

What taxes are best or worst for growth?

Insights from NiGEM

Motivation

- Original exercise conducted as UK government forecast to miss fiscal target
 - What's best way to raise revenue?
- Broad narrative around taxes to frame more specific discussions
- Raising taxes based on UK deficit, but lessons can be reversed for surplus
 - Which taxes are most damaging to growth and so would help the economy if they were to be cut.

Exercise

- Using our global econometric model NiGEM, we simulate tax rises in three main taxes for the UK
- We calibrate based on government meeting stability rule (based on previous forecasts)
 - Specific revenue target of £30 billion additional revenue in 2029-30.

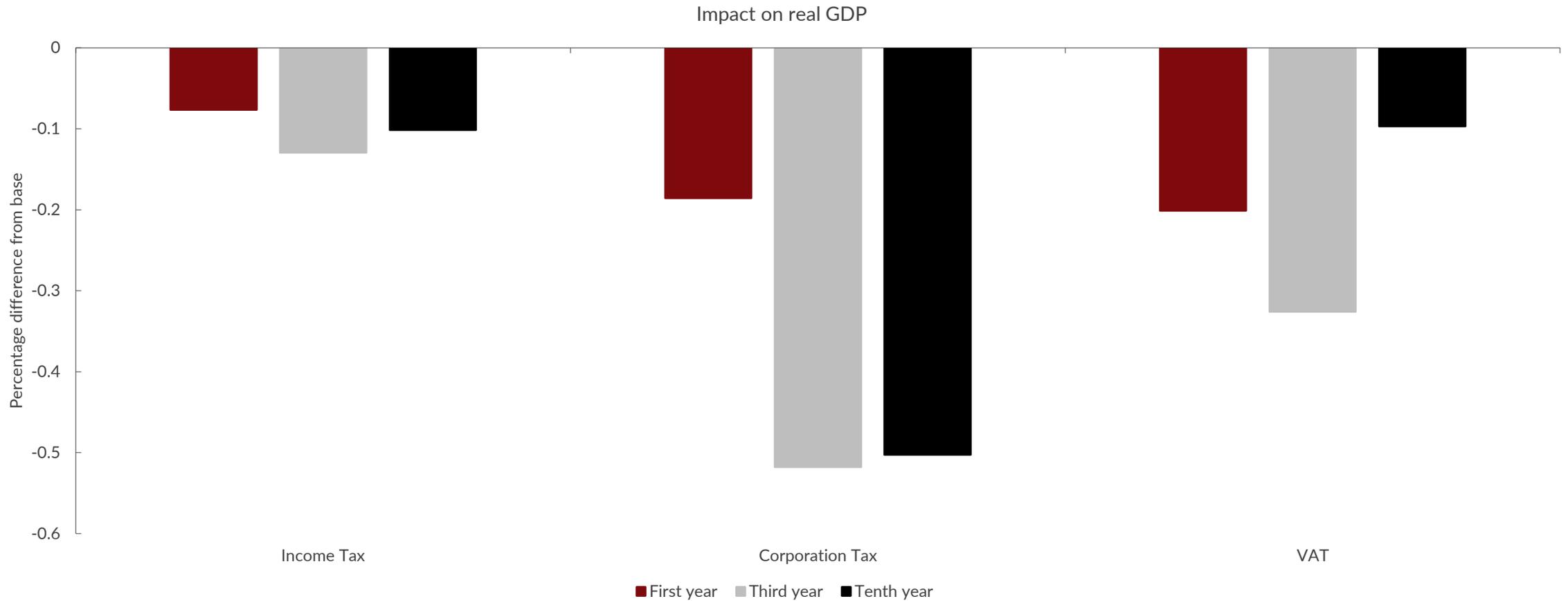
Corporation Tax

VAT

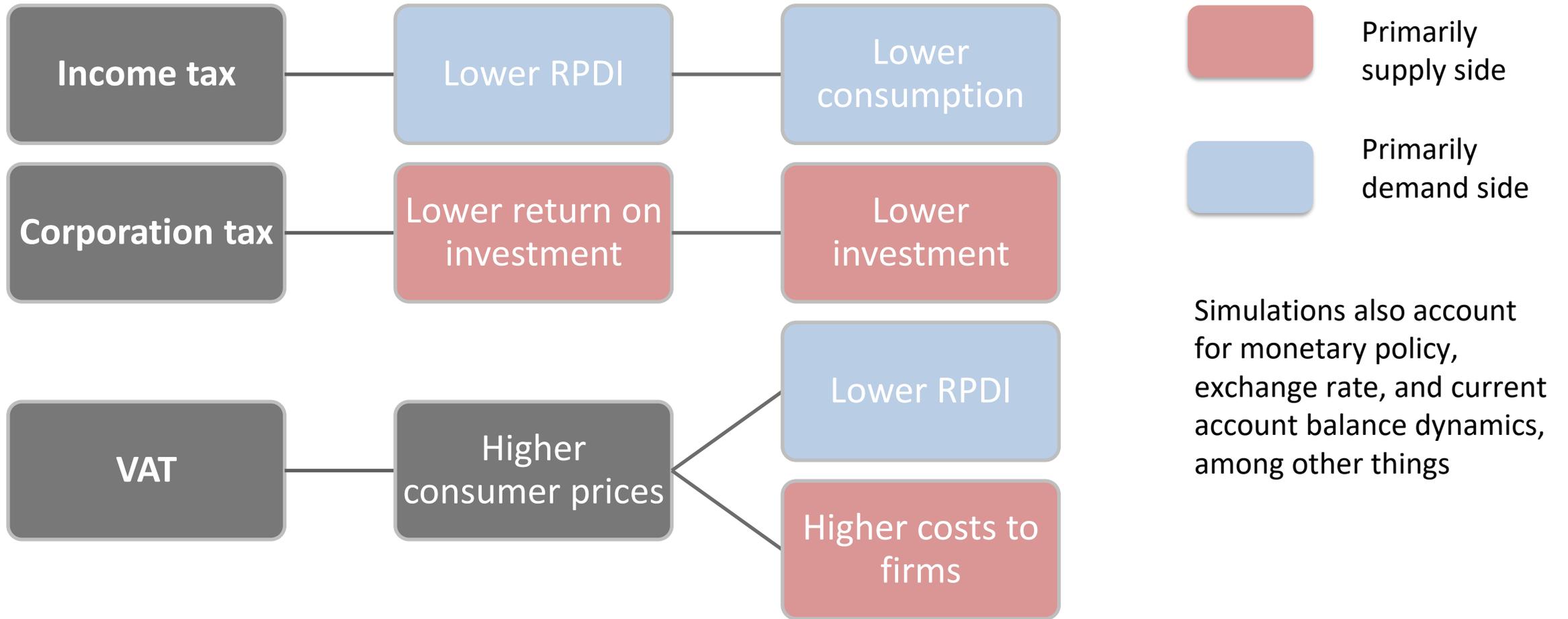
Income Tax

<i>Required rate change - treasury estimates (percentage points)</i>	7.5	Standard and additional rates: 3.0	Basic and additional rate increase: 3p
<i>Calibrated rise in average effective rate (percentage points)</i>	3.4	1.9	0.9

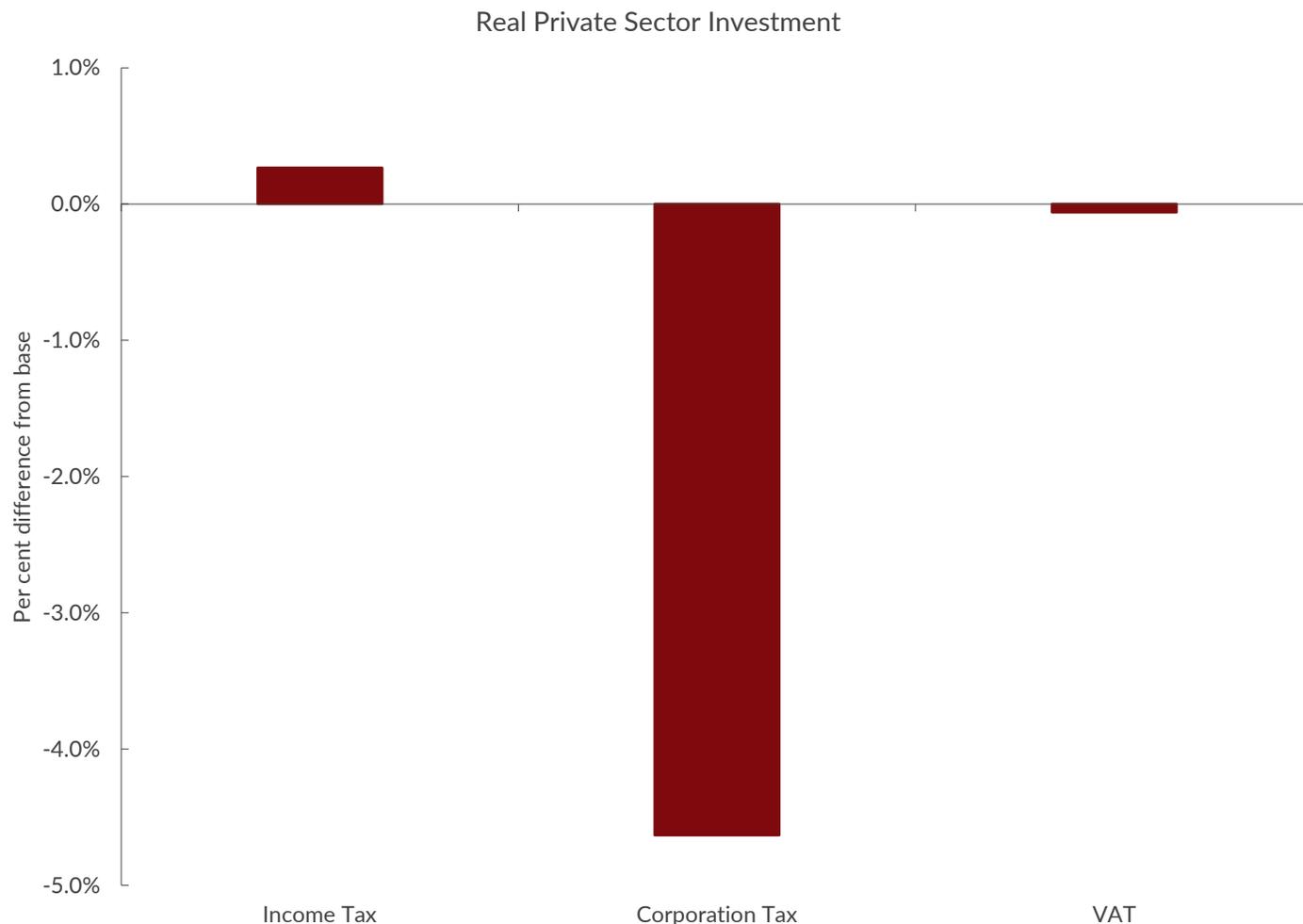
Main tax options – real GDP



Main tax options – primary channels

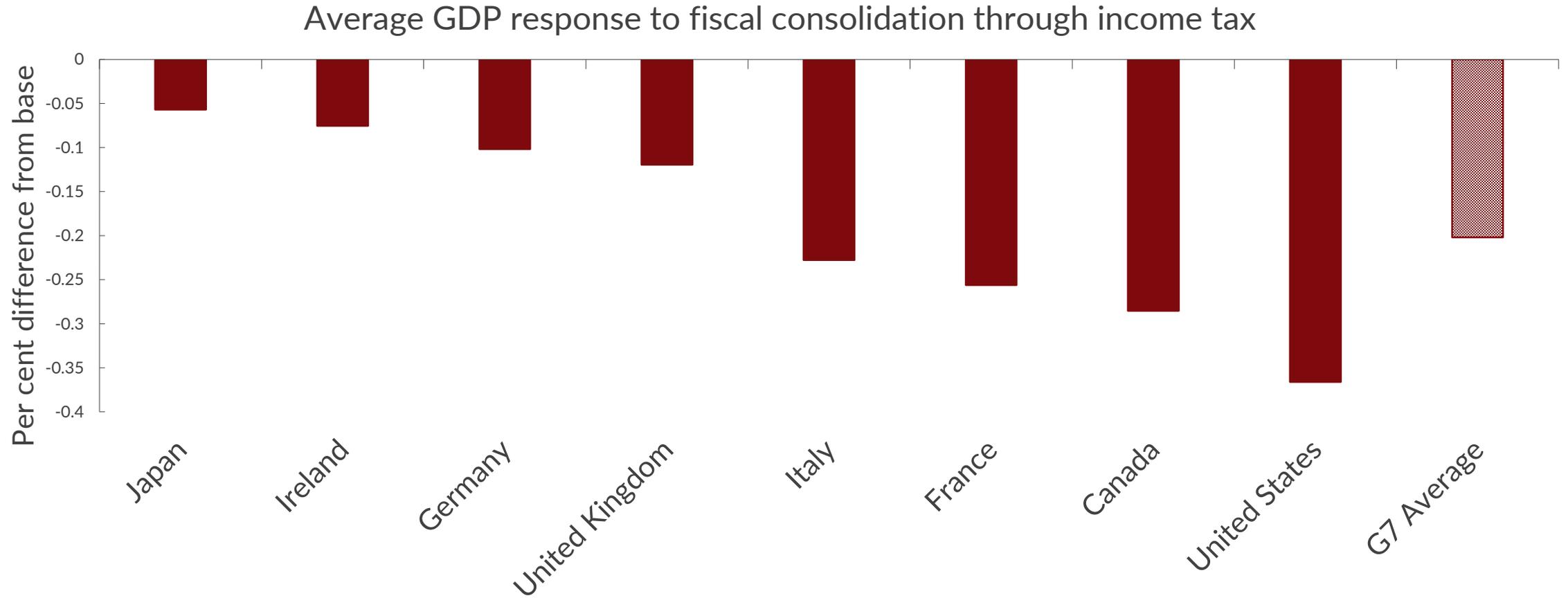


Main tax options – investment reaction



- Corporation tax adds investment costs on directly
- VAT inflationary so can raise short-term costs
- If taxes boost national savings rate and MP can respond, they can help reduce long run financing cost

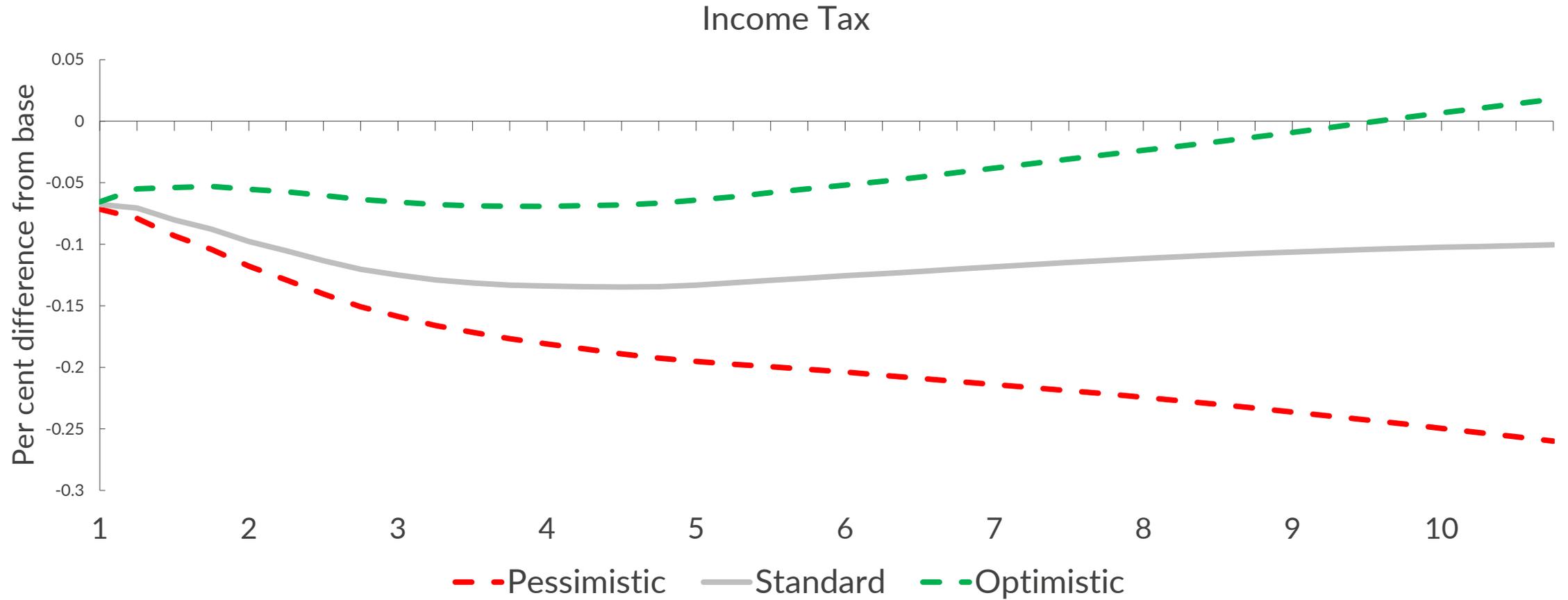
Tax options – Country dependence



Income tax- other considerations

- **Maintaining credibility**
 - Lowering government borrowing costs (reduce risk premium)
 - Meeting targets decisively increases businesses confidence
- **Labour disincentive**
 - People might reduce hours worked as leisure becomes relatively more attractive

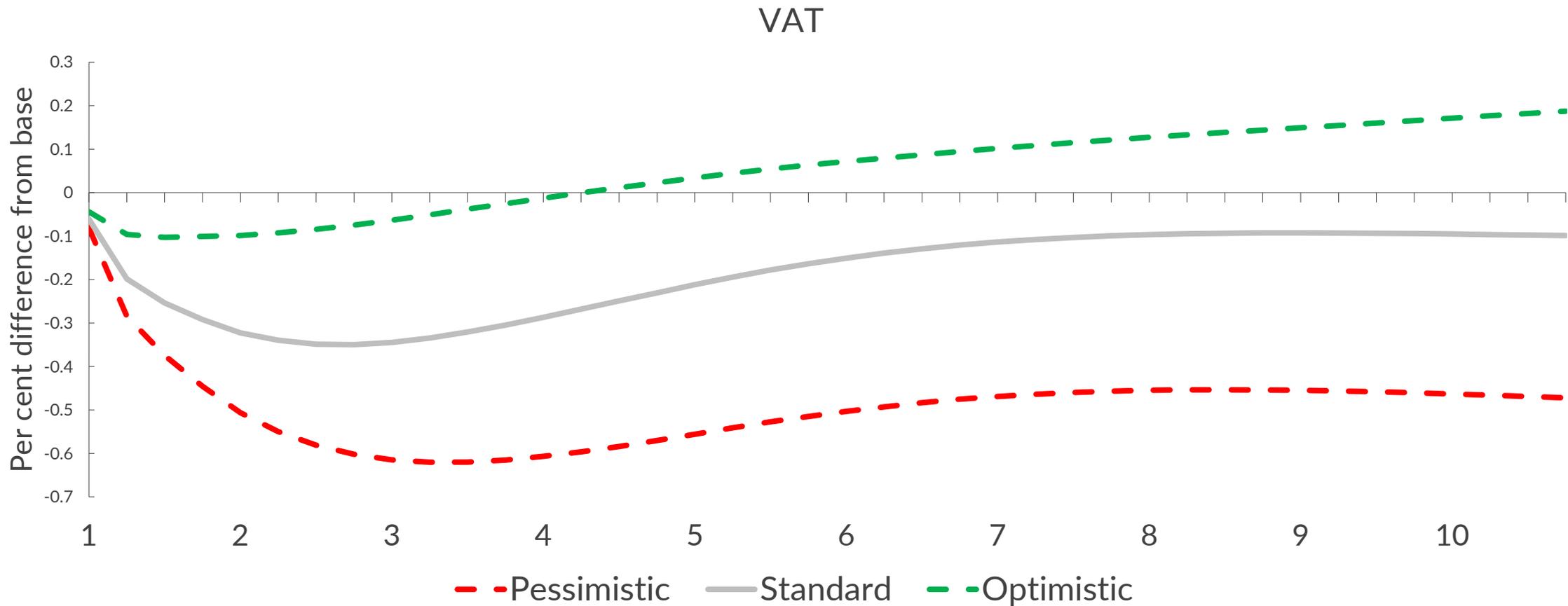
Income tax- other considerations



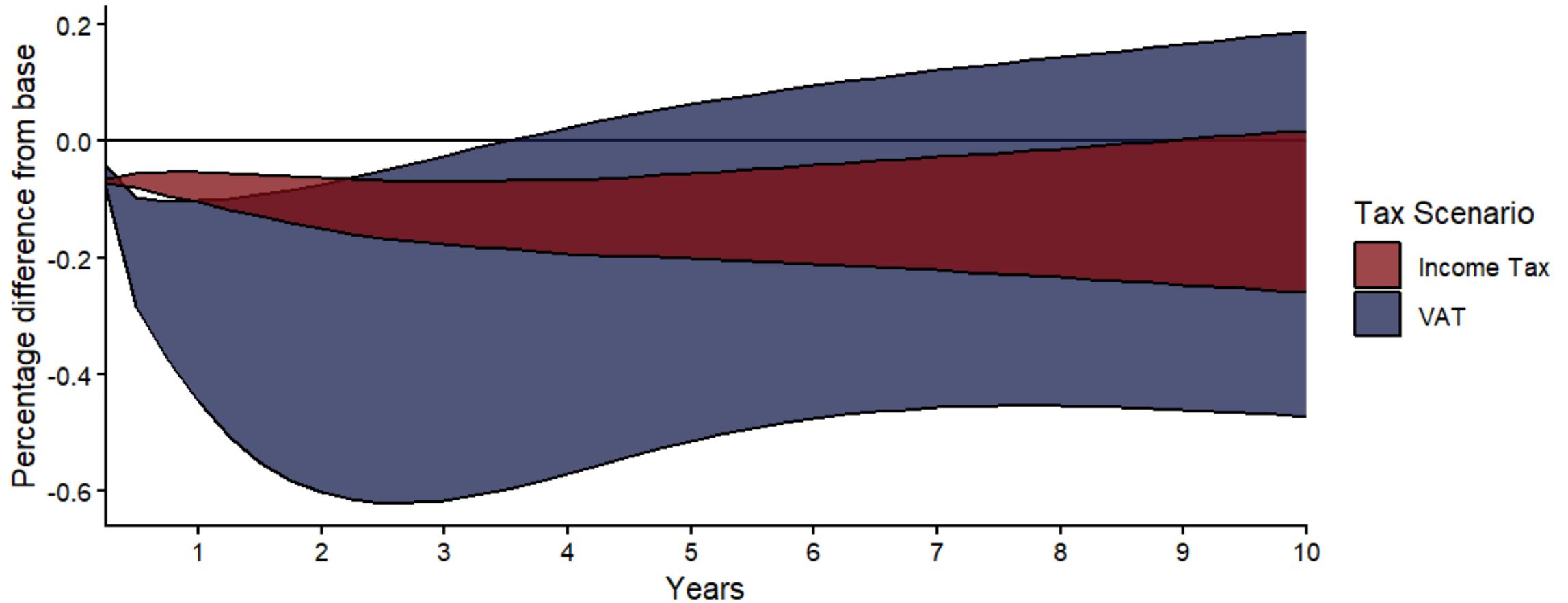
VAT – other considerations

- **Passthrough to consumer prices**
 - Inflation is minimised - but absorbed into profits and/or wages?
 - Long-run supply-side impact
- **Central bank reaction**
 - Does it look through inflation as a temporary rise in price level, or is it worried about unanchored inflation expectations?
- **Distributional consequences of the tax**
 - VAT can be regressive, depends on targeting of incidence

VAT – other considerations



Tax risk – range of outcomes

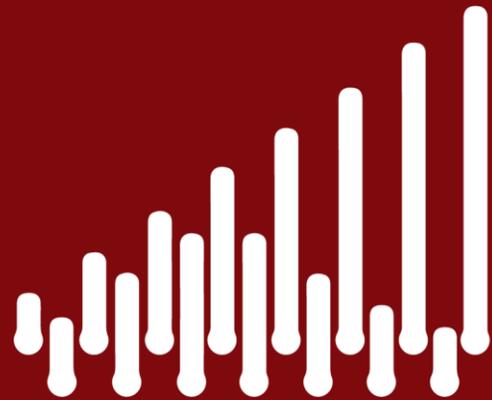


Key Takeaways

- **Economic context is key**
 - Does the tax contribute to inflation expectations?
 - Does it increase or reduce uncertainty and the cost of capital?
 - Does it affect national savings rates and interact with monetary policy?
 - Importance of country specifics
- **Risks inherent in taxes used**
 - Small changes in assumptions can lead to big differences in impact
- **Implementation of tax can mitigate risk**
 - Large, sustained increases that provide certainty are preferable
 - Larger the tax base -> lower individual impact and less behavioural distortion
 - Communication can calm bond markets, lower borrowing costs, and provide assurance that other piecemeal taxes won't be raised in the future

Further areas of exploration

- **Distributional impact**
 - Targeting different parts of the income distribution can change economic impact
 - Savings rates, labour supply, and tax evasion
- **Other non-tax fiscal measures**



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