Britain: Labour’s secret plans for tax hikes and spending cuts revealed

Chris Marsden
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Leaked documents reveal that the Labour government contemplated raising Value Added Tax (VAT) to 18.5 percent in Chancellor Alistair Darling’s pre-budget announcement. In the end, Darling’s report cut VAT to 15 percent.

The exposure indicates that VAT will probably rise to the higher level when the present 2 percent cut is rescinded in 13 months and may go much higher.

The Institute of Fiscal Studies (IFS) also estimates that the pre-budget announcement necessitates massive cuts in frontline public services of £37 billion.

The initial plan to hike up VAT from 2011 was one of Darling's proposals to claw back government debt accrued from its £20 billion economic stimulus package and the huge bank bailout. It was removed only a matter of hours before Darling made his statement and references to it were left in by treasury officials.

The most substantial evidence of the planned tax hike was a briefing note posted on a government website stating that after the 15 percent level ended, “The standard rate will then return to 17.5 percent from 1 January 2010, and subsequently increase to 18.5 percent in 2011-12.”

The leak created a political furore, with the government insisting that the hike was only “an option that was considered and rejected.”

The Conservative opposition accused the government of considering raising VAT far higher, to 20 percent, in 2012. Party leader David Cameron and shadow chancellor George Osborne challenged Prime Minister Gordon Brown and Darling, who did not deny the claim but said that a range of options had been considered. The pre-budget had instead raised national insurance contributions by 0.5 percent and proposed an increase on the top rate of income tax paid by the highest 1 percent of earners from 40 to 45 percent to help pay for the 2.5 percent VAT cut.

The government could not credibly deny the Tories charges. Cameron waved the briefing, which was signed by Treasury Minister Stephen Timms, asking, “If the Government doesn't have a secret plan to increase VAT, why did the Treasury minister put his signature to it?”

The IFS analysis of the pre-budget measures says the planned 45 percent rate of tax on those earning more than £150,000 will raise “approximately nothing”. The Treasury estimates the 45 percent rate will raise £1.6 billion in a full year, but the IFS states that the yield may be smaller and possibly result in a loss due to preventive action by the rich. Shifting their money into capital investment, taxed at 18 percent, is just one option.

The IFS states that, in contrast, once increased personal allowances of £600 per year come into effect, anyone on more than £20,000 a year will be worse off.

Even so, this leaves a black hole that demands cuts in public spending. The last budget in March indicated that overall public spending would grow by 1.8 percent a year in 2011-12 and 2012-13, but this was cut by Darling to only 1.1 percent.

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Darling announced that the government intends to find £5 billion in efficiency savings, but much more is required. The IFS estimates that the credit crunch and economic downturn thus far has meant a permanent loss of four percent of GDP, equivalent to £60 billion and leaving government finances down £40 billion.

Public expenditure under the pre-budget must drop 2.5 percent as a proportion of national income by 2012-13, £37 billion less than planned. Investment in hospitals, schools and infrastructure will be slashed by 16.5 percent in 2012-13 from previous planned spending. Treasury figures indicate that £1.2 billion has been cut from the Department of Health's capital spending programme for 2010-11.

In the immediate aftermath of Darling's pre-budget statement, the plight of Britain's retail sector has served to indicate how inadequate the measures such as the 2.5 percent VAT cut are.

Most major stores have continued with far larger price cuts in an attempt to stimulate consumer spending.

Tesco supermarkets have said they will halve prices on a thousand items. Marks & Spencer has continued with an across the board 20 percent cut. Sainsbury's and Asda say they will also make major cuts—all in addition to the VAT cut. Asda promised to sell all televisions and DVD players VAT-free for three days.

The crisis facing retailers was highlighted by the announcement that Woolworths, with more than 800 stores nationwide, has been placed into administration. Thirty thousand jobs are threatened as a result of an unsustainable £385 million debt. MFI, the furniture chain, has also been placed in administration.

In addition, there are meetings planned between UK car industry figures and Business Secretary Peter Mandelson. The auto executives are asking for special assistance because of what the Society of Motor Manufacturers and Traders said was a "dramatic fall in demand for new vehicles around the world, combined with the limited availability of funding and liquidity" that "now puts at risk valuable industrial capability."

The Nationwide building society has also announced that house prices fell again this month and are down 13.9 percent compared with November 2007. The price of an average house has fallen £25,000 in the past year. The house building industry has shrunk by half since last summer.

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