Briefing: potential tax cuts

June 2022

Background:

Following the vote of no confidence in the prime minister on 6 June 2022, calls have been made for the government to introduce a change in economic and fiscal policy. In a cabinet meeting the day after the vote, the prime minister was reported as saying: "We will have the scope, by delivering tax cuts, I think, to deliver considerable growth in employment and economic progress."[1]

Two thirds of Britons say the government is currently handling the economy poorly and this view has been worsening since May 2021.[2] The UK's growth is forecast by the OECD to be the worst in the G7 in 2023. They have also made calls for the government to cut taxes before growth stalls.[3]

The March 2022 spring statement lays out the urgency of the economic crisis enveloping the country. Growth forecasts have shifted downwards and inflation is set to reach almost 9 per cent by the end of 2022. By 2026-27, national account taxes are forecast to be their highest since the late 1940s.[4]

Using a dynamic tax model that has been commissioned by the TaxPayers' Alliance, this note demonstrates the real-world impacts on a range of potential tax cuts. The results include the change to real wages, investment spending and GDP.

Key findings:

- The national insurance rises in April 2022 continue to drag on the beneficial impacts of other potential tax cuts.
- Cutting the basic rate of income tax by either one or two pence would still mean lower average weekly earnings by 2029 because of the national insurance rises in April 2022.
- A reduction in the main rate of VAT to the 2010 level of 17.5 per cent could mean GDP being £30 billion higher by 2029. However, if the national insurance rises from April 2022 are not reversed, it would only be £3 billion.
- Combining a cut in VAT, income tax and raising the national insurance threshold could mean GDP being £56 billion higher, average weekly earnings £13 higher and investment spending up £12 billion by 2029.

Tax changes on labour and expenditure:

- Revenue from income tax is forecast to be £245.5 billion in 2022-23. For national insurance, it is £179 billion.[5]
- If the national insurance rises from April 2022 do not go ahead, then cutting the basic rate of income tax from 20 per cent to either 19 or 18 per cent would see higher output, investment spending and average weekly earnings.

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[1] O'Connor, M. & Parkinson, J., *Boris Johnson under pressure to cut taxes after confidence vote*, BBC, 8 June 2022, www.bbc.co.uk/news/uk-politics-61726091, (accessed 8 June 2022).

[2] Smith, M., *Labour have caught up with Tories on best government to manage the economy*, YouGov, 19 April 2022, https://yougov.co.uk/topics/politics/articles-reports/2022/04/19/labour-have-caught-tories-best-government-manage-e, (accessed 9 June 2022).

[3] Aldrick, P., *Cut Taxes Before Economy Grinds to a Halt, OECD Warns UK*, Bloomberg News, 8 June 2022, www.bnnbloomberg.ca/cut-taxes-before-economy-grinds-to-a-halt-oecd-warns-uk-1.1775918, (accessed 9 June 2022).

[4] Office for Budget Responsibility, *Economic and fiscal outlook: March 2022*, March 2022, p. 16.

[5] Office for Budget Responsibility, *Public finances databank – April 2022*, 28 April 2022, https://obr.uk/download/public-finances-databank-april-2022/, (accessed 9 June 2022).

- With the increase in national insurance primary threshold and lower profits limit increasing to £12,570 in July 2022, output, investment spending and average weekly earnings would all be slightly higher by 2029. However, the positive effects are far greater if the national insurance rises from April 2022 are reversed.
- Revenue for VAT is forecast to be £154.2 billion in 2022-23.[6] A cut in VAT of this size would increase output, investment spending and average weekly earnings. This is the case whether or not the April 2022 national insurance rises remain in place.

Tax changes combined:

- If all three changes went ahead, by 2029 GDP could be £27 billion higher, investment could be £6 billion higher and average weekly earnings could be increased by £6 a week. This includes the national insurance rises from April 2022, VAT down to 17.5 per cent, the employee national insurance thresholds increasing (as is planned) and income tax basic rate being cut to 19p.
- However, if the national insurance rise from April 2022 did not go ahead, making all three changes would have different results. GDP would instead be £56 billion higher, investment spending would be £12 billion greater and average weekly earnings would be £13 higher.

Table 1: forecast effects of tax changes on average weekly earnings, investment and GDP in 2029 (with April 2022 national insurance changes in effect), (£)

Tax and its change	Change to average weekly earnings (£)	Change to investment spending (£bn)	Change to GDP (£bn)
Basic rate income tax cut from 20p to 19p	-4	-4	-16
Basic rate income tax cut from 20p to 18p	-2	-2	-7
National insurance employee thresholds increased to £12,570	-3	-3	-11
Standard rate VAT reduced to 17.5 per cent	1	1	3

Table 2: forecast effects of tax changes on average weekly earnings, investment and GDP in 2029 (without April 2022 national insurance changes in effect), (£)

Tax and its change	Change to average weekly earnings (£)	Change to investment spending (£bn)	Change to GDP (£bn)
Basic rate income tax cut from 20p to 19p	2	2	9
Basic rate income tax cut from 20p to 18p	4	4	19
National insurance employee thresholds increased to £12,570	3	3	14
Standard rate VAT reduced to 17.5 per cent	7	7	30

Methodology:

- The effects of the tax changes are derived from a dynamic tax model that was constructed in collaboration with Europe Economics. It is a modified Ramsay-Kass-Coopmans model.

[6] Ibid.