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The Tories have been brainwashed by Tony Blair's 'progressive' tax cult

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Talking about her free market ideas, Margaret Thatcher once remarked that "Economics are the method; the object is to change the heart and soul." The lady of Grantham understood two key things about public policy. First, that its impacts went well beyond the direct, observable financial effects on families. Second, that changes to economic thinking under one government can have enduring consequences for how people perceive issues in future.

After 11 years in government, the Conservatives have been on an economic journey, flipping from austerity to a spending boom, while politically reorienting to a state-led commitment to "levelling up" left-behind towns and regions. Yet have they altered how people evaluate most tax and spending decisions? Probably not. To a large extent we are still living in Tony Blair and Gordon Brown's world. New Labour's static distributional lens remains the starting point for almost all analysis on tax and welfare policy.

Changes that "take" disproportionately from the rich or "give" disproportionately to the poor are dubbed "progressive," used synonymously with "good." Things that "give" disproportionately to the rich or "take" from the poor are deemed "regressive" and bad. Sure, hypocrites shirk these labels when it comes to sin taxes or the financial effects of carbon mitigation. But suggest broad tax cuts and pretty soon the need for any change to be more "progressive" will be used as a cudgel against you.

The Office for National Statistics last week showed that the UK's tax and benefit system is extraordinarily redistributive. Households in the bottom fifth of the income distribution face an effective tax rate of minus 114pc, while those in the top fifth face a tax rate of 30pc. For every pound they earn privately, the poorest households average £1.14 of net receipts from government—benefits and benefits-in-kind less taxes — while the richest pay in £0.30.

In money terms, the highest earning fifth of households put in an average of £40k per year net, while the poorest fifth take out over £13k. Yet still, whenever a specific tax cut is proposed, even on something as broad-based as raising the personal allowance, commentators line up to argue that it is not "progressive" enough. Every policy change, it seems, must benefit the very poorest disproportionately.

The Conservatives themselves use such framing. When Rishi Sunak, the Chancellor, froze the 40p rate income tax threshold earlier this year, he labelled the U-turn "progressive and fair."

Throw out once again the principle that thresholds should be inflation-protected? Fine. Drag more people into a higher marginal tax rate, dampening work incentives? OK. So long as this resulted in an increase in the net financial contribution of those richer than the poorest, the policy was deemed axiomatically good.

The ratchet New Labour threw into debates about the importance of analysing the distributional consequences of policy quickly became that every incremental policy change — each revision to individual benefit generosity or tax rates — should work towards greater material equality. Conservatives have deviated from this principle since, especially under George Osborne and David Cameron. Yet, rhetorically, public discourse — the soul of debate — is still permeated by the assumption.

This obsessive focus on distribution though comes at the expense of other important economic concerns, such as incentives. Assuming the need for ever-more progressive policy based on a static population would suggest paying the poorest higher and higher out-of-work benefits. We have never done that, because we recognise that paying people not to work would incentivise and entrench unemployment. “Rich” and “poor” are not fixed groups, after all.

When it comes to taxes, though, people talk as if incentives just don’t matter. In the pessimistic months of early 2021, when the Government was considering fiscal repair, all the focus on tax-raising ideas were for “the rich” to pay more, especially through raising taxes on capital. There was no apparent thought given to the fact that if we saw less entrepreneurialism or investment in innovation as a result, there would be significant negative consequences for those who, in simplistic financial terms, would be insulated from the policy.

There was a time when Conservatives understood that good tax policy entailed broadening tax bases and lowering tax rates. That Government should raise revenue as efficiently as possible in order to minimise the economic damage, with the spending side being where any social objectives were achieved. One consequence of the progressive-regressive framing, though, is that this more holistic conception of what makes a good tax system has fallen by the wayside.

As a result, we are left with a VAT system that has more holes in it than Swiss cheese, with politicians unwilling to reverse carve-outs on products like food, energy, and clothing that the poor spend disproportionately on. We have an income tax system that has lifted millions out of tax, but with millions more being dragged into ever higher bands as these thresholds are periodically frozen in the name of fairness. And we have a steeply “progressive” stamp duty system that creates all sorts of distortions in the high-end of the property market.

Worse, there doesn’t appear to be any prospect of meaningful tax reform soon. Budgets come and go with new wheezes, temporary “holidays” or time-limited improvements. But there is no serious effort to improve revenue-raising efficiency, while fertilising the economy with better incentives to work, produce, invest, or trade.

One reason for this is the enduring mood music New Labour created. The expectation that any individual changes to the tax system should be financially “progressive” simply rules out many pro-growth economic reforms. If Boris Johnson is serious about wanting a productivity boom, he must first work on shifting that assumption.

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