

## For Sunak, cutting the basic rate of income tax shouldn't be a political priority right now

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The tax-to-GDP burden might be rising to its highest level since 1950, but Rishi Sunak, the Chancellor, promises tax cuts soon. Reports say he is planning to cut both inheritance tax and VAT ahead of the next general election. The main “retail” ambition his team wants though is to trim the basic rate of income tax from 20 per cent to 19 per cent in 2023 and then to 18 per cent before polling day.

HM Treasury's bully pulpit really can be used to set the field for spending or tax battles, but Labour evidently fancies its chances on this turf. Rachel Reeves, the Shadow Chancellor, has already called Sunak's bluff, telling City AM that she “would like to see the chancellor do it” rather than “just talk, talk, talk” about it. Labour might have spent a decade moaning about underfunded public services due to “austerity,” but it senses backbench Tory unease on tax and will seek to exploit that weakness by ramping up this arms race.

But this raises the question: does the political consensus for a basic rate income tax cut represent good policy sense?

I broadly subscribe to Milton Friedman's dictum to “favour...cutting taxes under any circumstances and for any excuse, for any reason, whenever it's possible.” There are all sorts of weird asymmetries in the UK discourse that means it's easier politically to raise spending rather than cut taxes, so small staters should usually grasp what they can. And yet, for both economic and political reasons, cutting the basic rate of income tax wouldn't be high on my priority list of tax cuts right now.

First, because it's a tax cut for over 31.6 million people, reducing the basic income tax rate from 20 to 18 per cent is a big chunk of foregone annual revenue: £11.5 billion, according to HMRC's ready reckoners. That's a lot of moola to tell the 27 million basic rate payers that their marginal

rate will fall by just two percentage points, which not only doesn't sound a lot but would not substantively change their incentive to work or earn more income.

And there's a serious, serious opportunity cost here. For an equivalent revenue, the Chancellor could cancel his planned rise in the main rate of corporation tax to 25 per cent, instead keeping it at just 21 per cent. He could slash stamp duty land tax across the board en route to potentially eliminating the tax entirely. Alternatively, the Conservatives could achieve what their 2019 manifesto's "ultimate ambition": raising the employee starting threshold for National Insurance contributions to align it with the income tax personal allowance (perhaps as a step towards integrating the two taxes). That would be a tax cut better targeted at low earners, with bigger pro-work incentive effects across low levels of income.

That brings us to the second, more political, reason why a basic rate cut would be a weird priority in this Parliament. Sunak's recently announced "health and social care levy" – a 1.25 percentage point increase in National Insurance taxes that will eventually become its own earnings tax – would raise very similar sums to that lost from these income tax cuts. Not only would the Government have used the need for better public services as justification to raise taxes substantially only to then cut them by around the same amount. But in doing so, it would fall prey to criticism of generating unfairness given the two different tax bases.

The IFS's Paul Johnson, for example, has described raising National Insurance to fund the NHS while then cutting the basic rate of income tax as "indefensible." Why? Well, because the health and social care levy would only squeeze workers, whereas the income tax cut would benefit many other people earning incomes from holding assets, such as landlords or recipients of occupational pensions. That makes the Tories vulnerable to the accusation that, combined, these measures redistribute from poorer labourers to the wealthy.

Now Sunak might not be too bothered by this attack. Polling data regularly shows the more salient income tax second only to inheritance tax in the list of levies the public hate. It's clear that the creation of the health and social care levy was more about delivering a flowery sounding revenue stream that it would be politically easier to raise in the longer-term anyway. And left-wingers will always call every income tax cut regressive, dreaming up new dodgy statistics to prove it.

But even if the Chancellor is confident on the politics, there's another reason for caution on the economics. For when you feel you have the political and economic space to actually engage in a major tax cut, you should seek to achieve the biggest bang for your buck. And I've always been

struck by an old line from a ConHome piece by Matt Sinclair on this, which said “tax cuts without reform is a missed opportunity.”

Britain’s tax code remains a complete mess, with extremely high marginal tax rates littered through the code for income. We have business rates, investment incentives, vehicle taxation, and the VAT system all in need of a complete rethink, or at the very least being rationalised to eliminate absurd anomalies. Add to this the slow economic growth we’ve experienced since the Great Recession and Britain is crying out for meaningful tax reform to improve incentives to work, save, and invest, and to remove tax-induced distortions to economic activity.

With all these challenges, it would seem short-sighted not to use a large tax cut to at least aid the process of some lasting, meaningful pro-growth reform. Big tax cuts of 10s of billions of pounds can play a crucial role in greasing the wheels for controversial tax changes, in fact, because any losers from a revenue-neutral reform can then be bought off through a lower overall burden.

If the Chancellor is really determined to do a large, broad-based pre-election tax cut, his ambitions should therefore not be limited to a simple rate reduction. He might prioritise a big rise in the starting national insurance threshold or to cut the headline VAT rate while phasing out many zero- or reduced ratings. Both would still be large tax cuts for most households, but they’d bring a double dividend: either substantively improving work incentives for those on very low incomes, or improving the coherence of the code too.

With an ageing population raising demand for government spending, political opportunities for major tax cuts seem to be getting scarcer. That increases the importance of using them prudently. Sunak’s aim should be to use any cuts to improve our lasting economic potential and not just put more cash in pockets before elections.

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