

# How will this government solve our economic ills?

David Cameron's government seems to be sprawling across the ideological divide, says Roger Bootle



By [Roger Bootle](#)

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What a strange creature today's Conservative party is. A visit to the **party conference** in Manchester last week to address a fringe meeting made me feel both inspired and fearful. Mr Cameron's government seems to be sprawling across the ideological divide, stealing some ideas from the Liberal Democrats and the Labour Party, while still clinging to a few normally linked with the Thatcherite Right.

Nothing wrong with that, you may say. But where is the intellectual ballast of this government? Without this, it will be difficult to remain consistent and focused – and difficult to tell a convincing story to voters. Concern and good intentions are not enough. On pretty much every issue it needs to have a perspective on how far a government should go in trying to correct society's ills. On economic policy specifically, it needs to be guided by a perspective on where intervention should begin and end.

The philosophy behind the Government's economic agenda should be very simple: first, for the things that only governments can do, ensure that they are done really well; second, in the areas where government does not need to be active and/or where it performs much worse than the market, get out; third, where markets seriously malfunction, intervene to ensure that they work tolerably well. If this government wants to stimulate the wellsprings of growth, it needs to apply this philosophy to several key areas: the tax system, education, infrastructure, the housing market and regulation.

On tax, the Government can build on the significant achievement of the preceding Coalition. But there is a long way to go before we reach a tax system that is reasonably efficient. Of course, the major determinant of the average level of tax is ultimately the share of government spending in GDP. There is plenty of room for reasonable people to disagree on exactly what the right figure is. Yet 40pc, which is roughly the percentage that we have been operating with recently, strikes me as much too high. Nearer 30pc would provide the scope for significant reductions in the overall rate of tax.



Photo: ALAMY

The detailed structure of taxation matters, too. In the last budget, the Chancellor balked at reducing the top rate of **income tax**, no doubt because he worried about juxtaposing such a measure with less welfare spending. But if a top rate of 40pc was good enough for a Labour government until Gordon Brown wanted to lay a trap for the Conservatives, then 47pc now (45pc income tax plus a 2pc National Insurance surcharge) seems inexplicable for a Conservative government facing a feeble Opposition. It harms enterprise and gives the wrong signals to the ambitious and hard-working.

Over and above this, the personal tax system needs to be simplified. It would make sense to combine income tax with National Insurance and to aim for a flatter system of tax rates with fewer exemptions and subsidies. As part of this ambition, the VAT base needs to be broadened.

Education is hugely important for both economic performance and society's health. The Coalition made huge strides in raising standards, but again there is much to be done. The ultimate ambition should be to achieve state education that, for most people, would make the private alternative unnecessary. This is not pie in the sky – it is essentially the position in Germany today.

There is more need for radical action in higher education. Far too many universities and colleges provide fourth-rate education to students who emerge at the end burdened with debt but not noticeably more enlightened, knowledgeable or skilled than when they came in. This involves a chronic waste of resources. Worse, it involves a chronic waste of human talent. This

is not a market failure. On the contrary, the solution will require more use of markets.



Many graduates will not be getting their money's worth from their increasingly expensive degrees Photo: Alamy

Infrastructure is a key policy area where the state is bound to play a major role. But I am afraid that the recent record is not good. In common with many preceding administrations, when faced with financial stringency, the Coalition slashed spending on public investment – doubtless because this was easier than to make the equivalent reductions in current spending. The UK spends a pathetically small proportion of its GDP on public investment. Yet in the Chancellor's current fiscal regime, no distinction is made between borrowing for investment and borrowing to finance day-to-day spending. Of course, we need to invest the money well but the overarching point is that we need to invest more.

We also need more activity in house-building, but here the key problem is different. At least we finally seem to be having a serious debate about the appallingly high cost of housing. It seems now to be recognised that there is a seriously inadequate level of supply, given the increased population. But let us be clear about this: for all their foibles, the house-builders are not responsible for the housing shortage. The failure of supply reflects a failure of government rather than markets. Here, the agenda for government should be to undo past interventions – freeing up land for development and reducing the burden on developers and builders.

Similar things can be said about regulation in general. Excessive government has been the problem and less government is the solution. Again, the

Coalition made some inroads and again the current administration talks a good talk. But here it will run into a much bigger issue that will limit its scope to achieve major change, namely our continued membership of the EU. That is surely the subject for another day.

- *Roger Bootle is executive chairman of Capital Economics*

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