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There are much more effective ways to help young people than a tax break

By Ryan Bourne

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YouGov polling after the last election found that the Conservatives received just 21 percent of 18-24 year olds' votes and 23 percent of 25-29 year olds'.

The young have since borne the costs of lockdowns for a disease of low personal risk to them, while graduates are suffering punitive student debt interest payment hikes due to the high inflation generated by subsequent macroeconomic mismanagement.

Add this to young peoples' long-standing housing market woes, and is it any wonder Conservatives are grasping for policies to help under-30s financially?

One idea that crops up regularly is simple: cut the young's taxes. This past weekend on GB News, Esther McVey and Philip Davies raised the idea of taking under-25s out of income tax altogether.

This brainwave isn't new. Marine Le Pen has pledged that under-30s will be exempt from income taxes (and corporate taxes for their businesses) if the French Rassemblement National candidate wins the presidential election.

Back in 2017 Philip Hammond, as Chancellor, considered targeting cuts to National Insurance rates at under-30s, while Nadhim Zahawi called for large income tax rate cuts for the same group.

My instinct in favour of "broaden the base, lower the rates" as a tax lodestar leads me to knee-jerk scepticism of such policies. But many arguments against them don't really stand up to scrutiny.

Yes, age-dependent taxation would add some further complexity to tax codes. Yet it would be a relatively minor technical issue in the grand scheme of things. HMRC already knows our ages and those above the state pension age already don't pay national insurance, for example, unless they are self-employed and pay class 4 contributions.

Differential tax burdens dependent on personal characteristics is not an alien concept to tax systems either. Most carve out allowances for those with children, or disabled dependents.

Before taxation was viewed largely through the progressive-regressive prism for income redistribution, in fact, it was thought that taxes should be levied according to one's "taxable capacity" – a conception of your ability to make a payment. Having a child reduces a family's income-earning capacity, so mitigating parents' ability to pay taxes.

Likewise, you could argue that young workers, having had less time in the labour market accumulating skills, would find it more difficult to earn any given income level.

Theories of optimal taxation try to identify ways that tax systems can generate revenues to pay for public goods and redistribute to the low-skilled without discouraging work effort.

The difficulty is that our observed incomes are a function of both ability and effort. Since young people have had less time to accumulate human capital and know-how, they tend to need to put in more effort to generate an income level, making their willingness to work more sensitive to its after-tax return.

An income tax system that is unvaried by age will therefore tend to tax young peoples' work efforts at higher rates than older workers, potentially reducing the young's labour supply more sharply.

Age-dependent tax cuts for the young would therefore be expected to generate a larger increase in work effort, with fewer young people doing low-value degrees or gap years. Theoretical studies also find that lower taxes when young can allow people to better spread out their lifetime income over their career when saving or borrowing isn't easily accessible.

Through both effects, and contrary to my instincts, economists regularly produce models finding that a tax system where rates vary by age can actually make society better off.

Now, this esoteric literature is not what animates the idea's consideration today. No, the desire to cut the young's taxes is, as ever, about using fiscal tools to try to give a demographic group a financial break (and hope they vote accordingly).

To the extent that it might mitigate more damaging ideas, such as further housing subsidies or forgiving student debts, the politics may coincidentally chime with "less bad" economics.

But looking at the economics of the policy as if it is one of a set of subsidies or tax cuts to help the young is incomplete. We also have to consider the broader political blowback associated with age-dependent taxation and indeed some non-fiscal ways of helping that might produce better results still.

First, cutting tax rates on under-25s would, for any given level of revenue, require higher tax rates elsewhere. Yet with an ageing population, the number of dependents in old age is increasing dramatically.

To maintain current public service promises, as well as entitlements for the elderly, tax rates on prime working age adults would therefore need to rise even higher – not least on parents and 40-60 year olds, the latter of which are core Conservative voting blocks.

The second problem is that our tax system has moved so far from the principle of taxing by capacity to pay towards purer income redistribution that trying to shoehorn intergenerational concerns into the code would generate blowback. Just wait until we start hearing tales of young city bankers in their late 20s getting large tax cuts paid for by NHS nurses in their 50s.

Inevitably, ‘safeguards’ would be introduced to ensure that ‘the rich’ don’t benefit. Then the tax system really will get much more complicated, with the economic benefits of age-dependent taxation significantly watered down.

The main reason that I still reflexively question this policy, though, is that it is a poor substitute for solving the underlying problems young people face.

True, young idealistic people are always more likely to be left-leaning and the Conservatives were going to have difficulties in 2017 and 2019 as the young overwhelmingly opposed Brexit. Pandering to them won’t do much in the face of these structural challenges.

But to the extent that certain problems might influence their votes, housing and student loan repayments are likely to be two big concerns. Indeed, McVey tweeted that the income tax exemption was interesting precisely because it could be used as a means of “helping them [the young] pay back their university fees and get on the housing ladder.”

In other words, because of the dire results of a government-run student loan system and a government-run land-use planning system, it’s regarded as desirable to use tax policy to indirectly forego debt repayments and indirectly subsidise house purchases.

Rather than throwing good money after bad, would it not be better to reform these areas separately so graduates see better returns for their debts, or cheaper housing overall?

How many alternative fiscal options will Conservatives dream up before grasping the nettle and reforming university finance to improve incentives, or devising a planning system that delivers the homes people want in the areas they desire to live?

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