

Needed: A radical vision that brings in lower and simpler taxes for all



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The tax system should be sufficiently simple that anyone and everyone can readily comprehend it CREDIT: JUSTIN TALLIS/AFP

It has been widely remarked that our Chancellor of the Exchequer doesn't appear to have a vision for the tax system. Does this matter? It assuredly does.

I have often asked why it is that many small countries are so economically successful. The answer, I think, is that their vulnerability makes it essential to get public policy right.

They simply have no leeway to indulge in grossly incompetent government. That applies, amongst other things, to the three key fiscal questions: how large the government should be; what it should spend money on; and how it should raise the money to pay for whatever it decides to do.

My favourite example is Singapore, which could have become a basket case. Instead, its economic performance has been marvellous, to the point where it now has a higher per capita GDP than its former colonial master, namely us. This is largely thanks to superbly effective government.

Getting the economic contribution of government right first demands that the governing party is clear about what the state does best and, relatedly, what it is that only the state can do. Making the tax system work effectively clearly falls into the latter category. That is what makes Mr Hammond's lack of vision so damaging.

What should he be aiming to do? You could argue that the tax system should be sufficiently simple that anyone and everyone can readily comprehend it and accordingly be aware of the influence of tax on their after-tax returns from different activities.



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Actually, in my view, in an ideal world, the tax system would be so simple and the tax rate so low that people might as well be ignorant of these details. Other than where the public interest is deemed to lie in restricting the production or consumption of “bads”, such as pollution, or the production of public goods or things that have externalities, the best result is achieved when no economic decisions are determined by the influence of tax. Effectively people can just ignore it.

Admittedly, in practice, British chancellors are seldom in a position to follow such an agenda. They are usually left scrabbling around to find money from any old source, while simultaneously feeling obliged by political forces to dish out much of it to supposedly deserving causes. The result is plain for all to see – a hotch-potch of a tax system with gross distortions to incentives.

The way to tackle this issue is to think through in advance what you want to achieve with the tax system and to lay out a plan. When the Chancellor has some available

fiscal resources to dispose of, he should then use these to make progress towards the desired goals.

This is critically important because moving to a rational system of tax always creates losers as well as winners and it is important to be able somehow to buy out or compensate the losers. Last week's shambles over raising national insurance contributions for the self-employed was a clear example of fiscal policy-making without vision.

National insurance is a tax by another name. It needs to be integrated with income tax. But getting this right, and avoiding the imposition of heavy losses on groups such as the self-employed and pensioners (who don't pay national insurance), is a mammoth task.

I believe that the Chancellor should have as his objective the abolition of national insurance. He should make a start by gradually lowering the standard rate, thereby reducing the gap between the effective overall tax rate paid by the employed and self-employed.



Chancellor of the Exchequer, Philip Hammond should have as his objective the abolition of national insurance CREDIT: CARL COURT/WPA POOL/GETTY IMAGES

Admittedly, for the next few years the Chancellor is bound to be absorbed with getting the deficit down and it seems unthinkable that there could at some stage be a different agenda.

Yet, in the 1980s the public finances moved from huge deficit to significant surplus – before the recession of 1990-92 brought the deficit back with a vengeance. Nigel

(now Lord) Lawson, the Chancellor during the key part of the 1980s, knew what to do with the room for manoeuvre that the improving public finances afforded him. He believed in lower taxes and a simpler tax system. That is what he delivered.

With Mr Hammond, and alongside him, Mrs May, we cannot be so sure. We know that they believe in low corporate taxes to attract and retain businesses in this country.

But what about low personal taxes? Talented people have always been mobile and they are even more so today. Surely we also need to attract and retain them. Is this a government priority or do May and Hammond believe in using the tax system to redistribute income? Or would they prefer a simple flat rate structure, as I would? We don't know. More importantly, it seems that they don't know.

Without a clear stated aim of where the Government wants to go, the whole fiscal dynamic is driven by the spending side. If the Government had a clear plan for what it wanted to do with the tax system, then there would at least be a serious tension between the two sides of the fiscal balance.

This is what happens in times of crisis when borrowing threatens to get out of control or when the taxpayers have been squeezed so tight that you can hear the pips squeak. But in more normal times, the tension lapses, with the result that spending surges ahead and the tax-raising function is left to play catch-up.

Bringing together the main spending and tax-raising events in one major financial statement in November, as Mr Hammond intends, will help. But he needs to go much further. We need a radical vision of the tax system that brings in lower and simpler taxes for all.

Spreadsheets are not enough. Mr Hammond needs to do some serious thinking and planning for tax reform. This is the best contribution that he could make to ensuring that the UK makes a success of Brexit.

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