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THE CONVERSATION

Academic rigour, journalistic flair

Could an end to corporate tax help Britain's Brexit-burdened finances?

November 25, 2016 2.24pm GMT

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For many of us small government liberals who thought that, however flawed the European project is, the UK was better off staying inside it, there was one Brexit argument that resonated. This was the promise that once it had removed itself from the shackles of Brussels, with its penchant for interference, overregulation, and general *dirigisme*, the UK would be free to return to the halcyon days of the mid Victorian era. A time of low regulation, low tax and free trade.

What remains of these promises? As I suspected at the time of the referendum campaign, not much. There will be no North Atlantic version of Hong Kong – during its heyday, a free-wheeling haven from overbearing regulation and punitive taxes. My guess is that all the heavy-handed, overweening (and vaguely French) interventionism of the European Union will merely be replaced by good old British red tape. I for one will struggle to appreciate the difference.

On the bright side, it could have been worse. Though there was some additional spending on housing, infrastructure and R&D in the recent Autumn Statement from chancellor Philip Hammond, we thankfully heard no more of the rhetoric about industrial policy that first accompanied prime minister Theresa May's ascension to office in the summer. Perhaps we can thank Hammond for that, or maybe it returns in the spring?

Economic theory as well as historical experience has taught us that best way to fix an ailing economy – and maintain popular faith in liberal democracy – might not be the method we have become used to. In the familiar scenario, we empower our social betters (politicians and Whitehall mandarins) to manage the nation's resources (other people's money) to the benefit of the most deserving firms

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(those that contribute most to the party in government) in areas of the country most in need of investment (marginal constituencies).



Hammond is trying a different route. EPA/WILL OLIVER

Rising debt

What we do know for sure is that the aforementioned small increases in government spending on R&D, infrastructure and housing – along with the freeze on fuel duty and the decision not to implement changes to the “PIP” payments for those with disabilities or long-term ill-health – will play only a small part in preventing the UK from achieving a budget surplus by the end of this parliament.

More significant is the revision downward in forecast growth, accompanied by lower government revenue. By the end of the next fiscal year, the debt burden will have reached 90.2% of GDP. These are the sorts of numbers we normally expect to observe only in the aftermath of a fairly large war – the UK went from 24% to 127% over the course of World War I.

And it gets worse, because any decline that follows will almost certainly be reversed by the end of the next decade due to the costs associated with the UK's ageing population. This is a problem likely to be exacerbated by any steep reduction in immigration because most immigrants arrive at the beginning of their working lives and often pay more in taxes than they receive in benefits.

There is a view, promoted by Carmen Reinhart and Kenneth Rogoff at Harvard, based on their own empirical research, that a 90% debt burden represents a singular threshold – borrow beyond that and a country suffers particularly low growth. This is a result that deserves to be treated with scepticism – it is generated by throwing into one dataset lots of very different countries across different time periods. Nonetheless, ever higher debts will need to be financed by ever higher tax rates.



A new model for pensions? Neil Wilkie/Flickr, CC BY-NC-SA

Doubling a tax rate does not double the amount of revenue a government collects. The distortions and disincentives the tax creates suppress economic activity at an ever increasing rate, shrinking the tax base. Beyond a certain point a debt becomes unsustainable, when taxes can no longer rise enough to service debt interest payments. Though the UK and other western countries may still be far from this Greek scenario, they will suffer, particularly once interest rates begin to rise and refinancing the debt being accumulated becomes more difficult.

Corporation tax

So more spending and lower taxes would be a recipe for disaster. That does not mean that the present way the UK spends or taxes is in any way efficient. Hammond did announce that corporation tax cuts planned by his predecessor George Osborne would be implemented. A bolder move, and one more in keeping with the anarchic, anti-bureaucratic spirit of Brexit, would be to abolish corporation tax completely.

Why? Because this is a singularly distortionary tax, and I would argue, deeply unjust as well. It only generates about 6% of UK government revenue, but collecting it imposes vastly more administrative costs on UK businesses. Abolish it and armies of intelligent people working as lawyers and accountants could be repurposed to more productive activities in place of their current function of paying (or avoiding) this tax. Justice too would be served.



Reflecting on new tax arrangements for business. Terry Johnston/Flickr, CC BY

Personally, I am not bothered that Amazon or Starbucks do not “pay their fair share”. Indeed, I believe they have a fiduciary responsibility to their shareholders to pay only what the law requires and not a penny more. Demanding they do otherwise is an assault on the very concept of the rule of law and seems vaguely fascistic.

What does irk, is that their smaller competitors or new firms that might compete against these incumbents cannot shift their profits to Luxembourg or avail themselves of the services of lobbyists that would ensure that tax regulations are written in a way that benefits them.

Ultimately, shareholders pay this tax and unlike the income tax, everyone, whether a millionaire or a destitute pensioner pays here the same rate. Shifting the burden to income tax would yield less waste and would actually be more progressive. It would also support the creation of a more entrepreneurial society, one with more competition and fewer large monopolies.


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