Twitter Thread by Richard Murphy

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Tax cuts are in the news as Tory party leadership candidates are talking about them as if tax was going out of fashion. It is very apparent that none of them know much about tax, so a thread to discuss some of the issues.

First, because all government spending is, as a matter of fact, funded by government money creation via the Bank of England, which was proved in the quantitative easing eras, the proper role of tax in the economy needs to be understood by these politicians.

That proper role of tax in the macroeconomy - which is what they're going to be responsible for - is to reduce inflation. Tax cancels government money creation. It takes government-created money resulting from government spending out of circulation.

There is no direct relationship between money creation and inflation. But it's clear that a government cannot spend without limit with newly created money and not create inflation as a result. So governments tax to reclaim the money that they spend.

This means that there are questions for ministers who want to cut taxes now.

The first one is how are they going to control inflation if they are going to cut taxes? We have an inflation problem. I favour selected tax cuts plus some big tax increases on the wealthy to tackle it. What do they propose?

The second is, if they do want tax cuts, come what may, with no other counter inflationary measures, are they as a result planning to cut government spending? As they all say they want growth, how do they think cutting government spending helps this?

For those of them who do not know, government spending is a key element in our national income. It is not money wasted. It is part of our national income. So, if they want to cut that part of our income, where do they think the replacement activity is going to come from?

I would be willing to believe that this growth might come from the private sector in some circumstances. For example, if there was a massive new technical innovation waiting to drive change and so growth. Or if people had money in their pockets waiting to be spent.

Maybe Tory party hopefuls think these situations exist. But all I see is the iPhone 13 (which looks like the iPhone 12, which is the state of play in all tech stuff now) and I see people suffering a massive cost of living crisis in desperate need of help to make ends meet.

This is not the scenario where a tax cut is going to help because it's not the scenario where private sector innovation is in the slightest bit likely. Businesses invest when they can see a return on their money. And those returns are scarce right now.

It's also interesting to note that so far no prime ministerial hopeful appears to want to address the one issue that is the biggest impediment to investment in the UK at present. That, of course, is Brexit.

Our exports are down heavily because you can't sell from the UK. It's a fantasy to suggest there will be serious investment in the UK whilst we are outside the single market and maybe the Customs Union. It's just too expensive and uncertain to locate in the UK right now.

Let's look at some other dimensions to this. It could, for example, be argued that tax cuts would help stimulate the economy if they were targeted at the most vulnerable. Companies are not the most vulnerable. But national insurance cuts could help.

The only problem for ministers seeking to help the most vulnerable is that tax cuts are a pretty poorly targeted instrument to achieve this goal even if the right tax is chosen. Increasing benefits will almost always work better. But they don't want to talk about that.

What they do all seem to want to talk about is corporation tax. All of them seem to have fallen under the spell of Arthur Laffer, who long ago proposed that if you cut corporation tax rates then tax yields increase because more profits are made.

Laffer claimed that the increase in profits was so big that it more than compensated for the cut in rates. Now it so happens I have met Laffer. We confronted each other, head to head in a debate at the OECD in 2018. You can watch it here. https://t.co/roKZRhH1lE

The debate was subject to a vote. I won. Those voting came from the American Chamber of Commerce in Europe. They weren't chosen for their left-of-centre credentials. I won because Laffer talks twaddle.

Tax cuts for businesses only increase revenues when the tax rate that is cut is very high. A corporation tax rate of something over 50% might be required for the effect to be seen. The current corporate tax rate is 19%.

Such tax costs also only work if regulation in other states let companies ultimately owned there move to the UK and take advantage of them. But US laws would already prevent US companies from doing that, and the OECD is moving worldwide tax in the same direction.

And then there is the problem that even if it seems that tax revenues rise because of corporate tax rate cuts that's only ever happened because people have shifted income into companies that was previously taxed in their own names.

If the corporation tax rate is 15% and the income tax rate is 20% which small business is not going to be set up as a company as a result? That's a massive gain to accountants and for tax avoidance but none to society at all.

And finally on this theme, the evidence is that when companies relocate for tax they do not bring large numbers of people and lots of new work with them. They bring a few head office personnel. And that's it. We win almost nothing as a result.

So, what all these Tory hopefuls are offering are big bungs to business and their friends in the tax avoidance industry, but what they are definitely not doing is offering any prospect of new work or growth as a result.

So, to summarise, these cuts will not help the least well-off. There is no chance of private sector innovation because the economy is already in the doldrums and Brexit is not being reversed. And corporation tax cuts just promote cheating. So what are they actually doing?

All these Tory party leadership candidates are doing is a) failing to tackle inflation b) creating big government deficits c) cutting growth d) laying the groundwork for massive cuts in government spending if they all remain committed to balanced budgets.

The last point is especially important, and I think what this is really all about. Cutting taxes is Tory leadership code for cutting the size of the state and yet in this country the only area where there is demand for growth is in the supply of state services.

We want more health and social care. We want a green new deal. We want education and criminal justice. We want to see people working for the state properly paid or we know we won't get decent services. We know there is no viable private sector alternative to these things.

This is the issue we really face. Instead, Tory party hopefuls offer us higher inflation, low growth, cuts, despair and poverty. They ignore green issues because their idea of growth is carbon consuming, and mine is not. They offer disaster.

And why do they do that? Because they are slaves of a defunct dogma that denies we live in a mixed economy when they would like to pretend in a pure market economy, which has not existed in anyone's lifetime. They are fantasists, and we will all suffer for it. ENDS