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Ryan Bourne: A message for Johnson and Sunak on tax rises. Not now. And not these.

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September 1, 2020

How's this for a false dichotomy? Last Saturday, *Prospect* asked: "Post-Covid, are taxes hikes essential to fund the future? Or should we abandon "deficit fetishism" and spend our way to prosperity?" [i.e. through borrowing]. I shouldn't need to tell ConservativeHome readers that "spend to grow" and "spend to grow"—the only difference being how to finance it—are not an exhaustive set of fiscal policy options post-pandemic.

But that tweet, sadly, reflects conventional wisdom. You should take the pre-Budget briefing in the Sunday papers about Treasury desires for £20-30 billion in tax hikes through capital gains tax, corporation tax, fuel duty, an online sales tax and restrictions on pensions tax relief with a pinch of salt. Before every recent budget such stories have emerged, perhaps due to kite-flying or overexcited journalistic coverage of illustrative exercises in how one could raise revenues. One suspects the briefings may even be a political ploy—raising fears in the Tory base before Number Ten saves the day.

Yet there's undoubtedly an unnerving regularity to them. Alongside a steady drumbeat from "One Nation" Tories and such organisations as the Resolution Foundation, the idea that large tax hikes will be desirable and necessary is taking hold, with Covid-19 apparently making this agenda more urgent.

We are told, as the kitchen sink of argumentation is thrown, that the pandemic itself proves the false economy of a "hollowed out" state after a decade of austerity. Or that the "levelling up" and the "inevitable" higher spending we will now want on health, welfare benefits, and higher public sector pay means tax hikes are needed. Or that the crisis necessitates urgent repair to the public finances, and that there's simply nowhere left to cut spending.

None of these arguments, however, stand the test of reason. Countries that have dealt with the Coronavirus better include those (South Korea, Taiwan, Australia) with much lower tax-to-GDP ratios than the UK and much lower health spending too. Many with higher tax-to-GDP ratios (France, Belgium, Italy) have seen similarly shocking death tolls to us.

At best, any failure to deliver resources where needed reflects bad state priorities, not an impoverished public realm. Indeed, the story of a hollowed-out state at a time of the highest tax burden since the early 1980s, coupled with this international evidence, suggests ascribing blame to austerity for poor performance is both ahistorical and parochial.

The wisdom or otherwise of the "levelling up" agenda, and how best to pay for it, is largely unrelated to the pandemic too. Actually, to the extent that Covid-19 affects the desirability of infrastructure and public service spending in the regions, it throws substantial doubt on the benefits of projects such as HS2 and other city and town revival plans.

Who knows what lasting impact the crisis will have on remote working, the location of activity, and favoured transport modes? One Nationers arguing that the virus proves the need to level up would have us believe that the pandemic's effects are significant enough for a tax revolution, but insignificant enough to alter the desirability of any of their proposed spending. One might almost suggest motivated reasoning here.

In macroeconomic terms, the case for significant tax rises now is weaker still. The point of bridging support through furlough was to shelter businesses and workers from this unexpected shock. To pass the bill to the private sector now as it struggles back to life would strangle the recovery. And for what? Borrowing costs are low, and we have no idea yet whether and how much this crisis will leave a permanent budget hole once emergency spending stops and private sector activity revives. In fact, even borrowing to date has not been as high as initially feared.

Of course, the extra debt to deal with the crisis has to be paid somehow, eventually. But, as I argued here before, unusual shocks such as pandemics and wars primarily result in step-level debt-to-GDP increases rather than ongoing budget holes, because you stop spending on the immediate threat afterwards.

The implication is that modest consolidation over decades is optimal to account for the extra incurred debt, rather than adopting large tax increases to compensate over a Parliament. Economists call it "tax smoothing"—debt provides a safety valve to allow us to only modestly change spending or taxation over long periods to maintain incentives. Of course, if the Government thinks that, for political reasons, it must expand welfare benefits or health spending permanently, this would be a normative choice: there is nothing inevitable about sharp tax hikes.

Even if you think permanent scarring will occur, those taxes suggested to raise revenue seem bizarre choices today. The Government presumably wants us to be Covid-cautious still. Two ways of reducing risks would be to drive more rather than use public transport and to shop more online.

Aside from all the other downsides of raising fuel duty and introducing an online sales tax, to use the tax system to incentivise worsening virus transmission right now by making driving and online shopping more expensive seems bizarre.

Raising top capital gains tax rates to 40 or 45 per cent would simply be self-defeating from a revenue-raising perspective. Capital Gains Tax on many investments represents a double tax. The justification for having it at all is to deter people hiding income as capital gains.

But there's a revenue-maximizing balance between this effect and deterring people from selling assets. The Coalition government introduced a top 28 per cent CGT rate precisely because HMRC research suggested this raised most revenue. Though it was then lowered to 20 per cent under George Osborne, raising it to 40 per cent plus would reduce revenue relative to a lower rate. We'd get less investment and entrepreneurship when we need it most too.

And then there's the mooted corporation tax rise from 19 back to 24 per cent. Taxes on mobile capital will deter foreign investment just as Brexit is set to happen, as well as reducing the after-tax return on new domestic projects. Who will bear the costs? Not just "the wealthy," as commonly asserted, but workers too: evidence suggests that they bear between 30 and 70 percent of the burden of taxes on corporations.

Not only is the tax rise call premature then, but the specific proposals don't conform to the pandemic's needs or Boris's Johnson's ambitions to create a high-wage economy. Covid-19 may permanently scar the public finances, sure. But as yet its full effects are unknown and there's little cost to pausing to see. Anything else at this stage is using the crisis as a pretext for raising funds for hobby horses.

If the Prime Minister truly objects to this rationale as reported and understands the threat to the nascent recovery of sharp tax rises today, he should take this message to his Chancellor: on tax rises, not now and not these.

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