

Goldmoney Insights®

Blueprint for a bright British future post-Brexit



As polls are beginning to show a growing lead for the ‘Leave’ campaign in the upcoming Brexit referendum, investors need to consider the potential implications of a ‘Leave’ vote for the British and EU economies, sterling and euro currencies and financial markets generally, as there could be potentially broader spill-over or contagion effects. Most mainstream financial media conclude that Brexit would be almost unambiguously bad. This facile view fails to imagine the possibility, however, that unshackled from the increasingly bureaucratic and highly-regulated EU, Britain might use her renewed independence to undergo a dramatic economic restructuring, thereby restoring the dynamism and high growth rates of Victorian times. In this report we consider what actions Britain could take in this regard, focusing on five policy areas. The results could be dramatic.

FIVE ELEMENTS FOR POST-BREXIT ECONOMIC SUCCESS

Britain was at the center of the industrial revolution which over the course of roughly a century completely transformed the European and North American economies. While associated naturally with technological advances, the industrial revolution nevertheless required a high rate of investment. This was enabled in large part by strong British private property rights and economic policies such as the gold-standard which encouraged a high rate of saving. While many new and promising technologies are coming on line today and promise to do so in future, without sufficient savings Britain will not be able to sustain the rates of investment required to realize their potential. Moreover, it stands to reason that you aren’t saving sufficiently if you carry around a massive, accumulating national debt. Debt service is also a drag on future growth. Thus if the British want to prosper long-term, whether inside or outside the EU, they are going to need to

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reduce the national debt as a share of national income. This is the first, essential element for an independent Britain to thrive.

THE FIRST ELEMENT: DEBT REDUCTION THROUGH INVESTMENT- RATHER THAN CONSUMPTION-LED GROWTH

Of course, this is easier said than done. It is also highly preferable to pay down debt out of a growing rather than stagnating income. Thus the key to successful debt reduction is strong growth. But by 'growth' we mean the growth of the capital stock, not the growth of consumption. This is the first element for success.

Although period novels and films may encourage us to see high Victorian culture as one of lavish consumption, the growth of Britain into the world's premier industrial power by mid-19th century has far more to do with high rates of investment rather than consumption. As mentioned above, Britain was at the heart of the industrial revolution, the most rapid accumulation of productive capital in recorded human history. But how could the British best facilitate comparably high rates of investment today?

There are several policies that would quickly create an investment boom. Most important, Britain should do better than Celtic tiger Ireland, with its low corporate tax rate, and abolish the corporate income tax altogether. Yes, you read that right: The effective corporate income tax rate in many countries now approaches zero anyway, due to all manner of creative cross-border accounting techniques. But while it might be creative, international tax arbitrage accounting and associated legal work is also expensive. Corporations the world over would far prefer to put clever employees to work on real productive activities if possible, rather than on elaborate accounting schemes requiring constant updating, a dead-weight loss for their customers who pay higher prices as a result.

For those concerned about the tax revenue implications of a zero corporate tax rate, don't be. What is not paid by corporations in tax is eventually paid out in profits (dividends). Those can be taxed instead, as ordinary income like anything else, thereby simplifying the local personal income tax, which ideally should be a flat amount, say 20%, prepared on a single sheet of paper once a year. So not only will international corporations want to relocate to and invest in Britain; skilled workers will be attracted by the only 'One-Rate, One-Page' personal income tax in the entire Anglosphere. Those already resident in Britain will benefit most



from the boost to economic activity and the associated general expansion of the domestic labor market.

Another tax policy that would both attract global investment and simplify things would be to tax capital gains at the same flat rate as on ordinary income. Capital gains are really nothing more than deferred investment income anyway, so by leaving the interim income untaxed, a huge incentive to save is created, thereby providing for the domestic savings required to fund the high investment rates enabling strong and sustainable growth.

As for other taxes, there is much more that Britain could do to attract investment and support healthy, sustainable growth. For example, Britain might sharply reduce duties on airfares currently mandated by EU law. This would have the effect of re-routing much transcontinental air traffic, including profitable connecting flights, from continental hub airports to Britain.

THE SECOND ELEMENT: DEVELOPING HUMAN CAPITAL AT HOME; ATTRACTING HUMAN CAPITAL FROM ABROAD

Developing human capital, at which the British excelled in the 19th century, is the second element. Consider which industries are most likely to relocate to take advantage of Britain's highly favorable tax regime: Those requiring neither natural resources nor extensive industrial infrastructure, that is, those comprised primarily of human capital. Although financial services come to mind, there is currently tremendous overcapacity in this area, including in unproductive yet risky activities. Better would be to concentrate on health care, for example, an industry faced with soaring costs and stifling regulation in much of the world.

Britain could, inside of just a few years, become the world's premier destination for so-called 'healthcare tourism'. Britain lies directly under some of the world's busiest airline routes, an ideal location. Medical professionals from all over the world would be attracted by the zero tax rates on their small businesses and low tax rates on paid-out profits, passing much of the savings along to their patients. In turn, patients from all over the world would travel to Britain, attracted by the low cost and high quality of healthcare. To further lower costs, the British could leverage off their strong legal traditions to reduce opaque malpractice liability disputes to a minimum, thereby making certain that the healthcare industry re-



mains centered around doctors, nurses and patients, rather than lawyers, regulators and insurance companies, as has become the case in the US, for example.

By attracting much global healthcare talent, Britain could easily become a leading global location for medical research, development, training and education to rival the US, where costs are now soaring out of control. Healthcare could thus provide the 21st century equivalent of, say, farm machinery or shipbuilding in the 19th: A central industry that, in turn, facilitated the development of many other associated industries.

No doubt, in addition to healthcare, at a minimum a handful of other human capital rich industries would take advantage of attractive British tax policies. Software firms, nearly devoid of anything other than human capital, would almost certainly respond. Film makers and artists of all stripes would be enticed by the low tax rates on their creative productions. Accountancy and business services firms would follow all of the above.

THE THIRD ELEMENT: SOUND MONEY AND BANKING

A third essential element for success is to implement traditional British principles for sound banking. This is of utmost importance due to the potential monetary and financial instability of the UK and much of the broader Anglosphere.

As a first step, Britain should re-introduce the traditional Scottish ‘free-banking’ model, which insulated Scotland from the serial financial crises arising in England as a result of the excessive risk-taking encouraged by the ‘lender of last resort’ function of the Bank of England. As George Selgin observes, although Victorian financial journalist, Walter Bagehot, is famous for his dictum: “Lend freely, against good collateral, at penalty rates of interest,” in fact Bagehot held that this was, at best, an expedient measure to discourage excessive reliance on the Bank. In fact, he preferred the Bank be abolished by an act of Parliament and he admired the alternative Scottish model for its comparable stability.

Operating under a ‘free banking’ model, banks would find they were under tremendous pressure from shareholders (or bondholders) to maintain a large capital buffer in the event of financial turmoil arising from other banks’ activities. Any bank perceived by its peers as taking excessive risks would find it faced a higher cost of access interbank liquidity. As such, the system could self-regulate. What



worked so well in Scotland in the 19th century (and in Canada during the 20th) could easily be replicated by an independent Britain today subject to writing the appropriate banking legislation.

No banking system can be truly sound, however, if it operates with a flawed currency. It is no coincidence that the industrial revolution and success of the British Empire over many decades took place while Britain operated under the classical gold standard. Indeed, it was only when the gold standard was abandoned to finance WWI that Britain began to chronically underperform other economies, including that of the United States. (Britain would subsequently experiment with socialism in the 1960s and 1970s, leading to further relative underperformance.)

THE FOURTH ELEMENT: DECENTRALIZATION AND ACCOUNTABILITY

The fourth element is a traditional British skepticism of central authority, which includes a fear of conquest from a continental power. Indeed, post-imperial British national pride rests to a great extent on the British success in retaining its independence through the 20th century world wars. How ironic it is, when viewed in that historical context, that the Brexit debate of today takes place because Britain has in recent decades willingly ceded material sovereign powers to the European bureaucracy in Brussels.

There are an increasing number of European countries and regions who are skeptical that the EU continues to operate in their respective interests. The British independence movement is thus not merely a local phenomenon. There are peoples throughout the EU seeking greater autonomy. The Belgian Flemings have been at it for decades, as have the Spanish Basques and Catalonians. Various regional organizations in northern Italy have pressed for degrees of independence in recent years. It stands to reason that national or local government tends to be more responsive and accountable to the citizenry than supranational. More efficiency and effectiveness in government is the result.

THE FIFTH ELEMENT: PRIVATE CHARITY

Finally, there is the fifth element: A strong tradition of private charity. There are few countries in the world in which private charity and volunteering work are held in such high regard. Yes, as with most all Europeans, the British have be-



come more secular in recent decades and charity has far fewer of the religious associations it once had.

The charitable tradition is misinterpreted by some to support a unique form of British socialism, but this contradicts the Protestant (ie Church of England) concept of man's direct relationship with God. Protestantism holds that to work hard, to be thrifty, to be charitable, is to do God's work and thus all three can be understood as forms of worship in their own right. However, genuine faith in God, genuine worship, cannot somehow be coerced by a central authority. It must be left to the individual, through their direct relationship to God, to find enlightenment, albeit with the strong support and influence of the local community. To put it somewhat humorously, an English vicar (or Scottish minister) might say to a British socialist: "Jesus told YOU to help the poor, not to create a centralized government bureaucracy to coerce others into doing so on your behalf!"

Nowhere in the developed world today is private charity taken so seriously as in the United States. Notwithstanding the wayward cultural traits of modern America, active private charity remains an integral part of the social fabric. This is without doubt a legacy of the Protestant cultural tradition from Britain and other northern European countries: Limited government yes, but with limited government comes far greater private and personal responsibility to help the poor or otherwise needy in the community.

So in the home-ruled Britain of the future, in which national sovereignty reasserts itself and government becomes more limited as per British tradition, so the vacuum can be filled by private charitable initiative. This will serve to assist those who struggle to wean themselves off a shrinking public sector safety net, notwithstanding the strong labor market associated with high rates of domestic and foreign investment.

Yes, some Brits might be intimidated by this ambitious plan, notwithstanding its firm rooting in British historical and cultural traditions. But with polls showing a growing number of British citizens prepared to countenance the uncertainties associated with reasserting their national sovereignty, perhaps those traditions could be about to make a comeback. If so, Britain may end up astonishing EU member countries and the rest of the world with a historic economic renaissance.



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