[Ease the squeeze]

This is my latest Conservative Home article.

Since March 2021 I have been telling the Treasury that their forecasts were far too gloomy. They underestimated growth, understated tax revenues and wrongly ballooned the likely level of borrowing. I was not surprised when the Chancellor had to report much better news and confess how wrong the budget forecasts had been , though even I was surprised that the latest figures just before the 2021-2 year end show that they borrowed an almost unbelievable £105,000 million less than planned! Keeping tax rates down, cutting Stamp duty and going for growth produced a much stronger economy than they expected. The extra tax revenues poured in thanks to more spending and more housing transactions.

So why change a winning formula? Why did the Chancellor fail to stress the successes and turn instead to more gloomy forecasts? Why did he think these mean he had to put National Insurance up, freeze Income tax thresholds and get ready for a huge increase in company tax rates next year? Once again we were treated to some bizarre figurework from the OBR and Treasury. Clearly upset by how much better the revenues were than expected they presented the costs of servicing the state debt in a new way designed to sensationalise it . It looked as if they hope that the government would be panicked into tax rises in the name of debt control. They decided to add to the legitimate and affordable cash costs of paying interest on the outstanding debts to savers and other investors the non cash costs of the indexation of the index linked debt. This only becomes a liability on maturity of any given bond and will simply be refinanced by rolling over the real value of the debt when it comes due. They did not put any offsetting figures into the account to show how much the state will benefit from the high inflation the Bank has now created or allowed, as it will reduce the real costs of refinancing or paying back the majority of the debt that is not index linked.

The government needs to understand that the cost of living crisis is going to be difficult for many people. It needs to do more to offset the effects of runaway energy price inflation, rising food costs and price hikes in a wide range of other goods and services. This is not the time to be taking more money off people through a National Insurance hike. It is not the time to insist on VAT on domestic fuel. It is the time to be more generous in offering a cut in petrol and diesel taxation which otherwise will rake in far more revenue than the original plans. Given the magnitude of the official forecasts for the hit to real incomes now coming the Treasury should at least have given back more than 1% of GDP. This was eminently affordable given the great performance of the public finances over the most recent year. Instead the Chancellor spent less than 0.5% of GDP in tax remission, leaving most of his revenue windfall untouched.

The danger now is of the opposite effects. The hit to real incomes will slow growth. Many people will be unable to afford discretionary goods and services after they have met the food and energy bills. The fast recovery of health output credited to the state last year on the back of free test programmes and massive roll out of vaccines will slow dramatically. Higher taxes will knock confidence and higher inflation will worry consumers. The economy is going to slow sharply. Instead then of a revenue bonanza from better than expected growth we will experience a slowdown in extra tax receipts. More people will qualify for top up benefits and income support. The Treasury will learn the hard way that higher taxes can lead to bigger deficits and fewer good options for economic policy.

The official figures tell us that tax as a percentage of national income was at 33% in 2019 and will be at 36.2% by the end of this Parliament. That is a substantial rise in the tax proportion. It comes from the upwards movement of rates for companies, the freezing of personal allowances and the introduction of the National Insurance/social care tax proposals. It will cut the growth rate and lower average take home pay. It will damage private sector investment, which is already disappointing despite the offer of a temporary super allowance. Businesses look at the coming hike in company tax rates and are put off.

I am glad the Chancellor wants to be a tax cutting Chancellor and admires Nigel Lawson who definitely was a tax cutting Chancellor. He slashed the rates of Income Tax and company tax and the extra money rolled in as a result. It would be a great policy to follow now. People want to know the government is on their side at a time of income squeeze. They will see that external events have created strong upward pressures on oil and gas prices and may understand government cannot protect us from all such pressures. They will be less understanding of why at the same time the government shifted from a successful relatively low rate of tax policy to higher tax rates. They will blame the government for taking money away that they need to pay the higher bills.

As the Treasury needs more revenue they need to help the private sector grow the economy to deliver the extra cash. They already get a windfall tax on home produced oil and gas in the form of a doubled corporation tax rate on such activities. They should make extracting more oil and gas at home a high priority with every government assistance to get it done. That will bring in a lot of extra revenue as well more well paid jobs. Then the Treasury needs to be more positive in support of domestic process industry which is struggling to stay alive against the background of such elevated energy costs. That too could be a net win on revenues. I will urge the government again to dump the gloomy Treasury fiscal rules and substitute just two key aims and controls. One should be to take the 2% inflation target seriously. That means the Treasury helping government do more to eliminate supply bottlenecks at home. The other should be a growth target to galvanise public policy to support expansion of jobs and investment.

We need an update on the Spring Statement urgently. It would be better to head off the worst of the income squeeze before it sets in and people have to pay the high bills.