Tax rises would hinder recovery

There was some strange briefing in the Sunday papers, purporting to come from unnamed people in the Treasury. The argument went that the budget deficit has ballooned to £400 bn so the budget would need tax rises to cut it. Various ideas of new taxes and tax rate increases were discussed, usually to raise relatively small amounts compared to £400bn. The individual proposals typically would cut the deficit by 1-5% only on the figures given.

The truth is the huge deficit is not sustainable, and needs to be brought down by getting the economy back to work. it will be recovery that makes huge cuts to the deficit, not tax rate rises. The deficit will tumble as soon as the controls are removed from social distancing so hospitality, travel, leisure and entertainment can flourish again. Let us hope vaccination and the decline of the virus allows the government to let this   happen soon. There is a double benefit for the deficit. Spending will fall sharply as furlough ends, special help to small businesses and the self employed ends and the extra money for health reduces with the job of vaccination done. At the same time tax revenues rises rapidly from low levels, as people spend money again, as businesses pay their rents again, as incomes of individuals and companies pick up from recovery.

It is most important that tax and benefit policy does everything possible to restore the lost 10%of national output and income the anti pandemic policies have taken away. Tax rises will deter investment, deter spending, reduce taxable profits and generally get in the way of recovery. They sap confidence and can even result in lower revenues if they hit transactions and activity. The country can afford the one off hit of a bad year with a massive deficit which everyone understands was a one off related to health policy. It is now important for confidence that there is a good prospect of early and sustained recovery to bring the deficit down by the reverse of how it rose. It went up because activity suffered such a bad hit, not because the tax rates were too low.