Group Economics

Taxing times lie ahead

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Tax has been a big talking point in recent years – we've had the sugar tax, the pasty tax, the plastic bag tax, and even the caravan tax. And locally, corporation tax long hogged the headlines. Some tax changes have been significant, others have been gimmicks, but the reality is that when it comes to dealing with the public finances, spending cuts rather than revenue-raising have been doing the heavy lifting. This dynamic though is about to change, and the contents of the recently launched party manifestos underline this.

The stark reality is that the public finances are still in a mess. Rewind eight years and the Institute of Fiscal Studies said then that two parliaments of pain lay ahead, during which austerity was supposed to sort out the problem. However, two parliaments have been and gone and the deficit very much remains. Indeed, Theresa May's manifesto of last week suggests that it will now be 2025 before a surplus is achieved. That would mean four consecutive parliaments of pain.

The pain to come though will be the pain of paying more tax. Revenue-raising is now the order of the day. The issue now is that the biggest pressures on the public finances are coming from a growing and aging population. For instance, health spending now takes up a bigger percentage of public spending in the UK than in around 2009, however, it is still not enough to match the aforementioned burdens. Such is the pressure that even cutting in other areas will still mean overall spending will grow; hence the need for higher taxation. Otherwise public service provision could be significantly impacted.

To date, it could be said that we have been living in an era of fake fiscal news, where the electorate has been fed too many partly-true, two-dimensional narratives about the public finances. The message has been lost in a partisan political tussle between left and right, and it seems almost impossible for people to now distinguish between mere political noise and fact. This has to change.

What is needed is an open and honest debate about tax and spending. The public needs to understand that health and pension costs are swelling so significantly due to a bigger and older population, that radical measures are needed. This will certainly mean more spending cuts in other areas such as transport and home security, but that won't be enough. Such is the pension and health spending pressures that overall public spending has to rise. And tax increases are an inevitable consequence.

There have been some significant tax changes in recent years, including an increase in VAT and pension reforms, however these have largely been offset by tax giveaways in other areas, including fuel duty, corporation tax, and the increase in the income tax personal allowance threshold. The next government simply won't be able to afford to be so generous.

Neither can the parties afford to make the kind of manifesto pledges around tax that they did before, such as no changes in VAT, National Insurance nor income tax. It has become increasingly apparent that the last general election's manifestos are something of a straight-jacket in the current environment. Philip Hammond found this out to his cost when he tried to increase National Insurance contributions for the self-employed. Indeed, it could be said that Theresa May's decision to call a snap election is as much about creating new pledges that are sustainable and affordable, as it is about Brexit.

There are already some significant tax rises in the system that are still to be implemented – such as the Apprenticeship Levy and a higher tax on dividends. But more tax rises are to come. Labour in their manifesto make clear that they want to levy an additional £49billion in taxation, through measures such as higher income tax rates for higher earners and increased corporation tax. The Lib Dems want to increase income tax to help fund social care. And the Conservatives have committed to what some have described, perhaps unfairly, as a dementia tax, whereby for the first time the value of an elderly person's property will be included in the means test for care in their own home, meaning more people will be liable to contribute to the cost of being looked after, and significantly this cost is not capped. This is a radical step to deal with the spiralling cost of care provision for the elderly. A new wave of means-testing in relation to a whole range of other benefits is also likely to ensue.

Up to now, it could be said that politicians have been guilty of not fully facing up to the realities of the public finances and not being completely open and transparent with the public about them. But at least in the latest manifestos, we are seeing some movement; albeit much more is needed.

In Northern Ireland, we saw the last Finance Minister put forward proposals to increase the cap on domestic rating in an effort to ensure that more money could be raised from those who could afford to pay. But that is just the tip of the iceberg. The next Executive is going to have to take revenue-raising to another level and move to take back some of the give-aways of yester-year. An acceptance of fiscal reality is paramount.

Whatever way you look at it, taxing times lie ahead.

Richard Ramsey
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