2011 and beyond, not next year."

3.18 Samuel Brittan, in his Financial Times article of 2nd October 2009, seeks to learn lessons from history in this regard: "The danger of premature tightening was illustrated in the US in 1936-37, when the ending of a war veterans' bonus and the introduction of social security taxes helped push the US back into recession when recovery from the Great Depression was far from complete."

3.19 So far, so good. The TUC states clearly that, whatever proposed measures may be included in the Pre Budget Report 2009, these must not come into effect until at least 2011.

Getting back onto a stable course: what needs to be done?

3.20 Although there is a great deal of complexity and uncertainty around the various projections for the deficit and the necessary tightening, a general consensus seems to be emerging that a fiscal gap of £30 billion to £40 billion must be addressed in order to put the deficit back on a sustainable course by

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[7] http://www.ft.com/cms/s/0/4679c2be-aed0-11de-96d7-00144feabdc0.html?nclick_check=1

2015-16. The IFS cited figures of around £40 billion in the lead-up to the Budget in April[8].

3.21 The IFS has also calculated that Treasury figures imply a real-terms cut of £33 billion by 2013-14, given unavoidable increases elsewhere in debt interest, benefit payments on so on. The Treasury projections include certain plans to increase the tax take which have already been announced, including increasing the top rate of tax to 50 per cent on those earning over £150,000 and the 0.5 per cent increase in National Insurance Contributions from April 2011.

3.22 The Treasury usually publishes spending plans broken down into current and capital spending, while also divided into Departmental Expenditure Limits [DELs), the money Whitehall departments have to spend on public services and administration, and Annually Managed Expenditure [AME}, other areas of spending less amenable to long-term planning, such as social security, debt interest and public sector pension payments.

3.23 In a detailed paper published this September, the IFS argued that:

> [a] reduction in DELs could be avoided if a combination of increases in tax and cuts to spending on welfare benefits with a combined value equivalent to 2.1% of national income (£930 per family or £29bn in total a year in today's terms) were implemented (p34).......by 2013-14 (p40).[9]

3.24 From these analyses, it seems fair to assume that, given the likely path of economic growth and rising tax revenues over the next four years, the Government must find or free up between £30 and £40 billion by 2014 to significantly reduce the deficit over the lifetime of a Parliament.

Principles for deficit reduction

3.25 We can expect more details on exactly how the competing political parties, Labour, Conservative and Liberal Democrats, would go about cutting the deficit in the debate that will accompany the run-up to next year's General Election. This is clearly a discussion that is going to run. From a TUC perspective, there are a number of principles that should inform any methods used to bring the budget deficit down:

3.26 **Effective.** Clearly any measures must lead to a real reduction in the deficit;

3.27 **Progressive.** For the TUC, a progressive solution to the deficit will be one which requires those who can afford to pay more to do so. Allowing a disproportionate burden to fall on the shoulders of the poorest would be the

[8] http://www.ifs.org.uk/bns/bn83.pdf
http://uk.reuters.com/article/idUKTRE5352LE20090406
[9] http://www.ifs.org.uk/publications/4618

least progressive outcome and this must inform the choices that any government makes;

3.28 **Proportionate.** The response to the deficit must be one which meets the genuine level of challenge posed by the fiscal situation, not one created by misleading media commentary or electoral expediency.

3.29 **Limited in its economic consequences.** Care must be taken to avoid any action that might lengthen the recession or take us back into recession once the economy is growing again.

3.30 **Just.** It is important that those who did not cause the recession, but are the victims of it, do not shoulder the burden of dealing with the deficit. Indeed, there is a strong moral case that the burden should, in fact, be borne more heavily by those who caused the financial crisis and recession, which has led directly to the fiscal problems we now face.

Spending Cuts

3.31 Some voices from the political right are advocating urgent and deep cuts in public services, benefits, public sector pensions and pay and the state pension, in the name of reducing the deficit quickly and under the guise of so-called prudent economics. It is essential that those voices are ignored.

3.32 Using the criteria set out above, such action would fail on every front.

3.33 For example, this approach fails the effectiveness test. The notion that cuts automatically translate into a reduced deficit is flawed. Previous TUC analysis has shown that a 10% cut in public spending would, on a conservative estimate, translate into the loss of 200,000 public sector jobs. In addition, cuts in public procurement (the budget for which now outstrips that for public sector pay) would lead to bankruptcies and further redundancies in the private sector. And the wider impact on the economy in terms of reduced spending power of the newly unemployed would itself further damage business growth and employment. The costs of this to the Treasury in terms of extra benefit payments and increased costs for policing, healthcare and social services, as well as reduced tax revenues, resulting from the recessionary impacts of a spending cuts programme, are enormous.

3.34 These implications help explain why, when Margaret Thatcher became Prime Minister, the public deficit actually rose rapidly following her implementation of cuts. Indeed, the deficit did not begin to fall until a full six years after she took power and once the recession of the early eighties had passed.

3.35 Major cuts would inevitably not be progressive. Public services are clearly more important to the most vulnerable, but are also a vital source of education, healthcare and other crucial services to millions of people on low and middle incomes across the UK. Major cuts in spending would inevitably affect these core groups of the UK economy and society most heavily.

3.36 As explained above, the notion that urgent and deep cuts are required to stem the threat of a sudden spike in interest rates, a gilt strike on the bond markets or a sterling crisis, is not proportionate to the actual fiscal challenge. Those who have been making this argument for some months now are beginning to look like the bearers of "the end is nigh" placards. Despite all their predictions, gilts are still being bought and the interest rates demanded by those buying them remain well within trend. Indeed, any downward pressure on sterling in recent months seems to have been caused by news about the troubles of the wider economy rather than the fiscal situation – a fact which suggests that those urging cuts may bring about the very crisis they claim to be averting.

3.37 Urgent and deep cuts also risk the health of the economy as explored earlier, meaning this approach fails the fourth criteria. Clearly withdrawing public funds from the economy and raising bankruptcies and unemployment just when the economy may be in a very fragile and volatile post-recession phase is to play with fire in a way that could threaten the long-term health of the UK economy.

3.38 Finally cuts would not be just. The burden would be borne initially by public servants and then by working people across the wider economy. These groups (despite the bizarre claims by the right-wing press and politicians that the cause of the recession is the size of the state) are entirely blameless as sources of the current economic and resulting fiscal troubles. Indeed, urgent and deep cuts would let those actually responsible for the problem entirely off the hook.

3.39 For these reasons, the TUC opposes deep cuts in public spending. Moreover, we warn against covert as well as overt cuts. Recruitment freezes are not direct cuts, but they have the same effect. In some instances, unnecessary cuts are taking place, such as in healthcare. This activity undermines the economy and society and should be stopped.

Higher VAT

3.40 Another deficit reduction option currently being discussed is to raise VAT beyond its normal rate of 17.5%. Again this is a measure that fails on many, if not all, of the criteria.

3.41 Raising VAT would certainly generate a considerable revenue stream for the Treasury to pay off a large amount of the deficit. Raising VAT to 20%, for example, could raise an extra £10 billion per year, although given that VAT is already a widely evaded tax, it is certain that raising the tax would increase evasion, with all the consequences that would have for longer term revenues from this source, as well as increased criminal activity.

3.42 In addition, a limited or gradual rise in VAT cannot be portrayed as a disproportionate response to the fiscal challenge, although a sudden and extreme hike to say a 22% rate is almost certainly unjustifiable.

3.43 However, on all other criteria, an increase in VAT fails. VAT is a notoriously unprogressive tax, taking a much larger proportion of the income of low and middle earners than those higher up the income scale. A VAT rise would not be just, as the burden of addressing the deficit would fall on those bearing no responsibility for the problem, while leaving those who do bear it relatively unaffected. Most worryingly, maybe, is the effect a rise in VAT could have on a still sensitive economy. Imposing extra costs on consumers just as confidence might be beginning to return would probably not have the devastating effect of public spending cuts, but it would certainly have a significant dampening effect just when it is not needed.

Higher Income Tax

3.44 Another option that some commentators expect is an increase in income tax rates. As with VAT, the actual speed and level of any rise would determine whether this measure was proportionate. Unlike VAT, income tax is a progressive tax and so would ensure that a heavier burden falls on those most able to pay.

3.45 A rise in income tax also displays a greater measure of justice, as more would be paid by the wealthy financiers and City traders who are primarily responsible for the recession and resulting problems in the public finances. However, to be an effective measure which would generate the significant levels of revenue needed to reduce the deficit, rises in the basic rate of income tax would be required, as 90% of taxpayers only pay tax at this rate. This would mean that the costs of deficit reduction would be borne by millions of people on ordinary incomes who bear no responsibility for the current crisis.

3.46 Like the VAT rise, however, a rise in income tax could also act as a dampener on consumer confidence and demand at precisely the point when the UK economy needs a sustained recovery in these areas. It is generally assumed that a 1% rise in the basic rate of income tax generates about £4 billion extra revenue for the Treasury. This would indicate that a rather significant rise in income tax would be needed to make a serious dent on the deficit if we accept the consensus of requiring £30 to £40 billion of new or released revenue for the deficit to be significantly reduced. For this reason, it would not perform well against the criteria of having limited economic consequences.

An alternative approach

3.47 This section has looked at the main methods of deficit reduction currently being widely discussed. It is clear that they all perform with varying degrees of success against our five criteria, but none perform well against all five. The next section proposes a series of tax options for addressing the deficit which are not widely discussed, but which we believe do perform far better against all five criteria.

Section four

Tax Solutions to the Public Deficit

Six Tax Options

The TUC does not believe that the public deficit will be reduced solely through the use of tax measures but we do believe that if the deficit reduction measures adopted are to meet the five criteria outlined above then the tax measures detailed below will have to bear by far the greatest burden.

4.1 We have identified six tax options which we believe could play a key role in deficit reduction. We are not suggesting that any Government would want to introduce these simultaneously or indeed over the medium term. However, this menu of options does show how central innovative tax policy can be to a deficit reduction strategy.

4.2 For the sake of brevity and to avoid repetition, we have not explored how every one of these proposals in turn meets the criteria, but each has been proposed because we believe:

1. they would be effective in generating significant revenue streams to address the deficit;
2. they are broadly progressive taxes with the burden of payment falling more heavily on those most able to pay;
3. they represent a considered and prudent reaction to the fiscal challenge and hence are proportionate;
4. they are just in that the burden of payment would be borne heavily by the individuals and institutions that created the recession and resulting fiscal problems;

- they either have very limited economic consequences and certainly represent no systemic challenge to the UK economy and in some cases actually have beneficial economic consequences.

The six options with estimates of the likely revenue they could raise over the course of one year, are:

- A Major Financial Transactions Tax (£30 billion);
- A General Anti-Avoidance Principle (£1 billion);
- A Tax Relief Cap (£10 billion);
- An Empty Property Tax (£5 billion);
- Collecting tax that is due by improving HMRC resources (£20 billion);

- Abolishing the Domicile Rule (£3 billion).

A Major Financial Transactions Tax

4.3 There has been considerable press discussion of late regarding so called ‘financial transaction taxes’ which can be charged on the speculative activities of banks. The G20 is currently considering such a tax at a global scale as a way of raising funds to meet the UN’s Millennium Development Goals and the Chair of the Financial Services Authority, Lord Adair Turner, recently suggested that a transactions tax would be an effective way of restricting the “socially useless” activity of financial institutions in the UK.

4.4 The TUC urges the Government to draw on these debates and consider introducing a tax on all major financial transactions It is suggested here that this not be adopted solely for its dampening effect on financial speculation but as a highly effective revenue raiser which could make a major or even the primary contribution to reducing the deficit.

4.5 As well as being effective, we also believe that such a tax would meet the other four criteria detailed above more closely than any of the other options which currently dominate public debate.

- It is proportionate in that it is a considered measure that allows the deficit to be reduced within a reasonable rather than urgent time frame and without causing deep damage to other aspects of the state’s functions.
- It is progressive because, by its very nature, it raises revenue from those with the wealth to undertake large, and often very large, transactions.
- Its negative economic consequences are almost certainly very limited. While many in The City will undoubtedly argue that such a tax will weaken London’s attractiveness as a business centre, it is clear that any of the other options (higher VAT and income tax, weakened public services and infrastructure) would also have the same impact. And, as noted above, many would argue that providing a disincentive to some of the more volatile and destabilising transactions is a positive rather than negative outcome. However, it should be kept in mind, as is shown below, that such a tax could generate very high revenues when set at a very low rate, thus having a very limited economic impact.
- It is a just measure because the great burden of this tax will be borne by the very institutions which created the financial crisis and resulting recession and which thus are the main causes of the current public deficit.

How much would a Major Financial Transactions Tax (MFTT) raise?

4.6 The total volume of major financial transactions recorded by the Association for Payment Clearing Services in the UK for 2008 was £73,625,907,000,000 or just under £74 trillion. This is the amount that runs through the sterling version of the Clearing House Automated Payments System (CHAPS) – the system used by large banks to make same day, irrevocable transactions. CHAPS is used for a number of purposes but by far the greatest part of its activity is generated by the trading activity of large financial institutions.

4.7 To put this in context, all other forms of transactions conducted in sterling in 2008 (such as debit cards, cheques and cash machines) amounted to just over £4.5 trillion. The total GDP of the UK is approximately £1.5 trillion.

4.8 At these scales, a Major Financial Transaction Tax would net £37 billion in tax revenues if the tax was set at just 0.05% - that is about one eighteenth of one per cent. With such a rate, on £1 million the tax due would be £500. The average transaction through CHAPS in 2008 was around £2 million. This would attract a tax liability of just £1,000. It is hard to believe that such a limited tax relative to the size of the transaction would be a major burden to large financial institutions.

4.9 Of course, smaller transactions do run through the CHAPS system which are conducted by various businesses and, on occasion individuals, especially when purchasing a property. But if these were to be taxed at these rates, the amounts are very small. The tax due on a transaction of £100,000 would be just £55, on a transaction of £10,000 it would be just £5.50.

4.10 Given the sorts of revenues that a MFTT could generate, we believe that using such a measure for deficit reduction must be investigated urgently by the Government and we urge the Chancellor to announce a speedy consultation on the use of a MFTT in the Pre-Budget Report to be completed in time for Budget 2010.

4.11 There are, of course, some important questions such a consultation should consider:

- How should such a tax be raised? It is not clear whether using the CHAPS system as the base for a MFTT is possible or desirable. In particular, CHAPS is used by ordinary businesses and individuals on occasion (although irregularly and for much smaller sums) and it is important that a MFTT does not constrain their activities.
- What exactly might such a tax raise given that financial transactions have almost certainly reduced somewhat since 2008 and given the possible dampening effects of the tax? It seems prudent to assume that the amount of Sterling transacted through CHAPS in 2009 may have declined by 10% compared to 2008. In which case, an MFTT set at 0.050% would raise closer to £30 billion. However, given that there is no urgency to raise this amount immediately, an MFTT could be introduced once the economy and financial sector had recovered from the crash or could even be phased in over a number of years.

- Should a MFTT be a temporary or permanent tax? If the primary aim of a MFTT is to raise funds to reduce the deficit then it use could expire once the deficit had returned to acceptable levels. Alternatively, if a MFTT does have genuine economic benefits in dampening speculative financial activity then it may be maintained over a longer period or even permanently.
- What anti-avoidance measures need to be put in place to prevent financial institutions shifting transactions overseas, denominating in other currencies, or artificially reducing the size of transactions?

4.12 These questions reflect the significant debate likely to be generated by the introduction of a MFTT but we do not believe any of these questions are irresolvable and we do not believe that they should be used as grounds to reject a tax which could play a very significant role in reducing the deficit in an effective, proportionate, progressive, just way without causing economic damage.

A General Anti-Avoidance Principle

4.13 The TUC has estimated that tax avoidance of various sorts costs the UK at least £25 billion a year. Piecemeal attempts to tackle this issue only meet with howls of protest from the business community. An attempt to introduce a Code of Conduct for British Banks that asks them to voluntarily stop tax avoidance has been greeted with claims that the Code is unconstitutional and that to comply would be contrary to a company's duty to minimise its tax bill, although no such duty actually exists in law.

4.14 It is becoming apparent that there is no prospect of voluntary restraint in this area and legislative action is needed to tackle abuse that originates within these professions. This could be done by enacting what is called a General Anti-Avoidance Principle (GAAP). The idea behind a GAAP is simple: if a step is added to a transaction with the sole or principal aim of securing a tax advantage (which is defined as a saving in tax) then that step in the transaction is ignored for tax purposes. In other words, it tackles pre-meditated attempts to subvert the intention of the tax system. There are a great many 'pre-packaged' abuses of the tax system sold by tax advisers, despite the existence of law since 2004 supposed to expose such schemes. A GAAP would simply render them inoperative.

4.15 The result will be simpler, and better, law and a significant reduction in the level of tax avoidance. Estimating by how much that abuse will be reduced is hard to do, but each year it seems that the government seeks to close at least £1 billion of tax loopholes, and more must slip through the net because of a lack of time to create law to tackle them. It is, therefore, quite reasonable to think that as much as this should be saved a year by a GAAP, making at least £5 billion over the life of a parliament, and maybe somewhat more if, as is likely, behaviour changes as a consequence of such a law, the like of which has proven successful in other locations such as Australia and South Africa.

A Tax Relief Cap

4.16 By restricting total allowances and reliefs for those earning over £100,000 to the maximum average level claimed by those earning less than £100,000, the total tax saving each year would exceed £10 billion. This would not only generate large sums to help pay off the deficit, but would achieve greater equity in the allocation of expenditure on tax reliefs (much of which goes on pensions), and by replicating this restriction in national insurance reliefs and reliefs for employer contributions to pension funds.

4.17 It is stressed, this replicates in part (but not entirely) work already done by the TUC on pension tax relief for this income group.

4.18 The change would have the added benefit of significantly simplifying the tax regime by making many smaller allowances and reliefs redundant.

Background

4.19 The UK has, at least nominally, a progressive tax system. In practice, however, tax is not paid at the rates due to the wide use of various tax reliefs and allowances. The major such income tax allowances and their cost is as follows in 2009/10[10]:

10 Source: HMRC stats table 1.5 accessed 7-10-09 http://www.hmrc.gov.uk/stats/tax_expenditures/table1-5.xls barring pension data which is from table 7.9 accessed on the same date taking into account income tax on employee contributions alone http://www.hmrc.gov.uk/stats/pensions/table7-9.xls The TUC's estimated total cost of tax reliefs for pensions includes NIC relief and the cost of employer's relief and reliefs within funds – making the total overall almost £37 billion.

Estimated costs of the principal tax expenditures and structural reliefs

	£ million 2008-09
Tax Expenditures	
Income tax	
Relief for:	
Registered pension schemes as per HMRC table 7.9	7,100
Share Incentive Plan	150
Save as you earn	230
Enterprise Management Incentives	150
Approved Company Share Option Plans	110
Venture Capital Trusts	60
Enterprise Investment Scheme	130
Professional subscriptions	80
Rent-a-room	120
Seafarers' Earnings Deduction	110
	8,240

4.20 Note, that tax relief for pensions shown here is only the figure that would go through an individual's tax return. The total cost is some £37 billion.

4.21 Unfortunately the data for the allocation of these reliefs to taxpayers sorted by tax band is only available at present for periods up to 2006-07, in which year the total such reliefs amounted to gross sum (i.e. before calculated at a person's marginal tax rate) of £28.8 billion. This is an implicit tax rate of 28.6% - although caution is needed because of the different years involved.

The allocation was as follows in 2006/07[11]:

Range of total income (lower limit)	Total income			Total deductions and reliefs			Personal allowances	Total tax			Total income after tax	Average rate of tax
	No. of individuals	Amount	Mean	No. of individs.	Amount	Mean	Amount	No. of individs.	Amount	Mean	Amount	
£												%
5,035	919	5,090	5,540	100	31	309	4,630	919	43	47	5,050	0.9
6,000	1,120	7,240	6,500	208	86	414	5,620	1,120	155	139	7,090	2.1
7,000	1,320	9,960	7,520	222	115	515	7,230	1,320	296	224	9,670	3.0
8,000	2,920	26,200	8,980	477	298	625	16,700	2,920	1,330	457	24,900	5.1
10,000	2,790	30,600	11,000	718	371	517	16,300	2,790	2,390	856	28,200	7.8
12,000	3,810	51,400	13,500	1,240	723	583	22,300	3,810	5,330	1,400	46,000	10.4
15,000	5,270	91,600	17,400	2,410	1,780	740	29,500	5,270	11,900	2,260	79,800	13.0
20,000	6,530	160,000	24,500	4,410	4,410	1,000	34,400	6,530	24,600	3,760	135,000	15.4
30,000	4,900	184,000	37,500	3,950	7,190	1,820	24,900	4,900	32,000	6,540	152,000	17.4
50,000	1,140	66,000	58,000	937	2,780	2,970	5,790	1,140	15,400	13,500	50,600	23.3
70,000	534	44,100	82,500	438	1,990	4,540	2,710	534	12,100	22,600	32,000	27.4
100,000	293	35,400	121,000	242	2,100	8,670	1,490	293	10,600	36,100	24,800	29.9
150,000	113	19,300	171,000	94	1,200	12,800	572	113	6,120	54,300	13,200	31.7
200,000	87	20,900	240,000	74	1,340	18,100	441	87	6,860	78,900	14,000	32.9
300,000	46	17,400	378,000	39	1,240	31,600	234	46	5,940	129,000	11,500	34.0
500,000	26	17,400	678,000	22	1,470	66,400	130	26	6,000	234,000	11,400	34.5
1,000,000	11	24,000	2,170,000	10	1,670	174,000	56	11	8,580	776,000	15,400	35.7
All ranges	31,800	810,000	25,500	15,600	28,800	1,850	173,000	31,800	150,000	4,700	661,000	18.5

Primary Source: Survey of Personal Incomes 2006-07

4.22 This data will be used for the purposes of calculations: the result will be conservative estimates.

4.23 It will be noted that, until income of £100,000 is reached, personal allowances are the most important form of relief given to a taxpayer. Thereafter other forms of relief (principally pension relief) are more important. Data for this range with regard to allowances and reliefs is:

[11] Source: http://www.hmrc.gov.uk/stats/income_distribution/3-5tabledec08.xls

Range of total income (lower limit) £	Total deductions and reliefs		
	No. of individuals	Amount	Mean
100,000	242	2,100	8,670
150,000	94	1,200	12,800
200,000	74	1,340	18,100
300,000	39	1,240	31,600
500,000	22	1,470	66,400
1,000,000	10	1,670	174,000
	481	9,020	n/a

4.24 It is apparent, therefore, that 3.1% of the taxpayer population received 31.3% of all tax reliefs in that year. The gross allowance to each averaged £18,750.

4.25 The proposal made here suggests that this is a misallocation of tax resources. It also means that the effective rates of tax are significantly lower than those noted in the graphs above. For example, for 2009/10 these reliefs would mean that effective tax rates would be adjusted as follows:

Income £	Notional tax £	Allowances, rounded down £	Tax saved £	Effective tax £	Notional tax rate	Effective tax rate
100,000	29,930	7,000	2,800	27,130	29.9%	27.1%
150,000	49,930	10,500	4,200	45,730	33.3%	30.5%
200,000	69,930	16,000	6,400	63,530	35.0%	31.8%

4.26 The tax rates suddenly look a lot less progressive: indeed, because of the significant rate of allowances and reliefs claimed by those on higher income, it is possible that the system, for some at least, is regressive, as is the overall tax system at this level.

Tackling the issue

4.27 One way of tackling this issue would be to introduce minimum tax rates for incomes over £100,000 so that the value of allowances and reliefs was restricted. However, because of the progressive nature of income tax between £100,000 and £200,000, and because of the new 50% tax rate there are computational issues involved in doing so: there would have to be a number of minimum rates with potential transitional calculations between them as Howard Reed of Landman Economics has pointed out when trying to model this proposal for IPPR. This would add greatly to the complexity of the tax system.

4.28 There does, therefore, appear to be a better way of tackling this issue. That is to restrict the total value of tax allowances available to this group of high income earners. The obvious way to do this is to cap the total value of reliefs they can enjoy to the average total actual value of the group with unrestricted reliefs.

4.29 The average value of reliefs given to those in the income band £70,000 - £100,000 is, according to the above table, £4,540. It would seem appropriate to round this sum up and make the maximum reliefs and allowances any person could claim in a year the sum of £5,000. Of course, if £5,000 was not expended on activities qualifying for relief the lower amount actually expended would be subject to relief instead.

4.30 This would mean that those earning over £100,000 a year should not, on average, be able to enjoy tax deductions of any more than the average maximum of those earning less than that sum. This appears to be eminently fair: tax allowances are a way of claiming tax subsidy. There seems no logical reason why the best off in society should be able to claim considerably more tax subsidy than those on low income.

4.31 The impact of this proposal is as follows:

Range of total income (lower limit) £	No. of individuals	Total tax relief for whole group	Mean	Revised allowance £	Disallowed sum £	Total tax relief @ 40% £'m	Total tax relief at 40% and 50% £'m
100,000	242	2,100	8,670	5,000	3,670	355	355
150,000	94	1,200	12,800	5,000	7,800	293	367
200,000	74	1,340	18,100	5,000	13,100	388	485
300,000	39	1,240	31,600	5,000	26,600	415	519
500,000	22	1,470	66,400	5,000	61,400	540	675
1,000,000	10	1,670	174,000	5,000	169,000	676	845
All ranges	15,600	28,800	1,850			2,668	3,246

4.32 It should be noted that pension tax relief is already proposed to be cut to those earning more than £150,000 a year from 2010/2011 onwards. As such, this level of saving would not, superficially, be achieved.

4.33 However, this is not the limit to the savings available. As noted, the calculation of pension saving here is only that which passes through the tax return of the individual tax payer. This amounts to £7.1 bn. In addition, £14.1 bn of tax relief is given to companies and £8.2 bn of national insurance relief is given. It is stressed, these are actual costs, not the value of reliefs. However, the above calculation suggests relief of about £2.6bn would be saved directly using the proposal made here. This is 31% of the total cost of tax reliefs. In that case if tax relief on employer pension contributions and on national insurance were restricted in the same way, 31% of these sums could also be saved: a total of £6.9 bn in all.

4.34 Added to the savings that could be made at the future 50% tax rate in total, this makes the likely savings £10.1 bn from restricting allowances and reliefs given to those earning over £100,000 to the maximum level granted on average to earnings below that sum. At a time of austerity, there can be no justification for providing this level of tax relief to the wealthiest in the UK. And this restriction would, by itself, fund one quarter of the sum needed to close the current UK funding deficit.

4.35 If it was thought that the impact of this change would be too great if imposed without transitional relief being given, then there are a number of ways in which transitional steps could be created.

4.36 First the limit on allowances need not be £5,000 in the first instance. A higher overall limit could be used, before being reduced over time until this overall desirable level was reached.

4.37 Alternatively, in the long term the full restriction on allowances to a sum of £5,000 might be matched to a target to remove the 50% tax rate. This has merit. The system proposed here means that higher rate taxes are collected. A 50% tax rate with a full range of allowances still being available means that at least some of the tax due at that rate will be avoided. For a person on earnings of £1 million, the new 50% tax rate notionally increases their tax due by £85,000. The restriction on allowances to £5,000 if applied at a 40% tax rate notionally increases their tax bill by the lesser sum of £67,600. However, the government is highly likely to collect the latter sum, but is not guaranteed to collect the additional tax due form introducing the 50% rate. There would also be significant saving to the taxpayer to take into account in the arrangement that restricts tax allowances as a result of the simplification of their tax affairs, so reducing their tax compliance costs.

An Empty Property Tax

4.38 A recent report[12] has suggested that there are at least one million vacant properties in the UK. This is a national scandal: waiting lists for social housing are interminable for many whilst large numbers are simply unable to afford a home of their own.

4.39 The same report suggested that the owners of many of these vacant properties were offshore, tax haven companies registered in locations such as the British Virgin Islands, Jersey, Guernsey and Switzerland. For all practical purposes, it is almost impossible to determine who owns these companies. They could, for example, be owned by UK resident people who are hiding that fact by registering these properties in the names of tax havens companies.

4.40 Anecdotal evidence from HM Revenue & Customs also suggests that, although there is a requirement that a non-resident landlord company be registered with HM Revenue & Customs[13] this scheme has become a virtual rubber stamping exercise: enquiry is not made as to the beneficial ownership of the companies that apply to receive rent from the UK without taxes being deducted at source and a list of properties the landlord owns is not demanded.

4.41 This combination of circumstances suggests a considerable problem exists within the UK housing market and that a problem exists with the taxation of offshore landlords and that the two issues might coincide, especially when landlords have kept properties empty, holding them purely for speculative purposes on which no tax will arise. These issues need to be tackled, and in combination.

4.42 We propose three changes to taxation as a result. Firstly, we suggest that there be an annual tax on empty homes. This tax should be designed to force the property back into the housing stock available for use i.e. the rate should be designed to encourage those facing the charge to avoid it by selling or letting the property. The charge should therefore be a sum equivalent to five times the council tax charge that would be due upon the property if it were in use as a dwelling. This is reasonable: it represents the cost to society of having available dwellings left unoccupied in terms of deterioration of neighbourhoods, cost of alternative housing, the artificial increase in rents because available property is not made available to the market, and more.

4.43 The current average annual council tax[14] in England is £1,175 meaning the average tax charge under this proposed arrangement would be £5,875 and the total tax raised would amount to more than £5 billion a year, with a declining yield over time as properties are brought back into the housing stock. The average house price in the UK is currently[15] approximately £225,000,

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12 http://www.guardian.co.uk/society/2009/oct/16/empty-houses-london-wealthy-owners
13 http://www.hmrc.gov.uk/CNR/nrl2.pdf
14 http://www.communities.gov.uk/documents/statistics/pdf/1289026.pdf
15 http://news.bbc.co.uk/1/shared/spl/hi/in_depth/uk_house_prices/html/houses.stm

meaning that the average tax due would be about 2.6% of a property's value. The yield from this tax would be increased if vacant properties in the top council tax band were individually assessed to the tax at 2.6% of estimated current value. This would make the tax charge on an averagely priced detached house in Greater London (currently[16] £521,000) approximately £13,500. In the event that tax was not paid the charge would be registered as due on the land registry entry for the property and would be collected whenever a future sale of the property took place, plus interest.

4.44 The second tax we propose is that unless an overseas landlord who is an individual is willing to prove that they have paid tax in their place of residence on the rent they will receive from a property in the UK then tax at basic rate should be deducted from all payments of rent made to them either by their tenant, or with much greater likelihood, by their letting agent. Procedures to do this are already in existence, but it is at present possible to apply for gross payment of the rent without ever proving that tax is paid elsewhere on the income arising. This should now change and tax should be paid in the UK in the first instance, until the income can be proven to have also been declared elsewhere.

4.45 In the case of the non-resident landlord being a company there should be a different requirement. In every such case tax should be withheld at source on the grounds that the property in the UK represents a taxable branch of the company in the UK. That tax withheld should be required to be paid to HM Revenue & Customs at least quarterly, but with the right to make applications for repayment at the year-end if it can be shown that the tax due on a properly computed profit was less, but then only if the full beneficial ownership is reported to HM Revenue & Customs with evidence of the standard required by anti-money laundering regulations being submitted as evidence e.g. copies of passports as proof of identity and utility bills as proof of place of residence. This would curtail the massive risk of tax evasion in this market through the use of impenetrable offshore companies.

4.46 The third tax would apply in the case of landlord companies that had not proven the identities of their owners: in such cases capital gains tax should be assessed on sale by requiring that 20% of all sale proceeds be paid as tax unless full beneficial ownership of the offshore owners of the company are provided and tax computations submitted, with tax still then being due on the resulting profit.

4.47 Research to date has not indicated precisely what part of the UK private rented sector is owned by companies to which these provisions might apply. The measure is suggested for reason of tackling abuse as well as for raising revenue, although it is very likely that a sum of hundreds of millions of pounds would be raised annually as a result of such changes.

16 http://news.bbc.co.uk/1/shared/spl/hi/in_depth/uk_house_prices/counties/html/county37.stm

Collecting Tax That Is Due by Improving HMRC Resources

4.48 Arrears of tax due to HM Revenue & Customs are rising fast and are well in excess of £20 billion. Despite this, HM Revenue & Customs persists in cutting staff. One consequence is that tax collectors are instructed not to chase debts of less than £10,000 even though such debts are commonplace.

4.49 In 2008-09, HM Revenue & Customs employed an average of about[17] 86,000 staff. Of these, about 11,000 were employed on border related duties, valuation issues and matters relating to child trust funds and other such matters, leaving about 75,000 on tax related work. It cost about £2.4 bn in total to employ these staff at an average pay rate, ignoring pension and social security costs, of about £25,300 each.

4.50 HM Revenue & Customs collected[18] £439 billion in 2008-09, i.e. £5.85 million per person employed.

4.51 Of course, it is quite impossible to say that employing 25,000 extra staff at HM Revenue & Customs would increase collection at that rate. It would not. But there is a total tax gap in the UK of about £70 billion, based on £25 billion of avoidance and about 14% total evasion (based on VAT figures, noted above).[19] If just one third of that gap could be collected by employing 25,000 extra staff, the recovery would be £20 billion at a cost of, maybe, £0.6 billion. The investment of that sum at this time seems to make complete sense.

Abolishing the Domicile Rule

4.52 The non-domicile rule allows those living in the UK (including UK citizens) who can claim some close personal or business association with another country to pay no tax on their earnings outside the UK. PBR 07 changed the rule so that those claiming non-domicile tax status would have to pay an annual charge of £30,000. In 2007, the TUC estimated that the domicile rule might cost the UK as much as £4.3 billion a year in lost revenue.

4.53 There can be no doubt that the changes to the rule introduced by PBR 07 will have reduced this loss, but given they will affect the lower paid using the rule and given that the £30,000 fee to continue using it affects only tens of thousands of the highest earning beneficiaries, for whom such a sum is insignificant, it is likely that the amount recovered in no more than £1 billion. This leaves £3 billion or so of tax that might be recovered by abolishing the domicile rule.

17 http://www.hmrc.gov.uk/about/hmrc-accs-0809.pdf note 9
18 http://www.hmrc.gov.uk/stats/tax_receipts/table1-2.pdf
19 £439 divided by 0.86 less 439

Section five

Tackling Unemployment

Tackling unemployment

5.1 Since the recession started the UK has seen sharp increases in unemployment. From April 2008-July 2009 unemployment rose by 833,000, and the current unemployment rate is 7.8 per cent. During the period July-Sept 2009, 2,461,000 people were unemployed by the ILO definition.

5.2 In line with trends from previous recessions, the TUC believe it is likely that unemployment will keep rising into 2010. However, while we may see further sharp rises in job losses, particularly as the recovery starts and firms begin to take longer term restructuring decisions, there are some early signs that the steep rises in unemployment that we saw at the start of this year may be behind us. Between the last two rolling quarters (July-September 2009 and June-August 2009) unemployment levels actually showed a slight fall, and there was a small increase in employment. While the ONS's preferred measure of quarterly change is still showing large increases in unemployment levels, the most recent increase (30,000 between April-June and July-September) has been significantly less than the quarterly increases of over 200,000 which were evident at the start of this year. Vacancies are also showing some early signs of possible recovery. While vacancy levels are still extremely low in relation to the start of the downturn, the rate at which levels are falling has slowed as the year has progressed, with the number of vacancies remaining static between the second and third quarters. And independent forecasters have been revising down their estimates of future claimant count increases – from April to October of this year the median forecast for claimant unemployment in 2010 fell from 2.4 million to 1.97 million.

5.3 But as with previous recessions, levels of long-term unemployment are likely to continue to increase even after overall unemployment levels begin to fall. The rate of increase in long-term unemployment is now much faster than the speed at which the overall unemployment rate is accelerating – between June and July of this year the number of people unemployed for over 12 months increased by 6 per cent. There are now 618,000 people who have been unemployed for over a year, and the number of people out of work for over 6 months has already passed one million.

5.4 It is also important to recognise that some communities are feeling the effects of the downturn much more acutely than others. For example, while unemployment rates in the West Midlands have risen by 3.4 percentage points on the year, the East Midlands has seen a much smaller 1.6 point rise. Given that variation within regions will be even greater than differences between them, the impacts of the recession will not be evenly spread across the country. Some local areas will already be experiencing ILO unemployment rates that are significantly above the national average, and are facing real risks of high levels of long-term unemployment in the future.

5.5 Long-term unemployment can cause significant social and economic problems for individuals and communities. Individuals and families who are affected face higher risks of poverty and of a range of poorer associated outcomes in areas including education, health and chances of sustained future employment. Communities with high levels of long-term unemployment also suffer from more social problems, less local demand and poorer levels of local job creation. And there are real economic costs - as well as the additional costs associated with long-term benefit claims, higher crime rates and poorer health, lower employment rates also reduce tax revenues. Research undertaken for the Joseph Rowntree Foundation has found that unemployment becomes more intolerable for individuals as its duration lengthens. In a comparative study considering the experiences of long-term unemployed people, researchers found that “respondents in all three countries felt lonely, isolated and stigmatised and lost self-respect. They relied on family and friends for company and support, feeling that their wider societies held unsympathetic and prejudiced views. [20]

5.6 Individuals were also likely to be unable to afford basic necessities and to be in serious debt. The TUC believe that continued targeted government investment to tackle long-term unemployment will be vital to protecting individuals, families and communities from the scarring effects that sustained high levels of worklessness can bring.

5.7 There is already some evidence that the Government's interventionist approach is having an impact. While recent falls in GDP mean the current recession is the most severe since records began, unemployment rates have not increased as quickly as in the 1980s recession, and employment rates have fallen less steeply than with the downturns of the 1980s or 1990s.[21] Analysis has also shown that the average length of time that new claimants are spending on JSA is now falling each month, with particular improvement evident from the point at which increased levels Jobcentre Plus support were introduced earlier this year.[22] High incidences of involuntary part-time and temporary work and self-employment are partly responsible for higher than expected employment levels, suggesting that, while more people may have kept their jobs, under-employment is set to become a significant issue. However, we also believe that continued Government investment in the economy, and in

[20] JRF (1997) *Long Term Unemployment and the Threat of Social Exclusion* Social Policy Research, 127. York: JRF.

[21] Analysis undertaken by the TUC, published in *Recession Report Number 12*, available to download http://www.tuc.org.uk/economy/index.cfm?mins=594/.

[22] Analysis undertaken by Paul Bivand at the Centre for Economic and Social Inclusion, available to download from: http://www.cesi.org.uk/statistics/.

Jobcentre Plus provision, is playing a significant role in limiting the extent of the rises in unemployment that we have seen during this downturn. We believe that if investment in tackling unemployment is sustained, the Government has a good chance of avoiding the extremes of long-term unemployment that followed the recession of the 1980s.

Young Person's Guarantee

5.8 In our submission to Budget 2009 we called for the introduction of a time-limited Intermediate Labour Market (ILM) programme, which would provide a route to open employment for people who could not otherwise find a job - either because of lack of vacancies or individual barriers to employment. We have therefore strongly welcomed the introduction of the Future Jobs Fund (FJF), which provides real job opportunities for young people who have been claiming JSA for over ten months. Around 60,000 jobs have already been funded, with initial allocations available across the country, and we look forward to the ongoing creation of further positions.

5.9 We believe that a Future Jobs Fund job will significantly improve the chances that many young people have of finding sustainable work, particularly where placements provide meaningful training opportunities and ongoing support to enable young people to search for job opportunities on the open labour market. We believe that local authorities are one of the best sources of possible jobs for young people, providing many opportunities for creating jobs of social value, as well having good training and support structures in place. We are keen to see more local authorities making use of the Fund to create local jobs for young people. We therefore encourage the Government to do all it can to enable more local authorities to develop successful FJF bids.

5.10 We believe that as jobs are allocated, it will be vital that measures are in place to give disadvantaged young people the best possible chance of obtaining a position. Ensuring that employers are providing opportunities that unemployed young people with lower skills and/or less work experience are eligible to apply for, and that Jobcentre Plus advisers are encouraging all unemployed young people to apply for jobs provided by the Fund, will be essential. We also believe that as the Fund is rolled out, and jobs begin to be taken up, it will be important for the Government to monitor participation closely to ensure that those young people for whom the Fund will be of greatest benefit are able to access the opportunities it provides.

5.11 We are also concerned that the scope of the Fund may not be large enough to meet demand. 167,000 young people aged 18-24 have already been out of work for over twelve months (and 158,000 have been out of work for between 6-12 months), and these levels look set to continue to rise for some time to come. As jobs start to be created, we urge the Government to keep take up of the Fund under review, and to consider extending its scope as demand for jobs rises.

5.12 For unemployed young people who are unsuccessful in finding work under the FJF, it will be essential that the Young Person's Guarantee provides alternative meaningful support. In particular, it will be vital to ensure that disadvantaged young people are not simply forced into compulsory work experience under the Community Task Force. We therefore also believe that the Government should monitor the characteristics of young people who are mandated to undertake this option, and to ensure that Jobcentre advisers explore all other options before requiring young people to undertake a Task Force placement.

Extending Job Guarantees

5.13 In July of this year the Government confirmed that from October 2010 two areas will host 'Work for your Benefit' pilots, which will require long-term JSA claimants to undertake six months of full-time compulsory work experience if they wish to retain their benefits. The TUC remains strongly opposed to such workfare schemes. One of the strongest reasons for opposing these proposal is that workfare is an ineffective employment policy. A comparative review of workfare programmes in the U.S. Canada, and Australia, published last year by DWP,[23] concluded that:

- there is little evidence that workfare increases the likelihood of finding work;
- the requirement to work for benefit can limit job search activity;
- workfare is least effective for those with multiple barriers to work;
- workfare is particularly ineffective where unemployment is high.

5.14 However, the same review also concluded that subsidised transitional job schemes paying a wage were a more effective way of supporting long-term unemployed people into sustainable jobs. More recently, Professor Paul Gregg's independent report to the Government[24] reached similar conclusions, finding that: "the overall consensus is that Intermediate Labour Markets (ILMs) have a useful contribution to make to improving the employability of the most disadvantaged individuals." Gregg highlighted that participation in an ILM can send a positive signal to employers about the job readiness of people who undertake transitional work. His report also noted that such programmes are most effective where they build ongoing support and jobsearch assistance into programme delivery.

5.15 Through creating the Future Jobs Fund, the Government has recognised the effectiveness that such demand-led interventions can have in enabling people facing long-term unemployment to move back into work. We also welcome the implicit assumption in the Fund's creation that long-term

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[23] Crisp R and Fletcher D R (2008) *A comparative review of workfare programmes in the United States, Canada and Australia* London: DWP.

[24] Gregg P (2009) *Realising Potential: A Vision for Personalised Conditionality and Support* London: TSO.

unemployed people want to work, but can't find a job. We now believe that the Government should extend this understanding to all unemployed people aged 25 and over.

5.16 Instead of piloting the 'work for your benefit' scheme, we urge the Government to extend its demand side approach nationally to provide a Job Guarantee for all adults who have been claiming JSA for over 18 months – six months after they become eligible for support under the Flexible New Deal. For adults at particular risk of long-term unemployment we believe that the option of applying for a post under the Job Guarantee should be available at an earlier point in their JSA claims. We anticipate that groups of workers who could be provided with earlier access could include those who:

• have been out of work for over two years as a result of spending over 18 months on IB or ESA, and at least six months on JSA;

• have been out of work for over two years as they are lone parents who have been caring for children for at least 18 months and have been claiming JSA for at least six months;

• are aged over 50;

• have a history of cycling between insecure work and unemployment, who have spent at least 12 of the last 24 months on JSA.

5.17 As with the Future Jobs Fund, this Guarantee should offer work in non-traded sectors, helping to minimise the displacement of other workers. It should be established in areas where the market economy is not creating sufficient jobs, workers should be paid the rate for the jobs they undertake, participation should be voluntary and childcare should be offered to participants. We believe that this investment will be needed to prevent a new generation of long-term unemployed workers and communities from facing a post-recession future of worklessness.

Short-time working subsidy

5.18 Since the start of the year, the TUC has called for the introduction of a short-time working subsidy package to support viable firms struggling with short-term economic difficulties during the recession. Across Europe, governments have made subsidy packages available to employers moving workers to short-time hours or making temporary lay-offs, and there is increasing evidence that such interventions have supported economic recovery. For example, in Germany recent evidence shows that over one million workers have benefited from short-time working, and that around 400,000 full-time jobs have been protected.[25]

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[25] H Bach H and E Spitznagel Betriebe zahlen mit - und haben was davon Institute for Employment Research (IAB) of the German Federal Employment Agency 2009.

5.19 Together with business organisations including the Federation of Small Businesses, the British Chamber of Commerce, EEF and the Work Foundation we have advocated for access to a subsidy package for private sector employers who make short-term reductions in staff hours or temporary lay-offs. We believe such a scheme would provide an important means to support firms to save costs and give businesses a better chance of survival. Such a scheme should be available on a time-limited basis, targeted at firms both in need and with strong long-term prospects and should only be available to subsidise a proportion of workers' previous wages. Such support would enable employers to avoid immediate redundancies and to retain essential staff and skills - making business success more likely in both the short and longer terms. It would also reduce the personal and social costs incurred by long-term unemployment (and increase demand by limiting the income reductions faced by workers on short-time hours or temporary lay-offs). If linked to training, it would enable longer-term workforce investment. The experience from Wales shows that such a scheme could be introduced quickly – ProAct was conceptualised in November 2008 and began operation in January 2009. ProAct has been able to support a number of key sectors, such as the steel industry.

5.20 We do not agree with the Government that the tax credit system provides a viable alternative to a short-time working subsidy package. We recognise that in some cases, for those who are eligible for tax credits, entitlements will increase as hours are reduced. And some people whose hours reduce, but who still work over 16 hours a week, will become entitled to tax credits for the first time. In addition, the tax credit system provides a four week grace period before claims have to be adjusted to take account of new working patterns. However, for workers on short-time hours for over four weeks whose reductions in working time take them below tax credit eligibility thresholds, and for those who are not eligible for tax credits in the first place, there will be no subsidy effect. In addition, the complexity of the tax credit system means that adjusting claims for short periods leaves claimants at high risk of incurring overpayments at the end of the year, particularly in the case of those who have no previous experience. And the level of subsidy provided, to those who qualify, is far lower than a short-time working scheme could allow. Where workers' hours are substantially reduced even those who qualify for tax credits will find it very difficult to manage on the reduced income and employers will not be able to fund increased hours or pay for workers' downtime - vital skills and posts will still be lost.

5.21 There is increasing evidence of high levels of short-time working during this recession, with over 3 per cent of the employed population (979,000 people - a 39 per cent annual increase[26]) working part-time although they would rather be in full time employment. With widespread consensus that limited growth in the fourth quarter of this year is likely, a short-time working

[26] Analysis by the TUC, ONS Labour Market data October 2009.

scheme could be of great importance in preventing a further sharp spike in unemployment in the early months of 2010. If firms who are considering redundancies are supported to retain workers for a further six months, in the knowledge of likely future increases in demand as the recovery gathers pace, significant numbers of jobs could be saved.

5.22 The TUC also supports other measures which could act to support such a subsidy package. These include reforming benefit rules that force workers who are on short-time hours or have been temporarily laid-off to look for new work after 13 weeks on benefits. Until 1996 workers who were temporarily laid-off could claim Unemployment Benefit (UB) for as long as the lay-off lasted. They had to be available for their normal job but there were no rules requiring them to give it up eventually. Similarly, when firms introduced short-time working, workers could claim UB for the weeks when they were not in work. When JSA replaced UB, these rules changed. Since 1996 there has been a 13-week period when the old rules apply, but after that claimants are expected to be available for full-time jobs even if it means giving up their existing post. We believe that Government should temporarily rescind these rules and return to the system that existed under Unemployment Benefit, enabling workers affected by reductions in hours or temporary lay-offs to claim benefits.

Retaining a welfare safety net

5.23 In the run up to the Pre-Budget Report there has been much public speculation about possible cuts in benefits including Child Benefit, Child Tax Credit and the Child Trust Fund. The TUC would strongly oppose any cuts in existing universal benefit provision, or the introduction of further means testing into the social security and tax credit systems.

5.24 There is strong evidence that universal benefits are the best means to ensure that support is provided to those who are in the greatest need, and that means tested benefits suffer from relatively poor levels of take up, particularly among those in disadvantaged communities. For example, the Child Poverty Unit recently concluded that 400,000 children a year could be lifted out of poverty if families claimed all of the benefits to which they were entitled.[27] In addition, as Professor Richard Titmuss noted during the founding days of the welfare state, “services for the poor will always be poor services”: when welfare is only provided to the poorest, political pressure for its retention falls, and the welfare system becomes increasingly residualised.

5.25 The TUC continues to emphasise that the rates at which many benefits are paid are too low to protect families and individuals from poverty. Our recent analysis of average earnings, unemployment benefit (UB) and JSA rates

[27] Take Up Task Force (2009) *Take Up The Challenge: The role of local services in increasing take up of benefits and tax credits to reduce child poverty* London: Child Poverty Unit.

since 1970[28] found that the value of out-of-work benefits compared to earnings has declined steadily and is lower now than in previous recessions. During the 1980s recession, unemployment benefit rates were around 17 per cent of average earnings. The rate fell to around 14 per cent of earnings in the early 90s recession and, in 2008, JSA reached a record low of 10 per cent of average earnings. Currently £64.30 a week, OECD figures show that the UK has one of the lowest out-of-work benefit rates compared to wages in the developed world.[29] The TUC believe that JSA should be increased to at least £75 a week, to provide more of a cushion for the newly unemployed.

5.26 Although we continue to lobby for the benefits system to become more generous, we also recognise the progress that the Labour Government has made in improving the lives of the poorest in our society. In the 2008 IFS Green Budget, David Phillips concluded that "Labour's tax and benefit reforms have been strongly progressive, and furthermore have focused resources on two particular groups – lower-income families with children, and pensioners." [30] Phillips calculated that tax and benefit reforms between 1997 and 2008 have raised the incomes of the poorest tenth of the population by 12.4 per cent (£1,300 p.a.) and lowered those of the richest tenth by 5.5 per cent (£4,200 p.a.).[31] Tax credits and benefits have also played a vital part in reducing child poverty by 600,000 since 1997.

5.27 The TUC is also therefore concerned to ensure that this recession does not reverse recent progress in tackling inequality and poverty. In a recent JRF publication, Donald Hirsch argued[32] that one likely effect of the recession will be that, over the next few years, a rising proportion of children in poverty will live in workless families. Hirsch predicts that by 2010-11 54 per cent of poor children will come from workless families. Hirsch also considers to the prospects of couples where one parent works full-time and the other is not in paid work. In 2006-7 one fifth of all such families were in poverty, but by 2010 this is expected to fall to 11 per cent – their relative position will be protected by the fact that a high proportion of their income comes from benefits and tax credits, which, on current policies, will hold their value better than earnings. [33] So long as the values of Child Benefit and Child Tax Credit (both of which can be claimed by low income working families) are maintained, working families should be comparatively well protected from

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[28] This is the first year that average weekly earnings data is available for men and women.
[29] OECD tax benefit calculator, accessed at www.oecd.org on 24 September 2008. Data cover OECD member
states in 2005, assumes the first month of unemployment and that each individual previously earned the average
wage in that country.
[30] "The impact of tax and benefit reforms to be implemented in April 2008", David Phillips, in R Chote et al (ed.s), *The IFS Green Budget: January 2008*, Commentary no. 104, IFS, 2008, p 288.
[31] Ibid, p 268.
[32] *Ending Child Poverty in a Changing Economy*, Donald Hirsch, JRF, 2009, fig. 2.
[33] Ibid, pp 4 – 5.

relative poverty. In addition, a high proportion of the incomes of the poorest depends on benefits and tax credits, which also means that policy here is also central to the impact that the recession will have on absolute poverty. A Government commitment to uprating tax credits and benefits at least in line with inflation will be vital in limiting the increases in poverty that result from the recession.

5.28 It is also important to remember that the purpose of the benefits system is not only to prevent the very poorest from falling into absolute poverty. The benefits and tax credit systems have valuable roles to play in offering a degree of income protection to all workers throughout their working and family lives. They also provide a key means to redistribute wealth to those in need, limiting the growth of inequality and improving outcomes across society.

5.29 The vast majority of people who receive state benefits and tax credits need these payments to prevent hardship and to support their families. The TUC have already shown that over the last 30 years median incomes have fallen relative to the mean.[34] In the shifting economic climate of recent decades, the losers have been concentrated among middle-paid earners and the winners among more highly paid professionals. Those on middle incomes have already benefited less than high earners from recent economic growth, and are feeling the impacts of the recession much more acutely. Any moves to further squeeze middle income households by reducing the state benefits available to them would only exacerbate recent regressive trends in income distribution in the UK. The TUC would strongly oppose any such policy.

[34] TUC (2009) *Life in the Middle: The untold story of Britain's average earners* London: TUC.

Section six

Conclusion

6.1 In this submission, the TUC has set out five principles for reducing the fiscal deficit, to be pursued when – and only when – such a reduction is the prudent course for economic policy. Measures to reduce the deficit must be effective, progressive, proportionate, limited in their economic consequences, and just. In our view, swingeing cuts in public expenditure, as proposed by some commentators, would fail just about every one of these five principles. A rise in non-progressive taxes, notably VAT, would fail most of them. Even increases in income tax, the most progressive of all taxes, would not meet our criteria as well as the options that we go on to advocate.

6.2 The centrepiece of this submission is a suite of tax solutions designed to address the public deficit in a way that meets the five principles set out above. The first of those solutions is a proposal for a major financial transaction tax. Our other proposals include a general anti-avoidance principle, a tax relief cap, an empty property tax, a commitment to collecting tax that is due by improving the resources of Her Majesty's Revenue and Customs, and abolishing the domicile rule.

6.3 Because of the specific economic and political atmosphere in which PBR 09 takes place, the TUC has not taken its usual approach of recommending tax and spending changes in wider areas of policy. The one exception, where we have devoted a section of this submission to a wider policy area, relates to tackling unemployment. It is impossible to talk about economic recovery, in any real sense, without addressing the scourge of unemployment, even leaving aside the colossal social damage that unemployment, and especially long term unemployment, inevitably causes.

6.4 At the time of writing, the UK is still technically in recession and may, in fact, be the last G7 economy to resume growth. It appears likely that the UK will exit recession by the end of the year and we hope to see new Treasury forecasts to that end in the PBR statement. Yet any recovery will be fragile. Entrenching the recovery must remain our highest priority and must certainly come before any attempt to begin paying back the deficit.

6.5 Certain historical revisionists try to argue that a cuts agenda, in the name of paying back the deficit, worked in the 1980s. But the TUC has a long memory. We remember the high levels of unemployment, with the accompanying social decay, once famously described as a "price worth paying". What is more, it would be one thing if Margaret Thatcher's cuts programme had actually led to a stronger economy but, as we note in paragraph 3.34 above, this tough medicine actually came close to killing the patient. Not only were communities destroyed as industries died, but Margaret Thatcher's cuts agenda led to a rapidly increasing public deficit which took six years to come down again.

6.6 Let us return to the wisdom of Keynes, who taught us that in times of economic crisis, the role of the state is more important than ever. The Government has used that Keynesian wisdom in the past two years and it may be no exaggeration to say that the Government saved our economy as we know it by putting that wisdom into action. This is not the time to turn back. This has been a crisis caused in the City and requiring the full power of the state to rescue the economy. The power of the state is still needed and will be resolutely defended by the TUC. Any actions taken in this Pre Budget Report, to strengthen the economy and prepare us for recovery, will have the full support of the TUC and the wider trade union movement.

Conclusions

7.1 Trades Union Congress

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