CENTRE FOR BREXIT POLICY

BUDGET STATEMENT

27 February 2021

The Budget will need to address two once in a century events at the same time: The effects of the Coronavirus pandemic and the UK's departure from the EU. The Chancellor should be able to look through the fiscal consequences of the pandemic, to some degree at least. Lifting the lockdown and completing the distribution of the vaccine should enable a substantial recovery in output and the public finances.

MACROECONOMIC MEASURES

1. The Chancellor's primary focus should be on taking action to boost the competitiveness of the UK economy post-Brexit (see microeconomic measures below). What we do 'the morning after' departing the EU will play a substantial part in determining the ultimate success of Brexit. The Chancellor needs to send out an unequivocal message that Britain is open for business and ready to take on the world.

2. Although the budget deficit is currently running at a peacetime high, this is not true of the ratio of government debt to GDP. Indeed, quite the opposite. Over the last 250 years we have spent more time with the debt ratio greater than 100 per cent of GDP than we have with it below. With gilt yields well below the growth of nominal GDP, tax revenue growth even greater, Covid spending falling away, and very low interest rates; the budget position should improve rapidly, paying off debt steadily. Accordingly, we should be in no hurry to bring the debt ratio down. It will come down of its own accord in response to economic growth and prices rising a bit, as it has done before.

3. The government can lock in current low rates by extending the maturity of government debt, increasing the share of perpetual bonds to the maximum, as was done during WWI. This will keep interest payments low when interest rates most likely rise during the coming, probably sharp, recovery.

4. Even though the Government has announced a series of 'temporary' Covid-recovery spending measures which may in fact linger on for a while, the pace of recovery is likely to be so strong that the deficit may fall to acceptable and sustainable levels pretty quickly.

5. We all know that forecasting the public finances is more of an art than a science and, like other forms of forecasting, is prone to serious error. Accordingly, we should not make a move towards a major adjustment until; first, when we are pretty sure that the public finances need such a move and, second, when we are sure that the economy can stand any measures to be imposed. If any such measures were ever to be imposed, cutting back on plans for increased expenditure should be chosen rather than increasing taxes.

6. However we address the medium-term problem of the public finances, we shouldn't do anything to reduce the level of real public investment. Quite the reverse. We need to make sure that the public sector makes a solid contribution to raising the overall national rate of investment. To this end, we favour a separation between borrowing for investment and borrowing to fund current spending. There should be no obligation for overall borrowing to be zero.

MICROECONOMIC MEASURES

7. The Chancellor should not be aiming to raise any of the key tax rates, either in this Budget or in the Budgets immediately beyond. Nor should he be aiming at any form of backdoor tax rise through such initiatives as freezing personal allowances. The pre-Budget mood music and leaks to the media suggest the Chancellor is considering substantial tax increases focussed on Corporation Tax and Capital Gains Tax (CGT). Raising these taxes is precisely the opposite of what is required post-Brexit. There should be no harmonisation of CGT with Income Tax, because it would undermine risk taking and investment - two things we need to project a dynamic image of a highly competitive 'Global Britain'. Despite the deterioration in the public finances, it is still possible to reduce Corporation Tax. The Chancellor should set out a pre-announced timetable[1] to reduce the rate of Corporation Tax to 10 percent by 2030 - 1 percentage point per annum beginning in 2022-23. This would be the lowest rate in the world outside of tax havens.

8. Business investment has been undermined in recent years by uncertainty around Brexit, followed by the effects of the pandemic. We need to kick-start business confidence. The Chancellor should introduce 100 per cent capital allowances on corporate spending for fixed investment. This should help the aim of boosting private sector investment.

9. We oppose a tax raid on Big Tech. Whilst there are issues around how much taxation some of the biggest tech companies pay in the UK, it would be a mistake to embark on a smash and grab raid of them, when the image we need to portray is of an agile low tax economy. We need digital economy FDI because of the positive 'spill over' effects on the rest of the economy it brings - in terms of employment and technological knowledge.

10. Looking longer-term more generally, we favour the principle of extending the tax base to consumption rather than income, and lowering marginal tax rates towards a flat-tax structure, favourable to entrepreneurial innovation.

11. We are in favour of the much-touted idea of establishing free ports, especially in the towns and cities in the north that have suffered disproportionately over the last few decades.

12. OECD measures of product and labour market regulation for the UK, show that it in a favourable light when compared with the EU. However, this does not mean that there is little or no scope to pursue deregulation. The benchmark for comparison should be the world not the EU. The Government will be committing a fatal error if it allows itself to be intimidated by level playing field clauses in the TCA agreement. It should reject both residual (as of 31st December 2020) and dynamic alignment (from now on).

13. The Chancellor must avoid any actions that restrict access to capital for fast growing, entrepreneurial businesses and for businesses seeking to grow to the next stage. It is vital if we are to see our innovators of today become the giants of tomorrow and if the UK is to retain its intellectual capital that entrepreneurs can choose to retain control of their businesses and grow them without the need for premature sale. The government should not be afraid to promote R&D investment, which because of its spill-over effects is a public good. Academic work has shown that public subsidies to R&D generate growth. Public-private collaboration can do the same, as exemplified by the recent rapid development of Covid vaccines.

1 George Osborne when Chancellor pre-announced Corporation Tax rate reductions that would not be implemented immediately, but in subsequent financial years

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