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The Reaganite recipe can help boost growth, but must be tailored to our circumstances

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Can Liz Truss's government deliver on its 2.5 percent annual growth target? Critics have dismissed the prospect as wishful. Real GDP has grown by just over 1 percent per year since the Coalition entered government in 2010. With monetary tightening, ongoing supply disruption, and population ageing, the underlying conditions look difficult. Yet there's an obvious precedent for the sorts of policies that Truss is offering: that of Ronald Reagan and his supply-side revolution.

Nobel prize-winning economist Bob Mundell and subsequent Reagan-leaning economists posited two key principles for economic policy. First, monetary policy must be the tool to deal with high inflation. Second, tax policy should be focused on setting decent incentives to work and invest, rather than being used as a tool for demand management or simple book balancing. In practical terms: let central banks worry about the price level and use fiscal and regulatory policies to set the microeconomic conditions for robust economic growth.

Doesn't that sound familiar? Targeted tax cuts and the overhauling of economically destructive regulation are what Truss promises too- and the Reagan example suggests it really can work.

Taxes were cut by 1 percent of GDP permanently over his time in office and the regulatory burden was eased. U.S. real GDP reacted well to these modest supply-side inducements, growing by a compound rate of 3.4 percent per year over Reagan's two terms, compared with a 2.6 percent annual growth rate for the eight years before. That sharp uplift is remarkable when one considers that the working age population grew more slowly under Reagan than before and the painful 1981-82 recession that occurred as the Federal Reserve gripped inflation.

Now, nobody pretends that Britain today is analogous to the 1980s US. America had the advantage of a dollar reserve currency, had lower public debt levels, and didn't face the headwinds of a rapidly ageing population. On the other hand, Truss's career suggests she is personally more committed to longer-term spending restraint than the Gipper, and there is still reason to think a large chunk of today's inflation is due to one-off supply shocks and pandemic monetary stimuli working through.

Yet, the central takeaway remains: Reagan shows supply-side policy can meaningfully improve growth or, at least temporarily bring higher growth en route to a higher level of output. Indeed, that the UK's growth has been so sluggish for the past decade is reason to be optimistic that with better policy, stronger growth is eminently deliverable.

It bears repeating again just how woeful our recent performance has been in historical and international context. The UK's economy is over a quarter smaller than if the pre-2008 GDP growth trend had continued unabated. Productivity growth has been largely stagnant since 2008, leaving us 16 percent less productive per hour than the U.S., 14 percent behind France and 12 percent poorer than Germany. It is this that has led to sluggish wage growth and zero-sum politics.

Given these facts, it's bizarre how certain centrist commentators deny the prospects for improvement. Many of the same people implied that the 2010s government spending cuts sharply curbed our growth, yet now suggest that there's just nothing that can meaningfully move the needle for GDP via tax cuts or regulatory reform. Does one seriously believe that lower working age welfare benefits were crucial to slow growth in 2012, but that better incentives or greenlighting major investment projects are irrelevant now?

As Sam Bowman has noted, some of the more thoughtful fatalism comes because analysts observe a slowdown in innovation-led productivity growth and ageing populations across the developed world. And, yes, raising the very long-run growth rate of countries at the frontier of prosperity is a tough task, with economists divided as to what to do to lift a growth trajectory, and whether policy even can.

Thankfully, that is not what is required in the UK. Here, higher near-term growth could be achieved by simply removing barriers to a more efficient economy, facilitating catch-up with other, richer countries. Higher GDP could stem from simply better matching of workers to jobs, more capital investment, getting many of the 400,000 additional inactive 16-64 year olds back into the labour market, stabilising our trade relations, improving transport connectivity, and cutting back on regulations that restrict the supply of goods and services in certain sectors.

There's legion ideas out there for how achieve these objectives, including: planning reform to make housing supply more responsive to market signals, broadening tax bases and lowering tax rates, holding down the growth of government spending, improving investment incentives in the tax code, unwinding NHS backlogs, liberalising trade with non-EU countries, stripping away childcare supply regulations, and providing certainty for other businesses by telling them: we are running an effective moratorium on new economic regulation until the next election, and hopefully after that too.

So obvious are certain ideas, in fact, that Ed Conway is right to note that it's politics, not economics, that is the ultimate constraint on raising output. Pro-growth efforts require taking on vested interests and sometimes -shock – even upsetting the median voter. Electors may see the perceived costs of, say, a new power plant or housing project, without envisaging the longer-term benefits.

Truss's government is doing its best to signal its hard-headedness about prioritising growth through its stated willingness to avoid or reverse populist, inefficient policies. It has ruled out a windfall tax on oil and gas producers. It has removed an outright ban on fracking. This past weekend, newspaper reports suggested that the repatriated EU working time directive could be for the chop. Coming so soon after rumours of scrapping the bankers' bonus tax too, the aim is clearly to dispel any illusions that growth will be sacrificed for cuddly Brownite notions of fairness.

Yet to get the buy-in from the public and market lenders, Truss will still have to deliver policies that are palatable enough to endure and credible enough to be financed. As with Reagan, that means she will need to make private sector-led growth the moral and practical focus of government and the central battle-line of politics, just as George Osborne and David Cameron achieved with deficit reduction.

But it also means her government must acknowledge the limits of the Reagan analogy. The UK is more sensitive to the whims of international investors, so must show it doesn’t intend to just rack up more and more debt each year. We will need some sort of program for spending or debt restraint. And with an election just two years away, Truss requires observable gains from pro-growth policies more quickly than Reagan enjoyed, to leave the public wanting more.

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