Opinion **UK Budget**

Rishi Sunak takes an axe to Thatcher's low-tax ideology

Planned increases are a move away from Conservative orthodoxy but may deter business investment

MARTIN WOLF

One might argue that Rishi Sunak's decision to raise corporation tax was an inevitable reaction to the Covid-19 fiscal disaster. But that is wrong © POOL/AFP via Getty Images

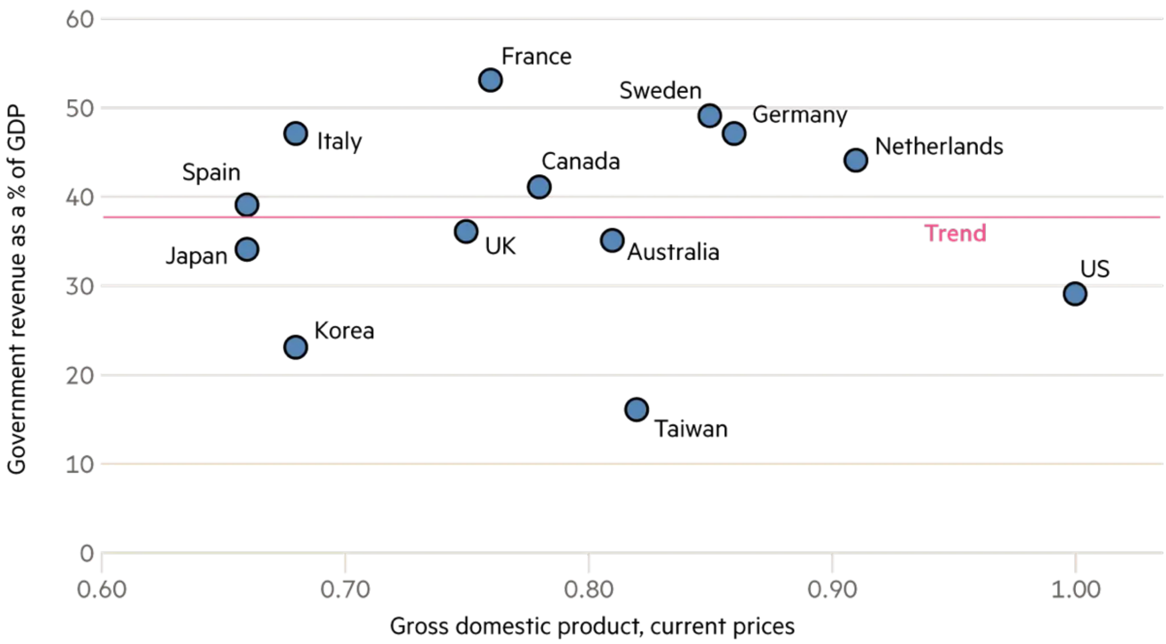
Martin Wolf MARCH 6 2021

For four decades, the free-market thinking of Sir Keith Joseph and Margaret Thatcher has been the stool on which UK Conservatives sat most comfortably. Believers were a driving force behind Brexit. Many hoped that liberation from the EU would lead to a low-tax, deregulated economy. Some called this aspiration "Singapore on Thames".

Yet, in last week's Budget Rishi Sunak, the chancellor, took an axe to one of the legs of this stool. He not only promised to raise taxes to levels not seen in more than half a century, but raised them specifically on business. What, then, is this government's economic vision?

One might argue that Sunak's decision to raise corporation tax (as well as freeze many tax thresholds) was an inevitable reaction to the Covid-19 fiscal disaster. But that is wrong. As chancellor, George Osborne demonstrated the Thatcherite alternative: tight control over spending and slashing the headline rate of corporation tax. Sunak could also have adopted this playbook. He did not. In this, Sunak was recognising new political realities. But does this bonfire of the verities matter economically?

There are high-tax prosperous countries and low-tax ones



Sources: International Monetary Fund; World Economic Outlook Database, October 2020

If the goal of Osborne's cuts in corporation tax was to stimulate investment, it failed. Investment in the UK has been the lowest among the large high-income countries. Andrew Smithers, a British economist, argues that this is because the bonus culture motivates management to use corporate profits to raise share prices, rather than invest.

Some argue that if the UK were to cut corporation tax far below the 19 per cent Osborne bequeathed or the 15 per cent he planned, the country could become a magnet to inward foreign direct investment, as Ireland has been. But the Irish population is 7 per cent of that of the UK. An economy the size of the UK's cannot be transformed by foreign companies that are mainly attracted by very low taxes. It is too big.

Nevertheless, the move to a relatively high corporation tax, along with a return to very small allowances for investment, after the "super deduction" of the next two years, is likely to make corporate investment even weaker. Sunak said on Wednesday: "Business investment creates jobs, lifts growth, spurs innovation and drives productivity." So why, one wonders, does he plan to tax it so heavily? This might not cripple the economy. But it will surely not help it build back better.

Sunak's planned bounceback of corporate tax revenue

Onshore corporation tax receipts vs headline rate

Source: OBR
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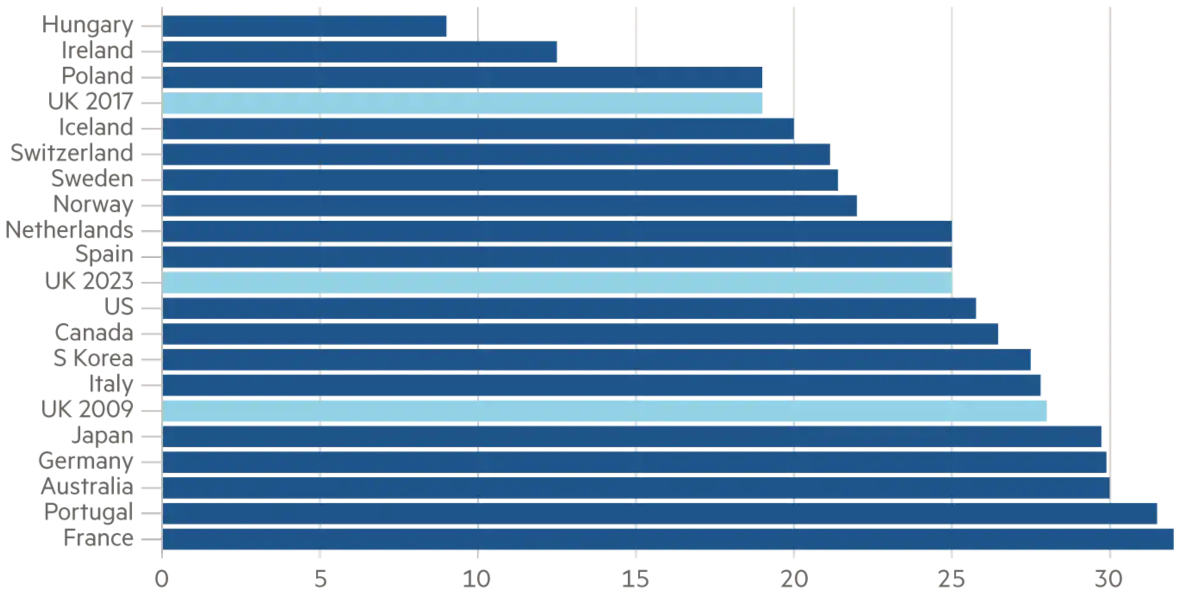
Osborne promised a low-tax economy. Sunak does not. How far does this matter, beyond corporation tax? The answer demands a broader assessment of the Thatcherite approach that has largely ruled since 1979. The good news is that the UK's relative position, in terms of average real output per head, has stayed in line with that of the US and caught up a little on the large European countries since then. The bad news is that average prosperity is still well below Germany's, the distribution of household disposable income is highly unequal by European standards, productivity has stagnated since the financial crisis, and inequality in regional productivity is very high.

John Van Reenen of the London School of Economics and MIT has argued that Thatcher's policies — among which, he notes, were the EU single market — helped secure the improvement in relative performance. He points particularly to increased competition and labour market flexibility. But post-Brexit, the UK confronts both new challenges and the old ones listed above. There is no reason to suppose that now, after four decades, a return to an idealised Thatcherism, even if politically possible, could solve them.

UK corporate tax rates will soon jump into the middle of the pack

International comparison of headline corporate tax rates in 2020 (%)



Source: OBR

One might argue, in Sunak's favour, that he does not pretend he has answers, offering gimmicks instead. As a recent report from UK in a Changing Europe argues, to the extent that freeports, his flagship idea, will do anything, they will shift activity from one place to another and income from the public at large to businesses operating inside these freeports. He also announced the establishment of a UK Infrastructure Bank in Leeds, with an initial capital of just £12bn and relocation of bits of the Treasury, with bits of other departments, to a new campus in Darlington.

What then is missing? Almost everything. Here are a few elements: a plan to raise investment substantially; a bold plan for innovation; a programme for regional devolution; a vision of tax reforms; a scheme for labour markets that combine flexibility with security; and a bold plan for the energy transformation. Naturally, the pandemic has made it hard to think about such things. But, once we accept that Thatcherism has run its course, what follows? At present, it seems, nobody knows. The time has come to think much bigger.