1. Introduction and summary

In this book, the themes of my earlier book, *Should Britain Leave the EU?* (Minford et al., 2015), are pulled together to discuss how we should follow up with post-Brexit policies, now that Brexit has finally taken place. ‘What should Britain do, having left the EU?’ This is what this book aims to answer. As before, I will rely heavily on research that my co-authors and I have done, mostly now in Cardiff over the last 20 years, building on earlier work in Liverpool over the previous 20.

The earlier book explored the gains from free trade that could be made by abandoning the EU protectionism that dictated our commercial policies. In this book, I flesh out how free-trade policies will reshape the economy, and, in turn, how other policies should be adapted to this new world.

Another set of gains will come from a new regulative approach, replacing the interventionist regulation of the EU, with its redistributive and socializing aims; continental law, where one can only do what is explicitly permitted, lends itself to prescriptive regulation, whereas common law, where one can do whatever is not forbidden, lends itself to independent innovation. We will set out a way of modelling these gains, and the policies that can reinforce them.

What we will see is that there is also a need for new policies across other areas – notably, fiscal policy, including tax structure, and monetary policy, including the new much-vexed role of ‘prudential’ controls. This is especially urgent after the coronavirus crisis. Then too we must look at how public money is spent: too much spending is not ‘joined up’ with good information and hence ineffective. In an age of huge information flows and easy communications, spending should facilitate and strengthen private choices at local level within the community.

We have an unparalleled opportunity to remould our policies across the board in order to set the economy on a new course with the ability Brexit gives us to rethink policy that has increasingly been dominated by EU institutions, which as our previous book argued, were not economically well structured.

This book starts with trade and regulation, these being the two key areas of EU control we will be dismantling. These involve the detailed settings of the tax and regulatory system, which act directly on the market behaviour of firms and households at the ‘micro’ level; we go on to consider the structure of the UK’s whole tax system to complete this microanalysis, affecting the supply side of the economy. We then move on to consider how ‘macro’ policy should be set in the future: that is, the management of demand in the economy. We review fiscal and monetary policy in the current crisis and go on from there to consider how they should evolve in the post-Brexit, post-COVID-19 economy. In what follows I give an overview of the book’s arguments.

PART I: RESTORING BRITAIN’S COMPETITIVENESS THROUGH FREE TRADE AND REFORMS OF THE TAX AND REGULATORY SYSTEM

Chapter 2 on Trade

At the heart of the EU’s powers is the control of commercial policy – that is, tariffs and non-tariff barriers, including standards set so as to exclude supplies from certain other countries, notably the US, and also anti-dumping duties and quotas on supplies from particular countries. Commercial policy is designed to create large trade barriers against non-EU competitors, both in agriculture and manufacturing. In services such as financial, which are not so important to the EU as industries, EU commercial policy is fairly liberal, though national governments remain highly restrictive of foreign competition, including from the rest of the EU; it is only recently that the single EU market has been extended to some services, so restraining national protection against the rest of the EU. UK service industries operate worldwide and so are little affected by this mainly national protectionism. UK service prices are therefore set by international competition at world prices; this will not change when we leave the EU.

However, UK goods prices are currently dominated by EU prices, which are higher than world prices by the percentage of trade barriers, which are estimated in our research and elsewhere at around 20% for both food and manufactures. Leaving the EU and negotiating wide free trade agreements (FTAs) with non-EU suppliers so that they gain free access to our markets will bring UK prices down 20% to world levels – this, which is equivalent in its effects to unilateral free trade, will, according to the

Global Trade Analysis Project (GTAP) model now used by the Treasury, bring gains of 4% of gross domestic product (GDP) through better prices to consumers and competition-led rises in productivity by UK producers. According to Cardiff research, the gain would be double, while simply abolishing half the EU protection would bring in the same gain. This is our preferred (cautious) assumption. Astonishingly, the Treasury, in its latest report, assumes this gain to be only 0.2% of GDP, on the grounds that this policy is barely carried out – totally contrary to announced government policy.

The Treasury's gloom does not stop there. It also assumes that large trade barriers will spring up along the UK–EU border after Brexit, for two reasons. First, the EU will refuse to recognize that our exports satisfy their standards, and we will do the same; second, it and we will institute border checks that artificially delay our trade in both directions at the border. However, both these things are illegal under World Trade Organization (WTO) rules, to which both we and the EU remain entirely committed. Under the GTAP model these new barriers cost us over 5% of GDP. Yet, these costs are entirely illusory.

The Treasury, on its own admission, has a bad track record on its trade modelling. Before the referendum it produced equivalent estimates of the Brexit costs to the UK due to trade; it did so using 'gravity' equations instead of a full model of world trade with implied Brexit impacts through all channels. Since then, it has conceded that its gravity equation methods were faulty because they did not compute the full Brexit effects on, but rather took as constant, aspects of the economy such as wages and other home costs that would also simultaneously change with Brexit. Hence, their move to adopt the GTAP model.

Unfortunately, in changing their model they did not change their determination to find negative effects from Brexit via absurdly pessimistic assumptions, such as we have detailed above. When we replace these assumptions about a Brexit on WTO rules, we find the GTAP model gives a net gain of 2.6% of GDP. Our own Cardiff World Trade Model on our assumptions gives a gain of 4% of GDP.

Chapter 3 on Regulation

Regulation is the second major area controlled by the EU, through its powers to regulate the Single Market. It exercises these powers according to a 'social market' philosophy. A nation state has the power to tax/subsidize, and it can use this power to redistribute income to the less well-off.

However, the EU has no tax powers because national governments have been unwilling to pass them over to it, even partially. Therefore, to achieve social objectives of a redistributive nature, the EU uses regulation; examples are labour market ‘rights’ that are essentially subsidies to workers paid for by implicit employment taxes on firms.

Thus, one finds that labour market regulation is a series of subsidies to workers and trade unions, paid for by firms. The effects on the economy can be assessed according to the labour tax equivalent, plus the direct implied transfer to worker-households. It was largely to carry out this assessment that my research team built the ‘Liverpool Model’ of the UK economy; this was the first macro-model of the UK to have a full ‘supply side’, designed to compute the effects of tax and regulation on the economy’s potential output. In an Appendix to this chapter, we take a backward look at how the supply-side reforms of the 1980s’ Thatcher governments affected the economy.

The EU’s regulation extends beyond the labour market to three other main areas. The first is general product market standard setting, which as we have seen is related to setting trade barriers. The general aim of standards is to benefit the main producer industries of the EU. Thus, these industry lobbies have essentially had the power to legislate what suited them. As Adam Smith noted centuries ago, such power in the hands of business is likely to be anti-competitive; one notices that the EU Competition Directorate takes its most stringent actions against foreign, often US, companies – such as Apple, Google and Facebook. One can in principle assess this producer regulation as the equivalent of endowed monopoly power, like a consumer tax. In practice, estimates of this are hard to make, other than via the direct effect of the trade barrier; this barrier also puts an effective limit on the extent to which home industries can raise prices. So, we have not estimated any additional effect of regulation as such via this route.

The second area beyond labour is finance, a service where the EU has shown a strong desire to control activity, although, or perhaps because, the biggest EU finance industry has been in the UK. It has intervened with highly prescriptive regulations in this major UK industry, in a way that is extremely unpopular among its practitioners – supposedly to protect consumers. These regulations have given rise to an army of ‘compliance’ executives, but while this has raised costs substantially, gains to consumers have been unclear; in other major markets, such as the US, similar interventionism has been avoided. We can leave on one side here the new regulations on banks associated with the financial crisis, which

we discuss later in the context of monetary policy. In the UK this was mostly self-inflicted.

Finally, there is the rest of the economy: (1) the environment and climate where the EU has regulated strongly to force the adoption of non-fossil-based energy; and (2) the regulation of technology, especially in agriculture and pharmaceuticals, where the EU has given primacy to the precautionary principle, and held back technological innovation. The main effect in the first has been to raise energy costs instead of primarily focusing on developing new technology that would be most effective in the long term and least costly in the short term. With regard to technology, EU regulation has held back innovation.

In all these areas we propose estimates of the cost to the UK economy. Overall, we suggest a cost of 6% of GDP, of which we suggest 2% can be rolled back. In a parallel piece of analysis of the Thatcher reform programme, discussed in the Appendix to this chapter, we find comparable gains, suggesting that this order of magnitude is indeed feasible.

To these gains we add that of avoiding uncontrolled EU unskilled immigration, which the UK taxpayer has subsidized by around 20% per migrant, costing 0.2% of GDP, mainly paid by poorer UK taxpayers. On top of this we eliminate the annual net payment to the EU budget, 0.6% of GDP.

Chapter 4 on Tax Reform

The UK needs a tax system for the twenty-first century that delivers large and stable revenues without penalizing either savings or incentives for successful people. We show that this can be done by rebasing the income tax system on consumption and cutting marginal tax rates in the process.

A good tax system is one that creates the minimum damage to everyone's incentives to work and save – the 'Ramsey Principle' – consistently with financing government spending and achieving the necessary income redistribution. This is achieved by taxes (1) that are 'flat' (i.e., the same proportional rate) across people of all incomes (the popularly known 'flat tax'); (2) that are flat across commodities of all sorts ('tax neutrality'); and (3) that are flat across time. This last means that the tax rate is constant over present and future consumption; it implies both that tax should be levied on consumption and that the tax rate should be planned to be constant under forecast conditions ('tax smoothing').

Taxes can be cut without being balanced by simultaneous cuts in spending because extra work and less avoidance create an offsetting

recovery in revenue (the Laffer effects) and because higher growth generates more future revenue. This is an important implication of tax smoothing. A UK flat tax on consumption would bring the imputed rent on owner-occupied housing into the tax base and would allow the standard rate of income tax to be cut cautiously to a 15% flat tax rate on consumption, thereafter being cut further in stages as the growth effect rolled in. Such tax reform would be popular since there would be no losers, no cutback in public spending programmes and many gainers, not the least of them the UK economy.

PART II: SUPPORTING BRITAIN'S ECONOMY THROUGH FISCAL AND MONETARY POLICY

Chapters 5 and 6 on Fiscal and Monetary Policy

We first explain how central banks have made a complete mess of monetary policy over the financial crisis. Their first major mistake was to stimulate a big credit boom in the 2000s, which was the main cause of the crisis situation, through overleveraged banks. Second, they permitted the Lehman liquidity crisis, by allowing Lehman to go bust instead of getting it taken over, with liquidity pumped into the banking system. It was this bust that precipitated the crisis proper. Third, they stymied bank credit growth post-crisis by draconian bank regulation just when credit growth was needed for recovery.

Fourth, they flooded markets with quantitative easing (QE, the aggressive buying by central banks of bonds and other assets by printing money), which has created large distortions in financial markets. There is now evidence that this last episode, zero interest rates and QE, have damaged competition and new industrial entry by subsidizing capital to large firms. This has created a market structure argument for 'normalizing monetary policy' besides arguments from monetary policy itself, to the effect that we need to make it effective again.

To restore monetary policy effectiveness, we need interest rates to rise back to normal, well away from the zero lower bound where they still are. The only way for policy to deliver this is via a fiscal expansion. This can be Brexit related, focused on using the much-improved public finance situation to deliver tax cuts and growth-supporting spending. We set out full fiscal and debt projections over the next two decades, which show that this can be done while debt remains under control in the long term.

Finally, we set out new work on how monetary policy can, once it recovers effectiveness, more effectively target nominal GDP than simply inflation. Such a new central bank-targeting set-up, backed up by a fiscal commitment to prevent a zero lower bound, will deliver a much more stable economy, making the whole programme of direct control of bank balance sheets and ‘prudential’ intervention redundant.

Chapters 7 and 8 on Fiscal Rules, Public Spending Reform and the New Fiscal Strategy for Growth

As we move out of the coronavirus crisis, fiscal policy needs to be guided by long-term rules about government solvency; these project the future long-term public sector balance sheet, rather than imposing short-term rule-of-thumb constraints on current budgets or borrowing. Owing to interest rates being close to zero, the long-run cost of the huge COVID debt is rather small. This means that post-COVID and post-Brexit, the government can continue to be bold in fiscal policy, making tax cuts and spending on infrastructure that creates growth, which in turn will create the extra revenue to pay for it. We show how a programme of continued borrowing in the order of £100 billion a year is affordable on UK post-Brexit projections, after the COVID package has been financed and the economy has recovered from the crisis.

If one examines UK public spending, it is a massive share of GDP, at around 40%, and yet its effectiveness is constantly in dispute, whether in health, education, policing, or almost any area of public involvement. Yet, the technical ability of central agencies to communicate and use information efficiently now exists, and with it the ability to coordinate decentralized efforts. Ideas for devolving areas downwards to communities could therefore be widely explored, following the work of Elinor Ostrom on public ‘commons’. Some practical experiments appear to have been made in social care by health boards in the context of the internal market for healthcare, and in education via work on competition with the public sector. There is scope for a rethink of how competition works in railways and between modes (road vs rail), as well as revisiting road pricing, where Singapore is a living example of how it can be done.

Barriers to growth: reducing government obstacles to entrepreneurship and entrepreneurial innovation

The ultimate job for government is to remove the obstacles placed by tax and regulative policies on business formation by entrepreneurs. The

very existence of government is an invitation to rent-seeking lobbyists for regulations that favour their special interests. Because there is then no general lobby for potential businesses opposing such open-ended interference, this lobbying process is constantly adding to the regulative environment in ways that impede business. It is this accretion that has to be periodically scraped away by a process of deregulation that prioritizes the business freedom on which our growth and prosperity depend.

In this context, we showcase recent research on how the Thatcher revolution in tax and regulation kickstarted productivity growth. An issue that comes up repeatedly is the ‘productivity puzzle’, according to which productivity growth has slowed down markedly in recent years. However, it seems most likely that this is simply mismeasurement of the effects of rapidly growing digital productivity.

The North–South policy challenge

A major challenge is to bring the North’s income up to the level of that of London and the South. As many people have pointed out, a good start would be to improve the infrastructure of the North, which has lagged behind that in the South, especially in terms of transport. HS2 has become controversial because of cost overruns, but the main argument for it is not faster journeys, which is where the cost–benefit has focused, but simply that it is the most economical way to produce the extra North–South journey and freight capacity needed because of increased congestion on road and rail. Doing this by expanding the current rail capacity would be expensively disruptive. HS3 should go ahead quickly as well, together with the improvements promised in the Northern Powerhouse programme.

However, the policies that will work to generate growth in the North are the same as those that will generate growth across the whole economy. Our new Regional Model finds that general policies cutting taxes and regulative intervention have the biggest proportional effects in the North, because there is less congestion there in resources, both labour and land. There is therefore no contradiction between stimulating the economy as a whole via supply-side policies and ‘levelling up’.

THE DOGS THAT DO NOT BARK IN THIS BOOK

This book does not deal with a number of topics that are widely discussed in the public debate: namely, climate change, the issue of ageing and the ‘demographic time bomb’, a detailed regulation agenda, and how to

ensure multinational firms pay their ‘fair share’ of existing taxes. Let me explain why.

In all these issues I believe the ‘solutions’ lie with individual actions within free markets, once the government has set out its actions in areas where it controls the levers. So, climate change is now something that ordinary households have clear concerns about: investors are therefore responding with new technologies to satisfy them by delivering the services they want in a way that improves the climate. One sees this in the rapid development of battery technology, of electric cars, and the increasing use of hydrogen. Top-down government action and controls look increasingly redundant and potentially counterproductive.

Ageing and demographics again are areas where private action is vigorous. The population is getting older because they are healthier for longer; as a result, they plan to work for longer and possibly in different ways or activities as they age. Similarly, population growth across the planet will adapt to household preferences – as women participate more in work, household incomes rise and living space becomes more expensive, they have fewer children and population growth falls. Government action to control demographics has rarely been effective, anyway; it is also undesirable in people’s choices.

I spend a fair amount of space in this book discussing the costs of bad regulative intervention. But I have nothing much to say about ‘good regulation’, because, again, markets should basically be left alone to create their own standards for products and services via the competitive process dominated by consumer preferences. Government’s role is to let markets do this job by getting out of the way, unless there is some clear social abuse. If government has information about the effects of consumer choices, then it should publish this effectively so that people make better-informed choices. In a free society, people must be left to choose their own lives.

The same applies to questions of ‘what industrial structure will emerge’ from the COVID crisis. This will be determined by consumer preferences interacting with new technologies and their costs. At this point we really cannot know what these will be. Will there be less travel? Will people telecommute much more and offices be used much less? To such questions, markets will provide answers in time; government should keep out of the way as resources are redeployed. Its role is to support the economy via general fiscal/monetary policies and good supply-side policies to support growth.

I have dealt in this book with how the tax system should be reformed to collect the needed revenue with the least damaging effects on growth. The tax base should be as broad as possible – consumption fits the bill – and the marginal tax rates as low as possible. What about those multinationals that brazenly avoid corporation taxes by ‘filtering’ their profits through tax havens? This activity has always been a predictable response to the foolish attempt by governments to tax mobile capital. It has revealed that corporation tax is a poor tax base. It is only paid by domestic firms that have no escape. Better to abolish this tax, and the complicated superstructure of double tax agreements; replace it with the consumption tax advocated in Chapter 4. As for the tech firms that provide ‘free services’ in return for our data, truly this is consumption via barter, much like the implied rental income from home ownership. Their value could be included similarly in consumption via imputation. Then there would be no need to single out ‘tech firms’ for a controversial ‘digital tax’.

This book focuses narrowly on how the government should use the levers it has: in trade barriers like tariffs and regulative discrimination, in taxation, in regulation, and in fiscal and monetary policies to support the economy on the demand side, these other policies all being operative on the supply side. These policies set the general framework within which the UK’s free markets can satisfy consumers’ needs. A government that can get this framework right is doing the best it can for the British economy. It should firmly resist the temptation to do more – let markets and consumers do the rest.

REFERENCE

- Minford, P., with S. Gupta, V.P.M. Le, V. Mahambare and Y. Xu (2015), *Should Britain Leave the EU? An Economic Analysis of a Troubled Relationship*, 2nd edition, Cheltenham, UK and Northampton, MA, USA: Edward Elgar Publishing.