Sate of the Nation

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As Queen Elizabeth has been laid to rest attention now returns to the current state of affairs facing Liz Truss and her government. Truss, of course, is currently in the US for talks with President Biden before returning to the UK later this week, though notably, a trade deal between the UK and the US is not on the agenda, and Truss herself sought to dampen expectations from her own Brexiter supporters.

That the US is already the UK's number one export market for merchandise or that the benefits of a trade "deal" are trivial – adding only 0.16% to UK GDP over a 15 year period[1] according to the Government's own analysis (in contrast to the 4% hit on GDP incurred by exiting the EU[2]) seem to go unnoticed by most commentators. Never mind, at least the PM can get to strut on the big international stage and make speeches at the UN.

However, for those struggling at home with the cost of living – with the pound taking additional hit due to the Brexit folly's impact on market expectations of the UK as a desirable place to invest now that we are no longer part of the Single Market – life isn't so much fun. Truss's proposed remedy for skyrocketing energy bills is to subsidise energy companies to the tune of £150 billion, effectively footing the bill on to you and I as taxpayers, as the Government will have to borrow the money.[3]

At the same time, Truss and her Chancellor, Kwasi Kwarteng, are widely expected to reverse recent rises in National Insurance contributions, and also to reduce the rate of corporation tax. So, in essence, tax cuts that will disproportionately favour the wealthy.

What is the justification of this approach? Truss has already made clear her disdain for "handouts" and that her policy proposals are not "unfair" and that she wants to steer public discourse away from "redistribution". Rather what we have here, to the extent that there is any economic rationale for what they are doing to prioritise "growth", is just another rehash of "trickle-down economics" – the idea that the rich will use their increased largesse to invest in the economy and thereby generate prosperity for all.

These ideas were summed up by the American economist Arthur Laffer in 1974, in the shape of his infamous "Laffer Curve", which posited an inverse relationship between the tax rate and tax revenue once tax rates reached a critical threshold.[4] Laffer argued that high tax rates would deter employees from working harder and make companies look to divest their revenue away from where governments could reach them (e.g., in tax havens).

Whilst there is some superficial appeal to Laffer's construct (and it influenced policy during the Reagan administration) it has been heavily critiqued and exposed. Laffer's analysis would suggest that tax cuts will stimulate business investment. However, firms don't just consider tax rates in looking where to undertake production. They also consider other factors, such as size of the market, ease of market access, raw material/energy costs, presence of a skilled workforce and nature of physical and digital infrastructure.

On all of these counts, Brexit has been a disaster for the UK with the creation of extra red tape as firms (SMEs in particular) struggle with the new customs regime and various checks, the loss of Freedom of Movement of labour impacting on the supply of skilled workers, and uncompetitive energy prices made worse by opting out of a common European approach to tackling the challenges of rising energy prices. How Labour still thinks that it can "Make Brexit Work" given all this is a policy stance that defies economic logic.

But I digress. In terms of the stated benefits of lower taxes, the evidence just doesn't stack up. George Osborne – then Tory Chancellor under David Cameron between 2010 and 2016 – lowered the rate of corporation tax from 28% to 19% on such a premise that it would spur increased investment. And Liz Truss, in her first ever stint at Prime Minister's Questions (PMQ) attempted to claim as much:

""*The last time we cut corporation tax we attracted more revenue into the exchequer because more companies wanted to base themselves in Britain, more companies wanted to invest in our country*…"[5]

However, as the Institute for Fiscal Studies have shown, other factors – namely the emergence from the 2008 Global Financial Crisis, and "base broadening", that is, the Government implemented changes that meant more businesses were taxed and corporation tax took in a greater scope of their profits – were responsible for the rise in tax revenue. As for business investment during this period, Richard Partington, writing in today's *Guardian* reports that:

"[d]*espite the repeated tax cuts to the lowest rate in a century, the UK fell behind Italy and Canada to rank with the lowest private sector investment in the G7 as a share of national income. The following year, the UK ranked 28th for business investment out of 31 members of a wider group of developed countries in the OECD*."[6]

So, by many measures then, the UK economy is flatlining, having failed to respond to 12 years of Conservative government and its economic policies. What a State of the Nation to be in. I can only be reminded of the notion of the medieval "physician" who when noting that the patient has failed to respond to his treatment of leeches, extols "more leeches"!

If we are to escape this malaise, then a radical alternative is needed. Space precludes an extensive discussion, but for a few pointers Ms Truss, try these:

- Restore the £20 weekly uplift to Universal Credit and thereby offer targeted help to the most vulnerable, rather than supporting the rich;
- Impose a windfall tax on energy companies;
- Start a massive programme of retrofitting insulation in the UK's moribund housing stock;
- Offer targeted tax cuts/incentives to companies that innovate and shift to green technologies, and;
- Rejoin the EU Single Market and Customs Union and thereby try and rebuild our battered trading relationship.

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[1] https://www.bbc.co.uk/news/uk-politics-51706802

[2] https://www.theguardian.com/politics/2022/jun/25/what-have-we-done-six-years-on-uk-counts-the-cost-of-brexit

[3] https://todayuknews.com/business/liz-truss-unveils-150bn-uk-energy-plan-but-limits-business-support-to-six-months/

[4] https://www.investopedia.com/terms/l/laffercurve.asp

[5] https://www.channel4.com/news/factcheck/factcheck-did-cutting-corporation-tax-raise-money

[6] https://www.theguardian.com/business/2022/sep/20/uk-business-investment-lowest-in-g7-corporation-tax-cuts-ippr