21 July 2020

Dear Chancellor,

In the course of your recent evidence to the Treasury Committee, we discussed the upper limit of the taxable capacity of the UK economy. I agreed to write to you with a paper from the economist David B Smith: please find this attached.

The paper examines the historic record roughly to estimate where the upper limit of taxable capacity may be and consequently where the sustainable limit to public spending may be found. The note only deals with fiscal sustainability though it does identify three inflexion points: the economic growth maximising point (20-25% of GDP), the welfare maximising point (30-35% of GDP) and the upper bound before private activity collapses, tax receipts shrivel and big government becomes unsustainable. The UK is far beyond the first two points.

The paper briefly considers some measurement issues before turning to the long-term evidence. The tax burden is found to have been close already to the upper limit of historic sustainability before the pandemic. The evidence shows it is difficult to raise the non-oil tax burden above 39% of factor cost GDP for any time. Even during WWII, the tax burden averaged 37.5%. In the four quarters to 2020 Q1, the ratio was 37.7%.

The data implies any attempt by the Government to tax their way out of the present fiscal situation will backfire badly. The paper concludes with a call for what I would characterise as a conservative economic policy. Please consider the implications for UK fiscal policy of the evidence in this paper.

This letter and paper arise from a Treasury Committee evidence session, so I copy the Chair and I have asked that the Committee consider publishing this correspondence and your reply in due course.

Yours ever,

[Handwritten Signature]

CC: Rt Hon Mel Stride MP, Chair, Treasury Select Committee

Enclosure: “What is the Upper Limit to Britain’s Taxable Capacity”, David B Smith, 20th July 2020