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This Budget lays bare the Tories’ blind spot on the economy

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Economic historians know that Franklin Roosevelt’s New Deal in the Great Depression incorporated three different aims: relief, recovery, and reform. With Covid-19 having reduced British GDP by 10pc in 2020 and led to a ballooning 17pc of GDP budget deficit, Chancellor Rishi Sunak sought to meet similar objectives in his 2021 Budget, albeit with his “Three Rs” comprising relief, recovery, and repair (of the public finances).

Having sunk £300bn into Covid-relief efforts already, the Chancellor understandably wanted to provide a glidepath for businesses reopening beyond June. So, he extended furlough until September (albeit upping businesses’ contributions from July), broadened eligibility for and extended self-employment relief, tapered VAT cuts for hospitality and business rates holidays for hospitality, retail and leisure, and provided another six months of the Universal Credit supplement. Overall, a massive £44bn in further relief was provided to households and businesses.

That, though, brings trade-offs with his second objective: recovery. Extending furlough will keep some people attached to jobs that ultimately prove non-viable, delaying these workers’ transition into new, sustainable roles. Another national living wage hike too will reduce hiring by small businesses struggling with pandemic debts and the costs of reopening. Temporary tax relief likewise eases pressure on hard-hit businesses, but, again, could prop up zombie companies if consumer demands or working-from-home habits prove sticky.

Keynesians will therefore complain the Chancellor did not follow US President Joe Biden in massive all-must-have-cash consumer-led stimulus to ease job or wage anxieties in the post-reopening period. But the Office for Budget Responsibility (OBR) forecasts a robust recovery this year and next anyway, as households draw down on savings made through the pandemic, unleashing pent-up demand. For the recovery to be real, rather than inflationary, we must ensure the economic capacity is there to meet demand.

To aid this, the Chancellor is providing a large £5bn in “restart grants” to help the most affected sectors reopen. More significantly, he announced a temporary “super-deduction” for expensing in the corporation tax code. Businesses will enjoy 130pc capital allowances for investment in certain plant and machinery, effectively subsidising such investments. This two-year, £12bn plus per year tax cut will raise investment, albeit mainly bringing future plans forwards if it proves temporary.

But what the Chancellor gives with his recovery hand, he then later takes with his fiscal repair one. Despite economists urging a “wait and see” approach on deficit reduction given the uncertainties about the scarring effects of this pandemic, the Chancellor

announced the biggest Budget of future tax rises since Norman Lamont’s ill-fated effort in 1993.

This deficit reduction proposal flips on its head the approach George Osborne took between 2010 and 2015, instead protecting overall spending at the expense of major private sector austerity. The measures announced, if delivered, would see nearly £30bn in deficit reduction by 2025/26. Of this, over £29bn comes from tax rises and less than £1bn from net spending cuts.

At the weekend, the Chancellor insisted he was a “low tax Conservative.” The numbers belie this claim. The national tax burden is forecast to rise to its highest sustained level since 1950. This is driven by a £17bn corporation tax hike, as the main rate rises from 19 to 25pc —the first time it has been raised since Dennis Healey’s Budget in 1974.

That is supplemented by £8bn of income tax increases as tax rate thresholds are frozen, making an estimated one million additional people 40pc income tax rate payers.

As the Office for Budget Responsibility makes clear, if these tax plans are delivered and the super-deduction expires, the effective corporate tax rate will rise by 5.7 percentage points and the UK will be back at the middle of the international pack for its headline rate. This will increase the cost of capital, lower business investment, and reduce productivity. The Budget therefore served households the dual longer-term gruel of both a higher income tax burden and the promise of weaker future wage growth.

And this, unfortunately, reflects a Conservative blind spot over the past decade, and a hole in Sunak’s priorities. Budgets come and go, usually offering near-term goodies for longer-term pain. This Budget took that approach to extremes. But robust private sector-led growth is what ultimately drives prosperity and on this the speech was typically fatalistic. Between 1979 and 2007, GDP per capita grew at an impressive average of 2.5pc per year. Now, the OBR reckons it will trundle along at 1.3-1.5pc sustainably once one-off activity has washed away.

Sunak will claim his free ports, investment banks, and visa reforms will help growth. And one reason he might have kicked consolidation to 2023 is in the hope the OBR’s forecasts prove pessimistic, allowing him to cancel the tax hikes. The problem is that forward-looking businesses make decisions in anticipation. His planned higher tax burden could therefore help make slower growth a self-fulfilling prophecy, at a time when the OBR says almost a third of the scarring impact of this pandemic will be from capital shallowing.

What’s more, by labelling himself as the protector of public services or jobs, he will find it politically difficult to ignore further demands for more health and social care spending, or the other more tendentious claims MPs will make for how the pandemic justifies new schemes.

Given he pledges not to borrow for day-to-day expenditure, Sunak is setting the stage for a high-spend, high-tax conservatism that will crowd out productive market sector activity and lower the UK's sustainable growth rate further.

His Budget was somewhat coherent, then, if you accept relief, recovery and fiscal repair as the overriding lodestars, recognising the tough trade-offs in meeting them. But long-term growth and prosperity? Not so much.

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