Does Britain Mean Business?

By Robert Colvile & Tom Clougherty

- **Britain is about to become a significantly worse place to do business, as corporation tax rises and the super-deduction expires**
- **Modelling by the CPS and US-based Tax Foundation suggests that the corporation tax rise will reduce long-run GDP by 1.2%**
- **Either of these measures would be bad for British businesses. The combination of the two will be even worse, seeing us fall from 10th to 33rd of 38 OECD members in terms of the competitiveness of our business tax regime**
- **Meanwhile, the US, China and EU are throwing tens of billions at firms in the form of investment subsidies**
- **It is still not too late for the Government to reconsider its planned corporation tax rise. But if it does not, it should offset the impact by introducing permanent full expensing as a replacement for the super-deduction**
- **CPS/Tax Foundation modelling shows that the most generous version of this could increase long-run GDP by 3.4%. A more limited version, restricted to plant and machinery, could increase GDP by 1.2%, compensating for the impact of higher corporation tax at a long-run cost of only £2.3bn per year**
- **Making life worse for business will leave us all poorer in the long run**

Introduction

When Rishi Sunak delivered his Mais lecture as Chancellor in 2022, two of his three core commitments were about business investment.[1] He argued, persuasively, that it was only by generating greater levels of capital investment by our businesses, and getting them to invest more in research and development, that we could build a high-skill, high-productivity, high-growth economy.

As the Prime Minister explained, and every academic and expert has confirmed, business investment lies at the heart of growth. It is through firms investing now that we generate greater productivity in the future. Which is a problem, because Britain has suffered from consistently poor levels of business investment. And things are about to get significantly worse.

[1] HM Treasury, ‘Chancellor Rishi Sunak’s Mais Lecture 2022,’ Feb. 24, 2022, https://www.gov.uk/government/speeches/chancellor-rishi-sunaks-mais-lecture-2022.

As of next month, the UK is set to raise corporation tax on large firms from 19 per cent of profits to 25 per cent. At the same time, the 'super-deduction' introduced by the Chancellor to support business investment during the pandemic will expire. In the process, the UK will go from having the 10th most competitive regime for business taxation in the OECD, as measured by the Tax Foundation's annual International Tax Competitiveness Index, to 33rd out of 38.[2] And this is coming at a time when our global competitors are putting huge amounts into subsidising what they see as the industries and sectors of the future, via Chinese state subsidies, America's Inflation Reduction Act and the European Union's NextGenerationEU Recovery Plan, including its European Green Deal.

There are of course many factors that go into firms' investment decisions – as outlined in the recent Centre for Policy Studies paper 'Why Choose Britain?', which collected views on the UK business environment from investors controlling hundreds of billions of pounds in assets.[3] But it is a matter of obvious fact that the tax and investment regime will play a crucial role – and that Britain's is about to get markedly worse.

Of course, we understand that the public finances are hardly in the best of shape. The Government absolutely needs to maintain its commitment to fiscal credibility, and avoid unfunded borrowing. But a tax regime that does not incentivise and attract investment will leave us all poorer in the long run – which is precisely why the Chancellor has insisted that he wants Britain to have the most competitive tax system of any major economy.

In this paper, we will therefore set out the case for lower business taxes as a driver of growth – both in terms of corporation tax and investment allowances. In doing so, we will demolish many of the myths that have sprung up around this topic, and show why supporting business needs to be at the top of the Chancellor's priority list in drawing up his Budget.

The context

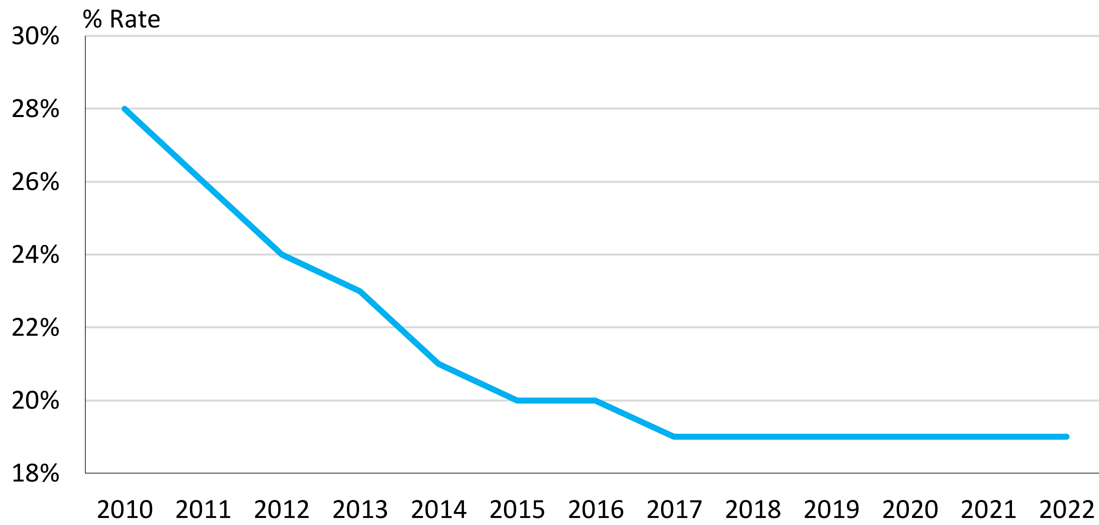
In 2010, George Osborne announced the first in a series of corporation tax cuts, taking the rate down from 28%. The ultimate target was to reduce the rate to below 15%, but this process was halted by Philip Hammond, who kept the rate at 19%.

Osborne's argument was that, even given all the pressures of austerity on the public finances, the best path to growth was to signal to the world that Britain was open for business. The commitment was to create the most competitive tax system in the G20, in the hope that growth would follow. 'We live in a world where the competition for business is growing ever more intense,' he told the House of Commons. 'I want a sign to go up over the British economy that says "Open for Business".'

[2] Tom Clougherty, 'The UK's International Tax Competitiveness: 2022 Update,' Centre for Policy Studies, Oct. 19, 2022, https://cps.org.uk/research/the-uks-international-tax-competitiveness-2022-update.
[3] Tom Clougherty et al., 'Why Choose Britain?' Centre for Policy Studies, May 23, 2022, https://cps.org.uk/research/why-choose-britain.

On the face of it, Osborne's confidence in the galvanising power of corporation tax cuts was well-placed. The tax rate went down and down.

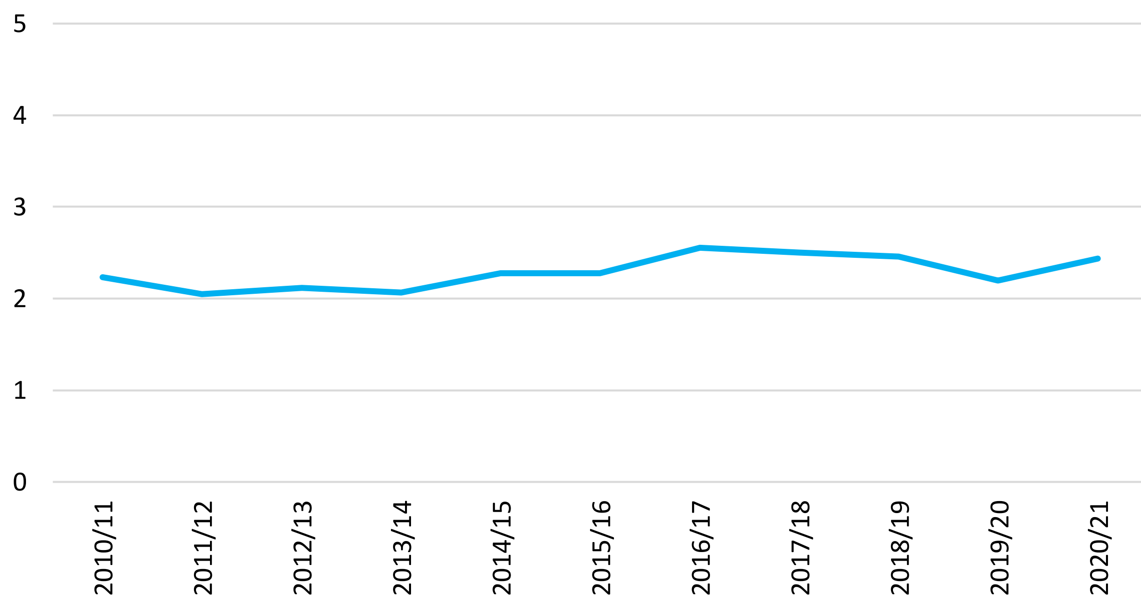
UK rate of corporation tax



Source: HMRC

But the share of corporation tax being paid as a share of GDP remained the same.

Onshore corporation tax receipts as a percentage of GDP



Source: OBR

This implied that Osborne's tax cuts had generated more business activity, resulting in a higher tax take on a lower rate. The Laffer Curve in action.

Indeed, the Office for Budget Responsibility noted in 2018 that 'onshore [corporation tax] receipts have consistently outperformed our forecasts in recent years. Having grown by an average of 2.8% a year over the four years to 2013-14, they have increased by a much stronger 10.1% a year on average over the past four years... Our forecasts consistently missed the pace of this growth, particularly in 2016-17.'[4]

However, the OBR also noted that this story was not quite as simple as it seemed. For one thing, Osborne had accompanied (and indeed largely funded) cuts to the headline rate of corporation tax by the removal of various tax reliefs and the addition of various surcharges. For example, the figures quoted by the OBR above include an 8pt surcharge on the profits of the banks from 2016-7 onwards.

More pertinently, the stability of the corporate tax base reflected a roughly 30% increase in the number of companies paying corporation tax between 2013-4 and 2016-7. Since the vast majority of these new firms were paying relatively small amounts in tax, the suspicion was that these were individuals who had chosen to pay themselves via companies in order to reduce their tax liabilities – in other words, that buoyant corporation tax receipts reflected revenue being leeched from income tax and National Insurance.

Of particular concern to the Treasury was the fact that lower corporation tax rates did not appear to be turning into higher rates of business investment. From 1995-2015, the UK had the lowest average business investment of all OECD nations, according to the ONS.[5] By late 2017, business investment was only 5% above its pre-financial crisis peak – compared with a 60% increase over the decade after the 1980s recession, and a 30% increase following the 1990s slowdown.[6]

Lacklustre business investment has also been a key weak spot since the Brexit vote. Before the referendum, the Bank of England expected that business investment would add 1.8% to GDP between 2015 and 2018, making up one-quarter of all economic growth.[7] In reality, it added only 0.3%. And in its latest forecasts, from February 2023, the Bank predicts that – due in part to the lingering effects of the pandemic and inflation crisis – business investment will actually

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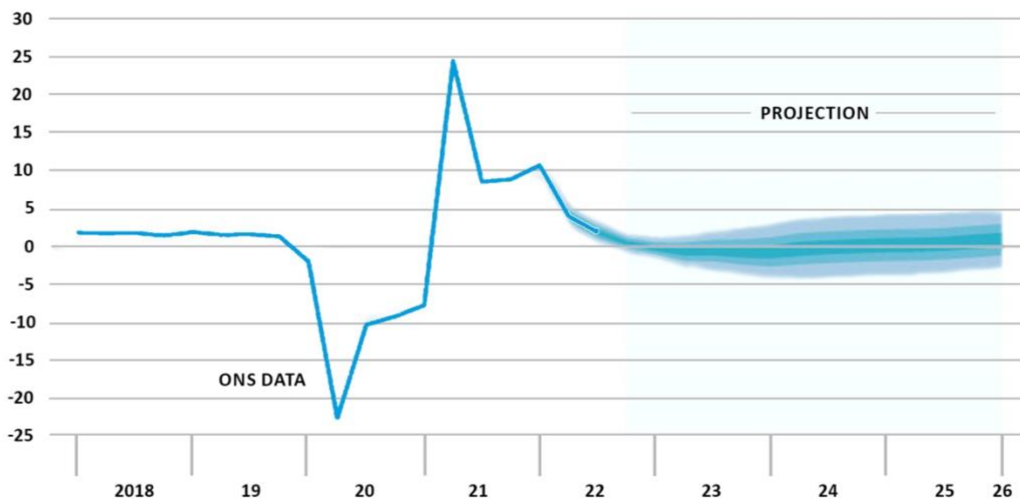
[4] OBR, 'Why have onshore CT receipts performed so well since 2013-14?' Dec. 2018, https://obr.uk/box/why-have-onshore-ct-receipts-performed-so-well-since-2013-14.

[5] ONS, 'An analysis of investment expenditure in the UK and other Organisation for Economic Co-Operation and Development nations,' May 3, 2018, https://www.ons.gov.uk/economy/grossdomesticproductgdp/articles/ananalysisofinvestmentexpenditureintheukandotherorganisationforeconomiccooperationanddevelopmentnations/2018-05-03.

[6] Gemma Tetlow, 'Four theories to explain the UK's productivity woes,' Financial Times, Oct.23, 2017, https://www.ft.com/content/b6513260-b5b2-11e7-a398-73d59db9e399.

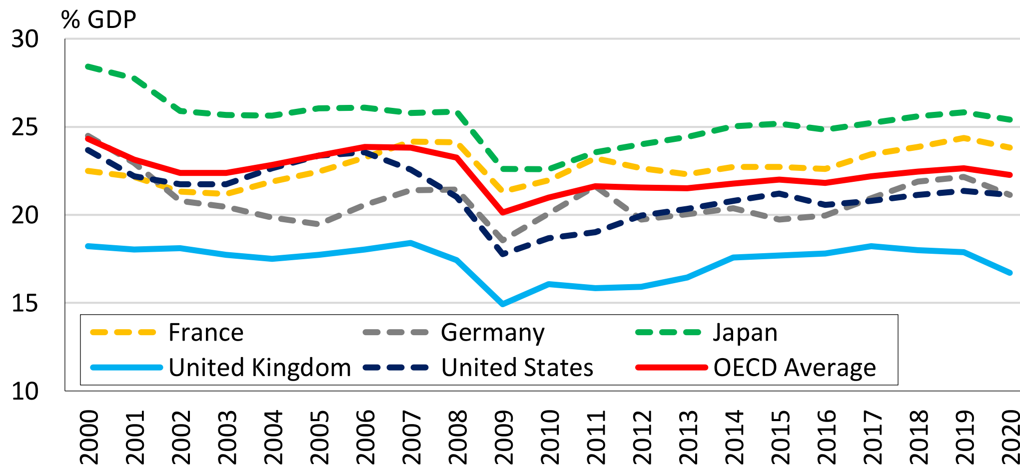
[7] Carl Emmerson et al., 'The IFS Green Budget – October 2018,' Institute for Fiscal Studies, Oct. 16, 2018, pp. 65–66, https://ifs.org.uk/publications/ifs-green-budget-2018.

fall in 2023 and 2024, by 5.5% and 5.75% respectively. Contributing to its awful GDP forecast (below).[8] This is recipe for continued stagnation.



Source: Bank of England

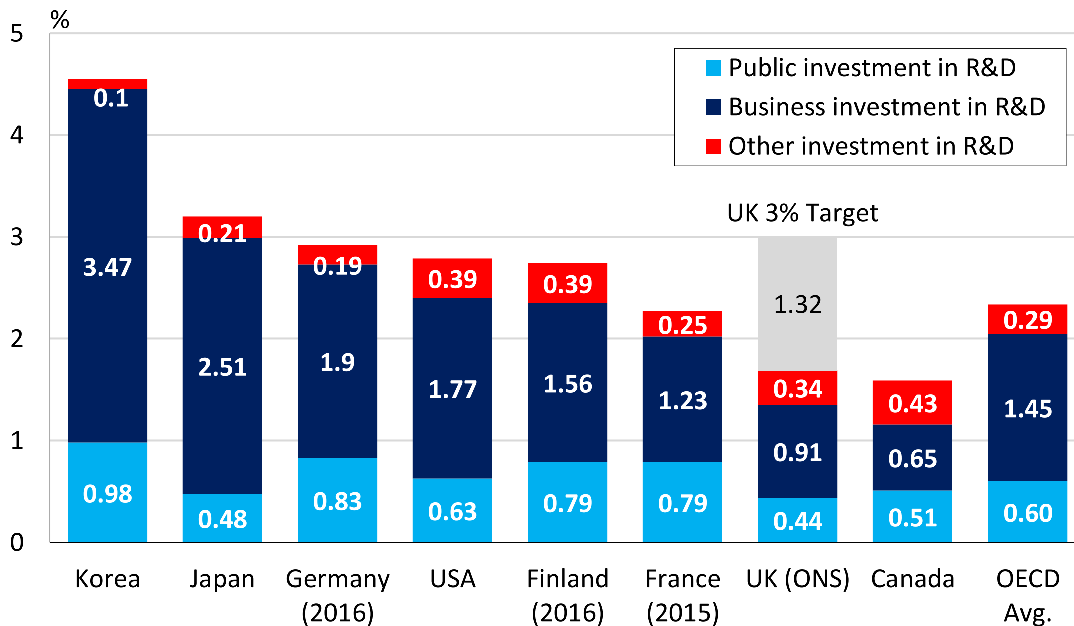
This reflects and entrenches a broader pattern in which Britain has become a low-investment economy – and therefore a low-productivity economy too. The charts below show our performance relative to other countries.



Source: World Bank

[8] Bank of England, 'Monetary Policy Report,' Feb. 2, 2023, https://www.bankofengland.co.uk/monetary-policy-report/2023/february-2023.

R&D investment as a percentage of GDP



Source: Royal Academy of Engineering

In Spring 2021, Rishi Sunak announced a six-point rise in corporation tax, from 19% to 25%, to take effect in two years' time – accompanied, in another inversion of the Osborne approach, by significant new incentives for investment, in the form of the temporary 'super-deduction' which gave 130% relief on plant and machinery. The rise in the headline rate was briefly cancelled by Kwasi Kwarteng, during his tenure as Chancellor, but has since been restored.

At the time of its introduction, the rise in corporation tax was presented as being an unfortunate necessity to help repay the enormous costs of Covid, and in particular the costs of supporting business via the furlough scheme. But there is no doubt that it also reflected a view in the Treasury, shared by Sunak himself, that Osborne's corporation tax cuts had gone too far and cost too much, relative to their economic benefits.

The arguments

At the time and since, the Treasury made multiple arguments to defend the rise in corporation tax:

1) It was needed to balance the books
2) It would only be introduced once the economy had recovered from Covid
3) It would only apply to the largest companies
4) We would still have the lowest corporation tax rate in the G7 and among the lowest in the OECD
5) Business taxation was not just about the headline rate, and we needed to take a more holistic approach
6) Osborne's corporation tax cuts did not do enough to stimulate economic activity
7) In particular, they failed to increase business investment

However, all of these arguments are open to challenge.

On the first point, yes, it is true that the Treasury needs to maintain the stability of the public finances as its top priority. But increasing corporation tax is a particularly bad way to do this.

Research by the OECD has shown that of all the different forms of taxation, taxes on business and investment have the worst impact on long-term growth.[9] This is unsurprising. Capitalism is ultimately, as the name suggests, about capital. The more capital you have, the more growth you create. By contrast, as we pointed out in our recent review of the UK's fiscal frameworks, taxes on consumption are by far the least damaging to the economy, because they are levying the tax on the fruits of growth rather than the seed corn for it.[10]

Increasing corporation tax therefore has a range of unpleasant economic effects. The central estimate from the academic literature is that FDI falls by 2.5% for every percentage point rise in the corporation tax rate.[11] A massive study of companies across Europe by Oxford University academics found that nearly 50p of every £1 increase in the corporate tax burden falls on workers, in the form of lower wages.[12] And evidence from the US suggests a 1 percentage

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[9] Asa Johansson et al., 'Tax and Economic Growth,' OECD, Jul. 11, 2008, https://www.oecd.org/tax/tax-policy/41000592.pdf.
[10] Tom Clougherty et al., 'A Framework for the Future: Reforming the UK Tax System,' Centre for Policy Studies & Tax Foundation, Oct. 24, 2020, https://taxfoundation.org/uk-tax-reform.
[11] Michael P. Devereaux, 'Be Cautious About Raising the Corporation Tax Rate,' Oxford University Centre for Business Taxation, Feb. 25, 2021, https://oxfordtax.sbs.ox.ac.uk/article/be-cautious-about-raising-the-corporation-tax-rate.
[12] Wiji Arulampalam et al., 'The Direct Incidence of Corporate Income Tax on Wages,' Institute for the Study of Labour, Oct. 2010, http://ftp.iza.org/dp5293.pdf.

point increase in the corporation tax rate is associated with a 3.7% decline in employment in start-ups.[13]

Indeed, as part of some recent work on capital expensing, the Tax Foundation and Centre for Policy Studies modelled the economic impacts of moving to a 25% corporation tax rate in the UK. It showed that keeping the corporation tax rate at 19% would result in long-run GDP being 1.2% larger. Investment would be 2% higher and wages 1.1% higher.[14]

Other studies have forecast larger economic impacts: a recent analysis by the Centre for Economics and Business Research suggested that raising corporation tax to 25% would reduce business investment by 3% after 5 years and reduce GDP by 1.8% in the long run.[15]

These malign economic effects also mean that increasing corporation tax will not make as much money as the Treasury hopes.

Back in 2013, as the corporation tax cuts were starting to kick in, the Treasury estimated that 'within 20 years, 45-60% of lost corporation tax receipts would be recouped through increased economic activity'.[16] In 2017, the Institute for Fiscal Studies said that this remained a reasonable estimate.[17] Again, this is an obvious point: lowering the tax on something encourages more of it to happen. But conversely, increasing the tax on something encourages less of it to happen. So by the same logic, a corporation tax rise of a similar proportion to the cut should result in a similar reduction in economic activity, lowering the corporation tax take and – more importantly – leaving us a smaller economy than otherwise.

Dynamic tax modelling by the TaxPayers' Alliance and Europe Economics supports this point of view: they estimate that the (anti-)growth effects of the six percentage point corporation tax hike will reduce the expected revenue increase by almost two-thirds after 10 years.[18]

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[13] E. Mark Curtis & Ryan A. Decker, 'Entrepreneurship and State Taxation,' Board of Governors of the Federal Reserve System, Jan. 2018, https://www.federalreserve.gov/econres/feds/entrepreneurship-and-state-taxation.htm

[14] Tom Clougherty et al., 'After the Super-Deduction,' Centre for Policy Studies & Tax Foundation, Sep. 21, 2022, https://cps.org.uk/research/cancelling-corporation-tax-rise-will-boost-gdp-by-1-2-but-reforming-capital-allowances-could-do-even-more.

[15] James Warrington et al., 'Britain's tax competitiveness is hurtling towards cliff edge deterioration,' The Telegraph, Feb. 22, 2023, https://www.telegraph.co.uk/business/2023/02/22/hunts-tax-raid-drastically-anti-investment-warns-bt.

[16] HMRC & HM Treasury, 'Analysis of the dynamic effects of Corporation Tax reductions,' Dec 5, 2013, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/263560/4069_CT_Dynamic_effects_paper_20130312_IW_v2.pdf.

[17] Helen Miller, 'What's been happening to corporation tax?' Institute for Fiscal Studies, May 10, 2017, https://ifs.org.uk/publications/whats-been-happening-corporation-tax.

[18] TaxPayers' Alliance, 'Pressing ahead with corporation tax rise estimated to cost £30 billion in lost growth,' Feb. 26, 2023, https://www.taxpayersalliance.com/pressing_ahead_with_corporation_tax_rise_estimated_to_cost_30_billion_in_lost_growth.

The Treasury's next argument is that the bill will only fall on those who can pay. The tax increase will not be applied to companies making less than £50,000 in profit, and apply in full only to those firms with profits of £250,000 or greater.

This might be true. But the Treasury still expects this tax rise to make £11.6 billion in 2023-4, rising to £17 billion by 2025-6.[19] The Office for Budget Responsibility predicts that it will rise from 2.2% of GDP to 3.2% - no surprise, given that the burden will effectively be rising by 32%.[20] The argument that business will simply shrug off the additional burden has always been highly questionable. This is a very significant rise, and it is bound to have adverse economic effects.

The next argument is that Britain will still have the lowest corporation tax rate in the G7, and that anyway, business taxation is not just about the headline rate. These arguments are, of course, contradictory. But they are also misguided.

As the Centre for Policy Studies and Tax Foundation have shown, the attractive headline corporate tax rate in the UK has masked serious problems with the competitiveness of our business tax regime as a whole.

Yes, the UK has had the fifth lowest corporation tax rate in the OECD. But more broadly, we come in only 10th out of 37 OECD nations in terms of the wider competitiveness of our business tax regime, in the Tax Foundation's blue-chip Tax Competitiveness Index – and that performance was largely due to the temporary introduction of the super-deduction, which saw us rise from 18th place.[21]

This was because the super-deduction addressed one of the core problems with our tax regime: our extremely stingy treatment of capital investment, whether that be in plant and machinery or buildings and structures. This was, of course, a problem which Osborne's changes made significantly worse.

The impact of the Osborne cuts

One of the core arguments made in favour of the corporation tax increases has been that Osborne's corporation tax cuts failed to stimulate economic activity – and in particular failed to stimulate business investment. Instead, companies used the extra money to increase dividend payouts and buy back their shares.

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[19] HM Treasury, 'Table 5.2: Growth Plan 2022 Reversals', Nov 17, 2022, https://www.gov.uk/government/publications/autumn-statement-2022-documents

[20] OBR, Onshore corporation tax, https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/onshore-corporation-tax/

[21] Tom Clougherty, 'The UK's International Tax Competitiveness: 2022 Update.'

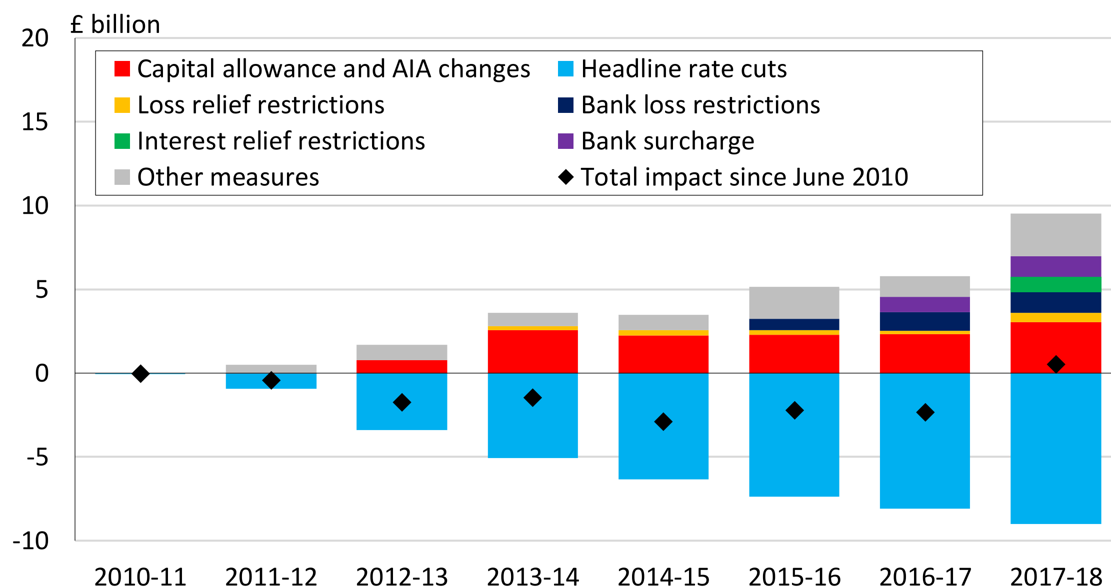
An obvious rejoinder to this is that just because gradually lowering a tax did nothing to stimulate growth, it does not mean that suddenly raising it – in a much harsher economic environment – will do nothing to harm the economy.

But in fact this argument is flawed, for two extremely important reasons.

The first point, as mentioned above, is that Osborne funded his cuts to the headline rate of corporation tax in large part by raising other taxes on business, or reducing incentives for investment.

This chart from the Office for Budget Responsibility shows that a large part of the expense of the corporation tax cuts was clawed back – in particular once the additional levy on the banks came in, at which point the increases in business taxes were almost exactly equal to the cuts.

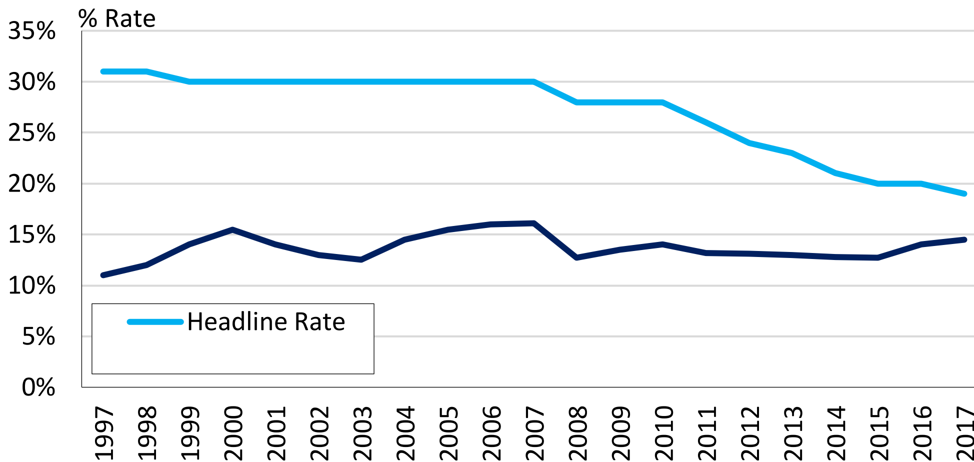
Cumulative impact of measures on onshore CT receipts



Source: OBR

It is no surprise, as Dan Neidle of Tax Policy Associates has repeatedly pointed out, that while the headline rate of corporation tax fell, the actual amount of tax being paid by companies, as a proportion of their profits, remained pretty much unchanged.

UK corporation tax headline rate versus overall effective rate



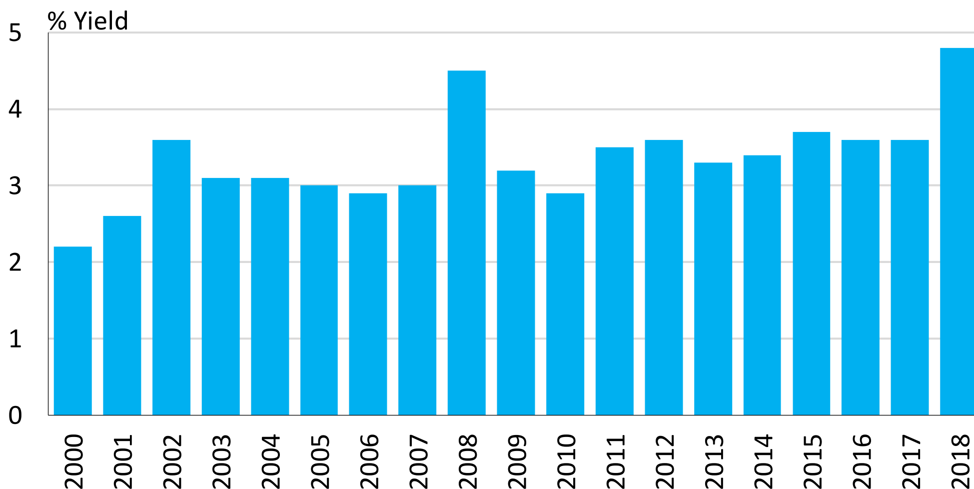
Source: Tax Policy Associates

It would be unsurprising, then, if companies had not increased investment – because the actual amount of tax they were paying had not changed.

But in fact, the entire narrative that companies did not increase investment in the Osborne era is open to question.

It is certainly true that over the 2010s, dividend payouts increased, as the chart below shows. But so too did business investment.

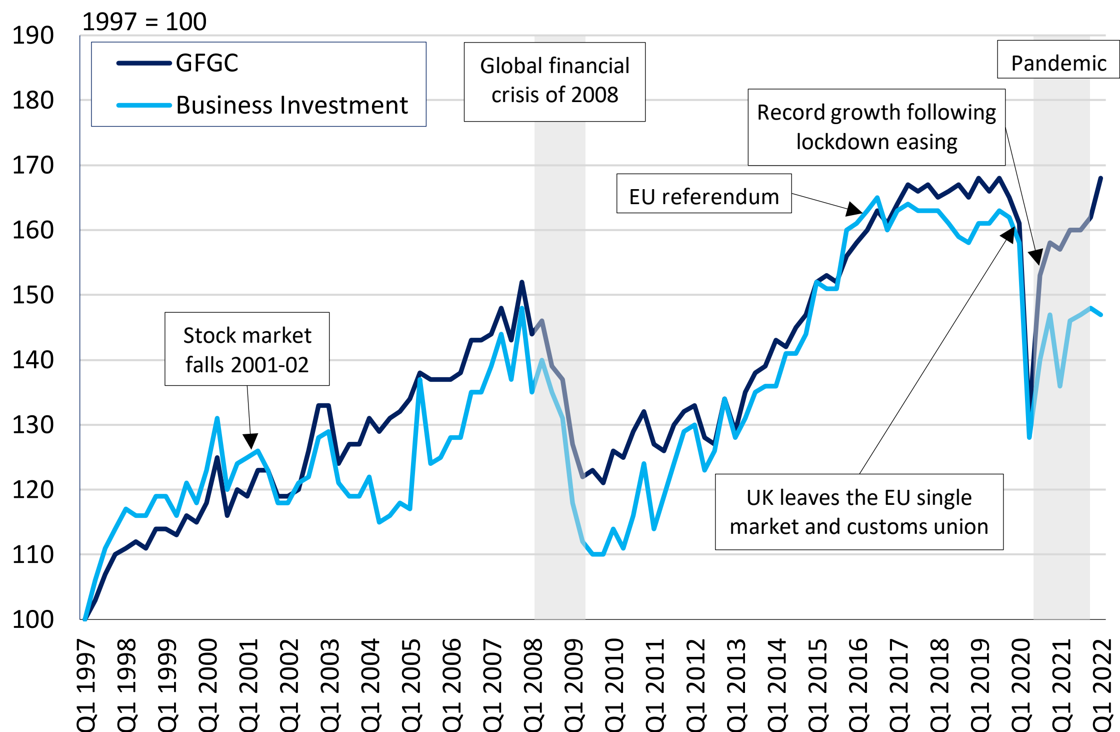
Average UK annual dividend yield



Source: FT

As the ONS chart below shows, UK business investment not only recovered after the crash of 2008 but began to rise at a far more rapid clip than in the years beforehand – until the Brexit vote and the ensuing political turbulence.

UK business investment, chained volume measure



Source: ONS

In fact, analysis of OECD data by the Centre for Policy Studies shows that gross fixed capital formation in the UK (the standard measure of investment, of which business investment is by far the majority) grew at the second highest rate in the G7 in the years 2010-22, even if you account for the turbulence of the Brexit years. In the 2010-2015 period, average growth of 3.7% was behind only America's among the leading Western economies.[22]

These statistics are particularly notable since government investment was actually falling consistently as a percentage of GDP during that period, meaning that the private sector was doing more of the heavy lifting.

[22] Authors' calculations via https://data.oecd.org/gdp/investment-gfcf.htm

Gross fixed capital formation in the G7

	2010-22*	Position	2010-15	Position	2016-22*	Position
Canada	2.1%	4	3.3%	3	1.0%	6
France	2.0%	5	0.8%	6	3.1%	2
Germany	2.2%	3	2.7%	4	1.7%	4
Italy	0.5%	7	-3.0%	7	3.8%	1
Japan	0.8%	6	2.1%	5	-0.5%	7
UK	2.4%	2	3.7%	2	1.2%	5
USA	3.7%	1	4.4%	1	3.0%	3
OECD Avg.	2.5%	-	3.0%	-	2.0%	-

Source: OECD **Q1 2022 only*

In short, you can very easily make the argument not that the impact of George Osborne's corporation tax cuts was minimal, but that it was surprisingly large – especially given the fact that he undercut its potential effectiveness by clawing back money from business in a multitude of other ways, in particular by reducing investment allowances.

All of this is without mentioning the argument made in the recent Centre for Policy Studies paper 'Why Choose Britain?'. As Osborne said, corporation tax rates act as a signal to investors and entrepreneurs both in the UK and overseas. We spoke to more than 100 major investors for our project, controlling hundreds of billions of pounds in capital, and they were clear that the headline rate is a huge signal in terms of whether a country is open for business. Raising it by almost a third was bound to have a chilling effect in terms of investment, and in terms of the UK's international reputation – at precisely the time when we need to be showing investors that a post-Brexit UK is the best place possible to put their money.

Business investment and the super-deduction

As we have pointed out throughout this paper, the business investment environment is not just driven by the headline rate of corporation tax, but by the generosity of the tax regime specifically devoted to business investment. This is why Osborne's decision to fund cuts to the former by slashing the latter was such a mistake. The change in the balance of incentives also had the effect of tilting Britain's economy towards low-investment services firms and away from high-investment manufacturing firms.

The full detail of the business investment regime in the UK is horrendously complicated (the CPS/Tax Foundation paper 'After the Super-Deduction' offers a good overview). But for the purposes of this paper, there are two important points to make. The first is that as well as being incredibly stingy by international standards, Britain's investment tax regime has also been the subject of an extraordinary level of ministerial fiddling – the threshold for the Annual

Investment Allowance, for example, has been changed five times in the past 10 years. This hardly gives companies certainty when making long-term investment decisions.

The second point is that the super-deduction has been subject to exactly the same kind of Treasury pushback as the corporation tax cuts. Officials will insist that it was too expensive compared to the benefits that were delivered, that it really did not do enough to move the needle on investment, and that it served mostly to bring forward investments that were already planned (which helps explain why the Bank of England is forecasting that alarming fall in 2023 and 2024).

But again, these claims can be rebutted.

In February 2022, a CBI survey of 325 firms found that more than half had taken advantage of the super-deduction to advance or accelerate their capital investment plans, or intended to do so.[23] It argued that a permanent equivalent of the super-deduction could trigger an annual 17% increase in capital spending, boosting investment by up to £40 billion a year by 2026. More recently, the group has called for capital allowances to be uplifted to at least 50% in the Budget, before moving to 100% (aka 'full expensing') within three years.[24]

The crucial thing, however, is that any new system of investment allowances needs to be permanent. If the super-deduction only brought investment forward, it is because it was always time-limited – and multinational firms making major investments are working on a far longer time horizon.

In the Tax Foundation/CPS paper mentioned above, we modelled a range of potential replacements for the super-deduction, covering both the options suggested by the Sunak Treasury in its original consultation on a super-deduction replacement, as well as some more generous options of our own devising. The basic principle was to let companies write off more of their investment against tax more quickly, rather than seeing its value (and the benefits) depreciate over time.

We calculated that the most generous form of expensing – 'full expensing', in which companies can write off 100% of tax on investment costs, covering structures and buildings as well as plant and machinery, could result in a long-run increase in investment of 4.2%, which would generate a 2.5% increase to GDP and 2.1% increase to wages. This would come at a long-run annual cost of £9.8 billion. However, we also pointed out that other versions of full expensing would have much lower long-run costs: for example, full expensing that just covered plant and machinery would cost £1.6 billion in the long run, for a 0.9% increase in long-run GDP. This would seem like a bargain by any stretch of the imagination.

[23] CBI, 'A super deduction successor could trigger £40bn-a-year boost for UK business investment,' Feb. 20, 2022, https://www.cbi.org.uk/media-centre/articles/a-super-deduction-successor-could-trigger-40bn-a-year-boost-for-uk-business-investment.
[24] CBI, 'Spring Budget submission 2023,' Feb. 9, 2023, https://www.cbi.org.uk/media/utccayj5/cbi-budget-submission-2023.pdf.

But in fact, that modelling undersold the potential benefits. Our paper was published during the Truss premiership. Accordingly, we set corporation tax at 19% in our modelling, as it was universally expected that the new government would reverse the increase. In an environment where corporation tax sits at 25%, being able to write off investments against corporation tax becomes even more attractive.

Accordingly, as the accompanying table shows, permitting full expensing and extending it to structures and buildings has the potential to increase investment by 5.7%, long-run GDP by 3.4% and wages by 3.0%.

Economic impact of capital allowance reform

	GDP	Investment	Wages
(a) Enhanced writing down allowance rates	0.1%	0.2%	0.1%
(b) 40% first-year allowance	0.5%	0.8%	0.4%
(c) 20% additional first-year allowance	0.7%	1.1%	0.6%
(d) Spring Statement 'full expensing'	0.9%	1.5%	0.8%
(e) Full expensing for plant & machinery	1.2%	2.0%	1.0%
(f) Full expensing for plant & machinery *and* structures & buildings	3.4%	5.7%	3.0%

Source: Tax Foundation/Centre for Policy Studies

Obviously, this would come at a cost – in this instance, of £15 billion a year in the long term and almost £30 billion initially, as firms immediately deducted the cost of new investments, while continuing to gradually write down ones made under the old system. This is self-evidently a very large number, especially given the state of the public finances.

(It is important to note, however, that our analysis of these fiscal costs is *static* – that is, it does not account for the effects of increased growth. If reform had the growth effects we anticipate, the actual fiscal cost would be significantly lower.)

Fiscal cost of capital allowance reform (static analysis)

	Peak year cost (£bn)	Long-run annual cost (£bn)
(a) Enhanced writing down allowance rates	2.0	0.3
(b) 40% first-year allowance	3.0	0.7
(c) 20% additional first-year allowance	4.0	1.7
(d) Spring Statement 'full expensing'	11.0	1.4
(e) Full expensing for plant & machinery	12.3	2.3
(f) Full expensing for plant & machinery *and* structures & buildings	29.7	15.0
(g) Full expensing for plant & machinery and neutral cost recovery for structures & buildings	18.3	14.6

Source: Tax Foundation/Centre for Policy Studies

Yet other versions of full expensing are much more affordable. Limiting full expensing to plant and machinery – as with the super-deduction – has a long run, static cost of just £2.3 billion per year. Set against a potential 1.2% boost to GDP, this is an incredibly good deal for the taxpayer. Indeed, the overall message of our modelling was very clearly that the bolder the reforms pursued, the greater the economic payout for Britain.

Finally, there is one other advantage to increases to capital allowances – they are a lot easier to sell to the public than cuts to the headline rate. In 'A Framework for the Future', a major survey of the UK tax system co-published with the Tax Foundation, we lamented the fact that the very tax rises that are worst for long-term growth – ie, those targeting business and investment – tend to be the most popular with voters. As James Frayne noted in his survey of the Conservative voting base for the CPS, 'A New Majority', 'the bulk of the public don't pay corporation tax and don't really know what it is or how it works. They think it's for "big corporations" and don't realise it's a tax that's most problematic for smaller businesses who lack the ability to offset it.'[25]

If the Government feels that it is unable, either for political or financial reasons, to revisit the topic of corporation tax, then increasing investment allowances is the obvious alternative – and fits perfectly with a narrative of levelling up, supporting manufacturing, green investment, backing infrastructure and so on. Indeed, distributional analysis of the super-deduction's impact shows that its effects were felt primarily in areas such as the North and Midlands – as

[25] James Frayne, 'The New Majority,' Centre for Policy Studies, Sep. 5, 2022, https://cps.org.uk/research/the-new-majority.

you would expect, since the manufacturing firms based there tend to be far more capital-intensive than southern services firms.

Conclusion

The situation facing Jeremy Hunt and Rishi Sunak is not one that anyone would envy. Given the state of the public finances, the strains on public services, and the need to avoid unfunded borrowing of the kind that undid the Truss government, there is extremely limited room for manoeuvre.

But as the Prime Minister outlined in his Mais lecture, increasing business investment is absolutely core to raising long-term growth rates in this country – and our incentives for business investment are about to become dramatically and alarmingly worse.

The CPS has argued strenuously against the proposed increase in corporation tax. We still believe it is a mistake. But at the very least, we urge ministers to compensate for its effects by introducing the most generous form of business investment allowances possible, even if there is a short-term cost – because it is only by persuading businesses to invest that we can deliver the growth the country needs.