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Budget 2013: Six pro-growth policies from around the world [1]

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Ahead of tomorrow's Budget, we look at six pro-growth policies from around the world that we'd like to see the Chancellor follow.

1) Abolish capital gains tax, like Singapore

For the meagre revenues it raises, Capital Gains Tax (CGT) is possibly the most economically harmful tax in existence. High CGT rates depress economic activity and prevent the flow of capital to where it can be most productively used. This lowers both economic growth and government revenue. We have found [3] that there was a 76% drop in normal disposals in the period following the government?s CGT hike from 18% to 28%, a clear sign that the government?s high taxes are costing it money.

A model for Britain to follow is Singapore. Singapore has no CGT and has proved to be a magnet for foreign investment. The Asia Pacific region attracted 33% of global foreign direct investment (FDI) in 2011, up from 18% in 2005. Thanks to its low tax regime, tiny Singapore attracted 13% of all FDI into the Asia Pacific region.

To restore Britain?s status as a global leader in competitiveness, the Chancellor should follow the Singaporean example and cut CGT back to pre-2010 rates. In the long-term, the government should aim to abolish CGT altogether.

2) Cut spending faster, like Canada

The Coalition is losing control of its deficit reduction strategy because of its overreliance on growth that has not materialized. Government spending cuts do not need to hurt the economy. Economists at Harvard University, Alberto Alesina and Silvia Ardagna (2012) [4], have found that fiscal contractions paired with structural reforms, such as labour and goods market liberalizations (see below), can be expansionary if they signal a ?decisive? change in government policy.

Canada?s experience with spending cuts in the 1990s offer a useful example of how deep spending cuts can be implemented to strengthen the economy. Chris Edwards has described [5] how in just two years between 1995 and 1997, Canada cut federal spending by 10%, including defence, business subsidies, local government grants and unemployment insurance, shrinking total federal and local government spending from 53 percent of GDP in 1992 to just 39 percent by the mid-1990s.

The Canadian government implemented a comprehensive ?Programme Review? of every department. This was a root-and-branch rethink, not just short-term adjustments like those being carried out by the UK?s Coalition government. Welfare was the biggest saving with 40% real terms cut 1990-99, and every dollar rise in taxes was accompanied by a six to seven dollar cut in government spending.

A 2010 IMF study [6] has shown that a 10% lower debt burden correlates with 0.2% higher growth, and Canada?s economic boom following its cuts supports this. Unemployment plunged and the formerly weak Canadian dollar soared to reach parity with the U.S. dollar.

Canada?s cuts coincided with the beginning of a 15-year boom, and Canada has bounced back from the global financial crisis robustly. It is a model for true cuts to spending that leave no department untouched. The Coalition should learn from the Canadian experience and make deeper cuts to spending immediately.

3) Simplify taxes and regulation, like Georgia

While the UK remains a pretty good place to do business compared to most other Western European countries, by international standards it is slipping behind. In many categories of the World Bank?s Ease of Doing Business Index [7], the UK performs dismally, including basic things like registering property (where the UK is 73rd in the world), enforcing contracts (21st), dealing with construction permits (20th) and starting a business (19th). The Chancellor should commit to getting Britain to the top of the Ease of Doing Business Index within five years.

One model for a dramatic improvement in these rankings is Georgia. Georgia has climbed from 112th overall in the world in 2005 to 9th overall in 2012. To do this, Georgia sharply reduced the number of licence-protected professions, simplified its tax code and reformed property registration to reduce costs and waiting times by 70%.

Every politician claims to want to cut red tape for business, but by committing to improve on an independent measure like the Ease of Doing Business, the Coalition could signal a real commitment to reducing regulatory barriers to business.

4) Liberalize employment law, like Germany

Unemployment has been a persistent problem for the UK since the 2008 recession, particularly youth unemployment. By making it easier to hire and fire workers, and to take on temporary staff as self-employed under contract, the government would reduce the risks associated with hiring new staff, which can put many businesses off employing extra workers altogether.

Germany?s Agenda 2010 reforms, implemented during soaring unemployment in 2005, limited wage rises to regain competitiveness and liberalized temporary work regulations to allow more firms to take on short-term employees. By 2011, unemployment had fallen to its lowest level since the early 1990s. Encouragingly, the number of short-term employees has fallen without a corresponding rise in unemployment.

One notable point about Germany?s labour laws is that Germany does not have any minimum wage laws. This avoids a situation where low-skilled workers are priced out of the labour market altogether. Combined with the Agenda 2010 labour reforms, this has helped to make the German work force significantly more flexible and robust to downturns than other European countries.

5) Cut corporation tax, like Ireland

The government?s corporation tax reductions are a welcome step towards making Britain globally competitive, but the cuts should be faster and deeper. Corporation tax falls almost entirely on workers? wages: a recent study [8] of European countries by economists at the Universities of Warwick and Oxford found that, in the long run, 92% of any rise in corporation tax falls on wages, not profits.

In Ireland, corporation tax receipts more than doubled after it cut corporation taxes from 40% to 12.5%, thanks to big increases in foreign direct investment by multinational corporations. Ireland still has the lowest corporation tax rate in Western Europe, and even in its recession has attracted big name firms like Google, Amazon and Twitter to headquarter there instead of London. Ireland is making the strongest comeback from its recession of any Eurozone country, thanks largely to its business-friendly tax regime.

To attract investment from outside Europe and grow its tax receipts, the Chancellor should reduce corporation tax to 10%, making Britain the most competitive country in the world for business.

6) Cut taxes for the working poor, like Australia

A full-time minimum wage worker currently pays £1,588 of their £12,875 gross earnings in tax. If low-paid workers were lifted out of tax, every full-time worker in the country would earn an effective ?living wage?. By making work pay, this tax cut would partially pay for itself by increasing the number of people in work and reducing welfare dependency.

In 2011, the Australian government raised the tax-free personal allowance to AUD$18,200 (£12,513). By letting its citizens keep more of the money they?ve earned and targeting tax cuts on the poor, Australia is mitigating increases in the cost of living that would otherwise hit its working poor hard.

The cost of living is rising quickly in Britain too. Though this could be significantly mitigated by liberalizing planning regulations, allowing workers to keep the first £12,875 they earn every year and taking minimum wage workers out of income tax altogether would go a long way towards ensuring a basic standard of living for all workers in Britain.

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