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The regional impact of increasing the personal tax allowance.

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In this brief the Sheffield Political Economy Research Institute (SPERI) considers the differential regional impact in England of raising the income tax personal allowance – a measure announced by George Osborne at the Budget on 19th March 2014. The measure has been championed by both coalition partners as a form of support for the low paid workers. However, the extent to which individuals benefit depends on the extent of their income that is 'taxable', and the proximity of their income to other tax thresholds.

Background

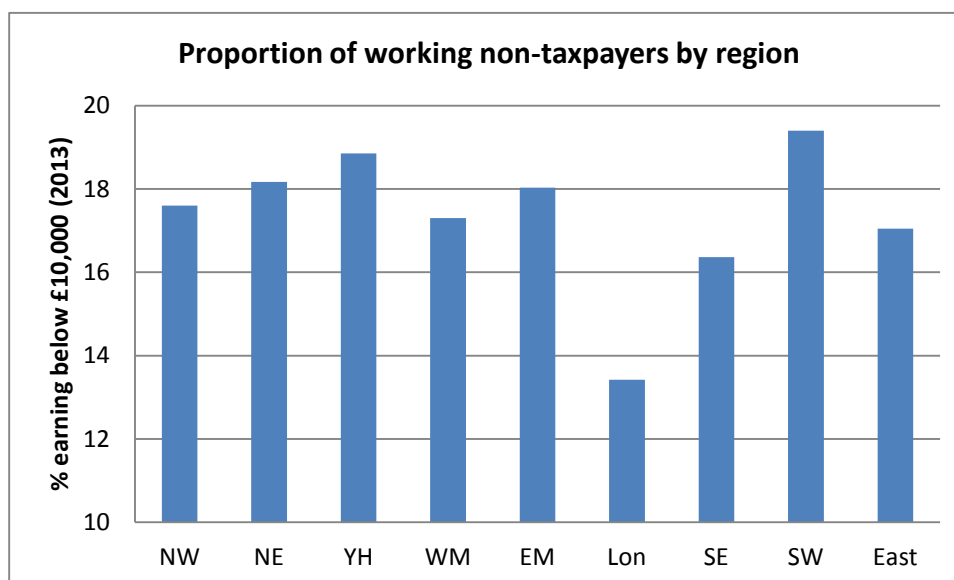
- The income tax system includes a 'personal allowance', meaning a portion of an individual's income is not subject to tax.
- This theoretically acts as a work incentive for the very low paid, but is of greatest benefit to those for whom a higher proportion of their income is taxable.
- The coalition government has consistently sought to increase the tax allowance since taking office in 2010. It will be £10,000 from April 2014, with the Budget announcing an increase to £10,500 from April 2015.
- Rapidly increasing the tax allowance was a Liberal Democrat manifesto pledge, but has seemingly been pursued by both coalition partners in government, leading to reports of an internal dispute over which party deserves credit for the policy.
- Raising the allowance by x benefits most people by the tune of $x/5$, given that the vast majority of people pay income tax at 20 per cent. However, this benefit depends on an individual's income being more than x above the existing allowance.
- The financial benefits are therefore not focused on the lowest paid, as all taxpayers at least x above the existing allowance benefit by the same amount; the Resolution Foundation reports that only 15 per cent of the cost of this measure accrues to those earning less than the median wage.
- There is a large group of people who will not benefit at all, as a result of earning less than £10,000 per year.
- Given the government's emphasis on a geographical rebalancing of the economy, away from London and the South-East, there is a need to consider the differential regional impact of this measure.
- The main public debate about tax in the run-up to Budget 2014 has focused on 'fiscal drag', with the Institute for Fiscal Studies claiming around 1 million people have become higher rate taxpayers since the coalition government took office, who would not have done so had the threshold for higher rate tax continued to rise.
- While the government has resisted calls to increase the higher rate threshold, increasing the personal allowance has the effect of slowing down fiscal drag. By making less income taxable, fewer people at the top of basic rate tax band will migrate into higher rate band, other things being equal.

Evidence

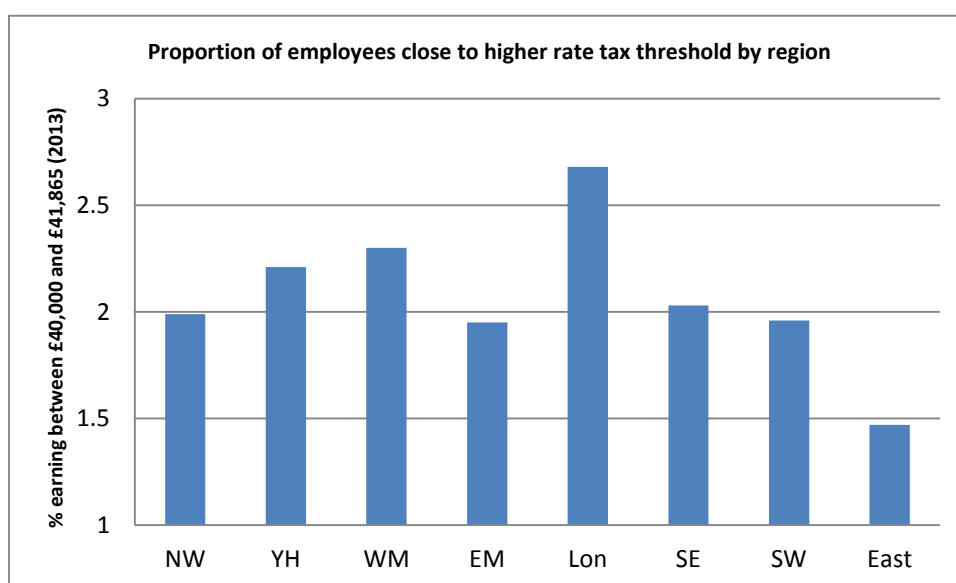
- Northern regions typically have more low-earners, and therefore a higher proportion of those who do not benefit from raising the income tax personal allowance.
- On average, 18.2 per cent of employees in Northern regions earn less than the current personal allowance. The average for the Midlands is 17.7 per cent, and 16.6 per cent for the

South.

- In London and the South-East alone, the proportion of those who do not benefit is much lower, 14.9 per cent.
- The region whose workers benefit the least from this measure is the South-West, where almost 20 per cent of employees earn less than the current allowance.
- Yorkshire and the Humber is also less likely to benefit than most other regions, with almost 19 per cent of employees earning less than the current allowance.



- The regional pattern in terms of those who benefit from the slowing down of fiscal drag is less clear cut.
- However, London clearly has a far greater number of employees with earnings just below the higher rate tax threshold (although, equally, London is also likely to have a greater proportion who will suffer the impact of fiscal drag).



Analysis

- Given that support for particular political parties tends to be regionally concentrated, it is important to consider the differential regional impacts of fiscal modifications.
- There is a clear regional basis to the differential impact of increasing the personal allowance, with workers in the Northern regions and the South-West benefiting the least, and London and the South-East benefiting more.
- The impact of this measure is therefore variegated in accordance with existing patterns of regional pay inequality – yet does not alleviate this inequality to any extent.
- More generally, the evidence here demonstrates the limitations of using the income tax personal allowance to support low earners.
- Increasing the progressiveness of the income tax system, rather than increasing the number of people exempt from the system, would be a more effective measure in this regard.

Conclusion

The increase to the income tax personal allowance announced at Budget 2014, continuing previous coalition government practice, has been presented as benefiting low-paid workers. We already know that most of the benefits of this policy accrue to those on above-average incomes, and the evidence presented in this brief shows that those who do not benefit at all – as a result of earning less than the current allowance – are more likely to live in Northern regions, particularly Yorkshire and the Humber, and the South-West. The measure is of greatest benefit to those with earnings at the top of the basic rate tax band, who are likely to be impacted by fiscal drag; this group is concentrated in London. The measure therefore neither benefits the lowest paid, nor alleviates regional inequality.

Annex

Earnings distribution (selected bands) by English region, year to April 2013					
		% earning less than £10,000	Regional average	% earning £40,000-£41,865	Regional average
North	NE	18.17	18.21	-	2.1*
	NW	17.6		1.99	
	Y&H	18.85		2.21	
Midlands	WM	18.03	17.7	2.30	2.12
	EM	17.38		1.95	
South	Lon	13.42	16.56 (Lon & SE = 14.89)	2.68	2.04 (Lon & SE = 2.36)
	SE	16.36		2.03	
	SW	19.4		1.96	
	East	17.05		1.47	

Source: derived from Annual Survey of Hours and Earnings (ONS)

*Excludes NE as the region has too few high earners too enable an estimate to be generated from published data



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