# Time to wake up to this damaging stealth tax

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Unlike a month ago, the latest inflation figures did not set pulses racing. The headline rate was unchanged at 6.7%, whereas the previous figure had shown a marginal fall from 6.8% at a time when most people, including Treasury and Bank of England officials, had expected a rise.

That fall helped tip the balance for the Bank to freeze interest rates last month after 14 straight rises.

And, while there was no repeat this time, the consensus in financial markets is that there has been nothing in either the inflation data or the latest pay figures to persuade it that it needs to raise rates next month.

A 6.7% inflation rate is, of course, far too high, and well above the official target of 2%. The latest figures marked the 20th month in a row in which inflation has been above 6%, and the 29th in succession in which it has exceeded the target. Inflation so far in this parliament has averaged 4.9%, the highest for 30 years. The peak a year ago of 11.1% was the highest since 1981.

Before the rate starts to fall quite sharply — as it should when this month's figures are released in November, to 5% or so as a result of favourable comparisons with the big energy price rises of a year ago — it is worth reflecting on the long-term effects of this bout of inflation. For, make no mistake, those effects will pan out over many years.

A few days ago, the great and the good attended a memorial service for Lord (Nigel) Lawson, the former Conservative chancellor and hero of Rishi Sunak, who spoke at the ceremony. In 1977, Lawson, as a Tory whip, offered his party's support for what was known as the Rooker-Wise amendment, brought forward by two Labour MPs. The effect of this was to commit governments to raise income tax allowances and thresholds in line with inflation, or require primary legislation not to do so.

Sunak is going against this convention in a spectacular way. Under his government's plans, set in train when he was chancellor, income tax allowances and thresholds will be frozen until 2027-28, as will those for national insurance.

The effects of this were laid bare by the Institute for Fiscal Studies (IFS) in its latest "green" budget. When the freeze was first announced by Sunak in March 2021, and intended to last for four years, the aim was to raise an additional £8.2 billion in revenues in 2025-26, the final year of the plan.

Two things have happened since then. One is that the freeze has been extended and applied to national insurance. The other is that inflation has been much higher, so the freeze will bite harder. The IFS, using inflation forecasts from the Bank, estimates that the policy will be raising an additional £52 billion in revenue in 2027-28, compared with indexation. That not only leaves the original £8.2 billion estimate for dust but is also higher than the £37 billion calculated by the Office for Budget Responsibility (OBR) in March.

This is a massive stealth tax increase, much of it explained by the loss of control of inflation. It will more than double the number of higher-rate taxpayers to nearly 9 million, and is the equivalent of raising the basic and higher rates of income tax by six percentage points, or putting up VAT from 20 to 26%.

My fear is that this — the biggest stealth tax increase, or indeed any tax increase, in history— is not fully understood by those on the receiving end. When I talk to people about it, their eyes glaze over. That is not so unusual, but if it means that this huge tax rise by stealth is working, it is worrying.


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It is, of course, not the only impact of inflation on taxpayers' pockets. The cost of the government's borrowing has been soaring, both because of the direct effect of inflation on the quarter of government debt that is index-linked and because of the rise in bond yields. Bond markets have been having another moment in recent days, pushing up yields due to fears that in order to control inflation, interest rates will have to stay high.

Again, the IFS has some useful and worrying figures on this. Even when inflation settles down, and rates edge lower, the legacy of this period of high inflation will be felt. The government's debt interest bill spiked above an annual £100 billion under the impact of inflation on index-linked gilts. But even in 2026-27, on official forecasts, it will still be just under £90 billion — the equivalent of 3.1% of gross domestic product (GDP). Under market interest-rate expectations, it would be £108 billion, the IFS points out, or 3.8% of GDP. That's right: nearly 4% of national income spent on servicing the government's debt.

These lasting effects will serve as a grim monument to the high inflation we have seen. In the meantime, the effects of all the rate hikes will weigh down on economic activity for some time.

Housebuilders are paring back their targets for new homes over the next 12 months as higher mortgage rates have an impact on demand. The latest purchasing managers' index for the construction sector showed the biggest drop in residential activity, outside the pandemic, since April 2009.

This is an important sector for employment and, while we await new figures this week, the labour market appears to be on the turn, with employment and vacancies falling and unemployment rising.

There was also a notable shock on Friday when the long-running GfK consumer confidence index, which had been recovering, showed a nine-point fall. It has not returned to the levels of last winter, when confidence was at all-time lows, but it does suggest that, while inflation has come down from its highs and should fall further, all households are noticing is that prices are still rising. It also points to the fact that the statistical turning point, with earnings growth now outpacing inflation, may be just that: a statistical nicety.

"This sharp fall underlines that the cost of living crisis, and simply not having enough money to make ends meet, is still exerting acute pressure for many consumers," said Joe Staton of GfK. "The fierce headwinds of meeting the accelerating costs of heating our homes, filling our petrol tanks, and coping with surging mortgage and rental rates, a slowing jobs market and uncertainties posed by conflict in the Middle East are all contributing to this growing unease."

The government will take some comfort from inflation still looking on course to halve by the end of the year compared with late 2022. On the evidence of this, they should not take too much succour. It will be a very long time before people feel that the burden of high inflation is lifting.

This is the first chance I have had to mention Professor Nick Crafts, the most distinguished British economic historian of his generation, who died earlier this month at the age of 74. Not only did he have a glittering academic career and reputation, mainly at Warwick University and the London School of Economics, but he never confined himself to the ivory tower.

I have lost count of the number of columns I have written over the years that drew on his work. Several of his former colleagues have written a tribute, which is available on the Warwick University and Centre for Economic Policy Research websites.

As they note, one of his most important contributions was a reassessment of the impact on the UK economy of the industrial revolution. In his book, British Economic Growth during the Industrial Revolution, he demonstrated that its impact was more gradual than generally thought. Far from immediately transforming a sleepy agricultural economy, it enriched one that was already rich and well developed by 1700.


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He also expertly analysed the UK's economic revival relative to other countries between the late 1970s and the financial crisis. It was due, he explained, to the Thatcher reforms, including privatisation and curbing the power of the unions; to the impact of investment in ICT (information and communications technologies); and to the competition-enhancing impact of membership of the EEC, and then the EU, from 1973 onwards.

He was optimistic about the potential productivity-boosting impact of technologies such as AI and he will be missed by many, including me. He was also a thoroughly nice man.



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