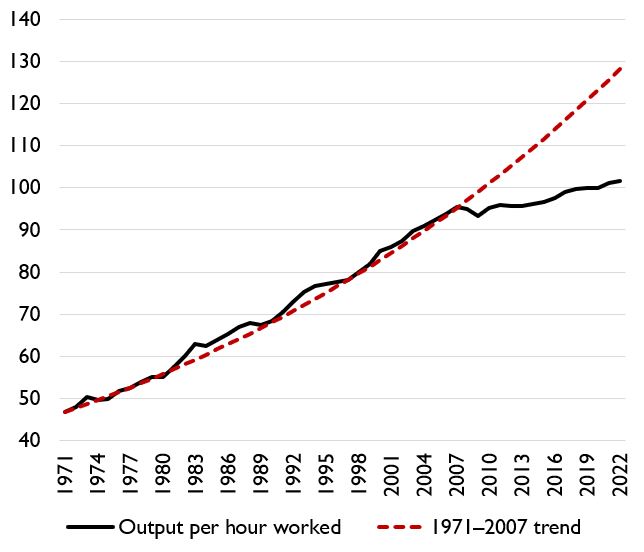
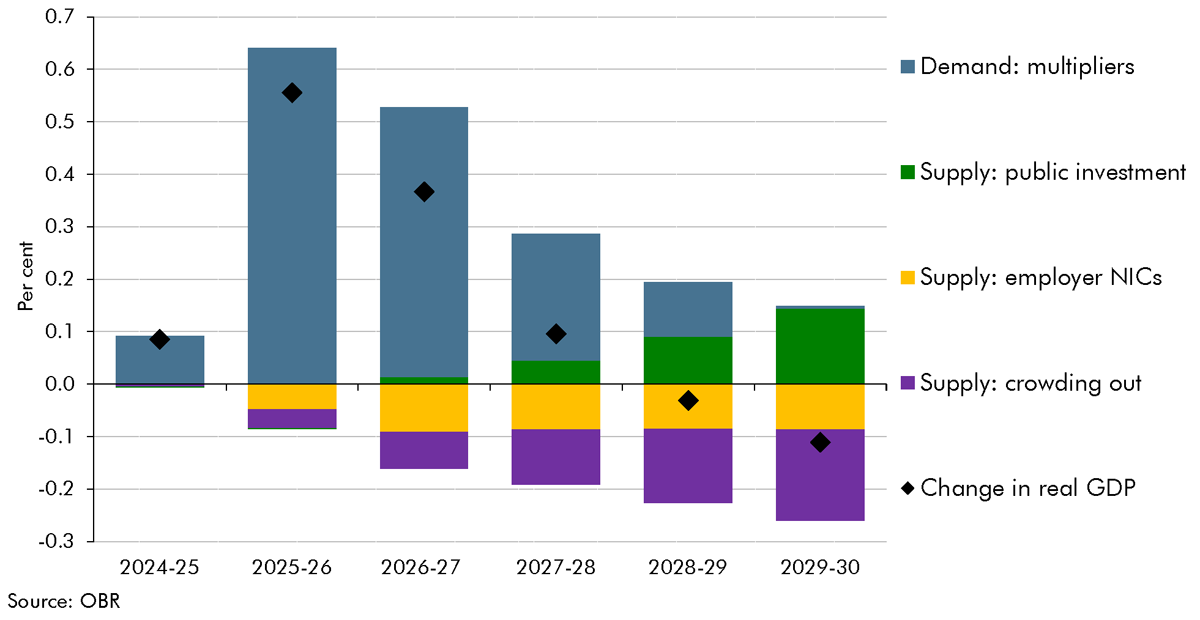
Gains i.e. growth

For the past few months, Labour’s rallying slogan has been excruciatingly clear: this country needs economic growth. To be fair, growth is pretty great. GDP going up is a sign of increased employment, potentially increased productivity, and it makes government debt more manageable due to increased tax revenues. The room to grow certainly seems to be there: as Rachel Reeves seldom fails to remind the nation, [“had the UK economy grown at the average rate of OECD economies over the fourteen years from 2010, it would be £143.3bn larger”](https://www.gov.uk/government/news/chancellor-unveils-a-new-era-for-economic-growth). There are similar signs for productivity – had pre-2008 trends continued, [it would’ve been around 26% higher in 2022](https://lordslibrary.parliament.uk/economic-growth-inflation-and-productivity/#:~:text=2.1%20Growth%20and%20productivity,-In%20historical%20terms&text=Productivity%20would%20have%20been%20around,the%20pre%2D2008%20trend%20continued.).



*UK productivity from 1971-2022. Source:* [*House of Lords Library*](https://lordslibrary.parliament.uk/economic-growth-inflation-and-productivity/)

Of course, it’s one thing to acknowledge this gaping Grand Canyon of an output gap, but if the parliamentary Labour party want to, as they put it, [“power up Britain” and “turbocharge growth”](https://labour.org.uk/wp-content/uploads/2024/03/Power-and-partnership-Labours-Plan-to-Power-up-Britain.pdf), more needs to be done. [The OBR estimates that, while the Autumn budget will boost GDP over the next 4 years mainly due to increased demand](https://obr.uk/economic-and-fiscal-outlooks/#chapter-2), it will damage the supply-side by increasing employers’ NICs and crowding out the private sector, which happens when interest rates rise due to government borrowing and subsequently disincentivise private investment. In totality, they project a lower GDP in 2028-30 than if there were no changes at all, but do expect a net positive impact in the early 2030s.



*Policy impacts on real GDP, by measure. Source:* [*Office for Budget Responsibility*](https://obr.uk/economic-and-fiscal-outlooks/#chapter-2)

Maybe the OBR missed a trick on this one. It seems to me that the Biden-Harris administration’s large public spending programs [crowded *in* the private sector and beat expectations](https://www.whitehouse.gov/briefing-room/blog/2024/11/26/the-biden-harris-administration-has-catalyzed-1-trillion-in-new-u-s-private-sector-clean-energy-semiconductor-and-other-advanced-manufacturing-investment/); considering it’s exactly that kind of government spending [that Reeves wants to emulate](https://www.bbc.co.uk/news/uk-politics-65695598), it could be Labour’s turn to surprise OBR economists and prove that we’ve been underestimating crowding in for far too long.

Setting that whole debate aside for a second, the common theme on both sides is clearly that the country needs *private investment*. The effective and efficient allocation of capital to productive enterprise is, if you think about it, kind of the whole point of capitalism – it is coincidentally also one of the best ways to grow your economy. At the moment, though, it seems our tax policy is contrived in such a way as to spit in the face of “efficiency” and maybe, probably, give a giant middle finger to the concept of “effective”. [At least, that’s what the IFS has determined after analysing how the UK currently taxes capital gains](https://ifs.org.uk/publications/capital-gains-tax-reform).

A capital gain occurs when I sell some capital at a profit – the gain *is* the profit, i.e., the difference between the value at purchase and at sale. Property and shares in a company are all taxable asset types – owner-occupied homes and ISA investments are exempt, though. Capital gains tax (CGT) is, therefore, a tax on profit, and a very popular one at that. Tax Policy Associates, a tax-oriented think tank, recently illustrated polling data from Portland Communications, finding that [CGT is the second most popular tax amongst the public](https://taxpolicy.org.uk/2024/10/26/the-publics-surprising-choice-of-tax-increase-and-why-we-should-ignore-it/).

A graph of a number of tax forms

Description automatically generated with medium confidence

*Popularity of taxes by voter base. Source:* [*Tax Policy Associates*](https://taxpolicy.org.uk/2024/10/26/the-publics-surprising-choice-of-tax-increase-and-why-we-should-ignore-it/)

The problem, as shown by the IFS, is the *distortionary nature* of CGT. A distortion happens when a firm forgoes an investment that they *would have made*, were it not for the presence of the tax. Obviously, we can all think of times where we want taxes to be distortionary – maybe carbon taxes, sugar taxes, cigarette taxes, etc. – but private investment is definitely *not* in that group and we *really don’t* want to be discouraging it when we don’t have to. Distortion happens because the projected return on investment (ROI) might be reduced by the tax to such an extent as to make the investment no better than simply putting your money in a savings account.

Imagine you are presented with an opportunity for a 5% return on investment (ROI) year-on-year in an economy where you can open a savings account at any bank to get a 4% AER for one year. We’ll also assume, for but a mere moment, that we are in January of 2024 and do not suspect for a second that Rishi Sunak will call a general election soon (he is, after all, floundering in the polls and it would be stupid not to wait until the end of the year). The CGT rate of 20% effectively reduces your ROI to 4% – because investing necessarily carries with it some degree of risk, you’re better off telling all those people you would have helped employ to stuff it and put your money in the bank.

In my eyes, one critical message stands out in the IFS’ report. Capital gains tax’s inefficient tax *base* (that is, *who*, *when* or *what* we choose to tax) means that an increase in the tax *rate* (that is, the amount paid by the tax base) reduces the efficient allocation of capital by a *disproportionately greater amount*.