

Investment  
update

5 October 2011


**Stewart Cowley, Head  
of Fixed Income and  
manager of the Old  
Mutual Global  
Strategic Bond Fund**

Stewart joined OMAM in June 2009 from Newton Investment Management where he held a similar role and managed the Newton International Bond Fund and BNY Mellon Global Bond Funds, both rated AAA by Standard & Poor's. He has more than 20 years' experience of global fixed income markets, having begun his career in 1987 as a broker before subsequently switching to fund management.

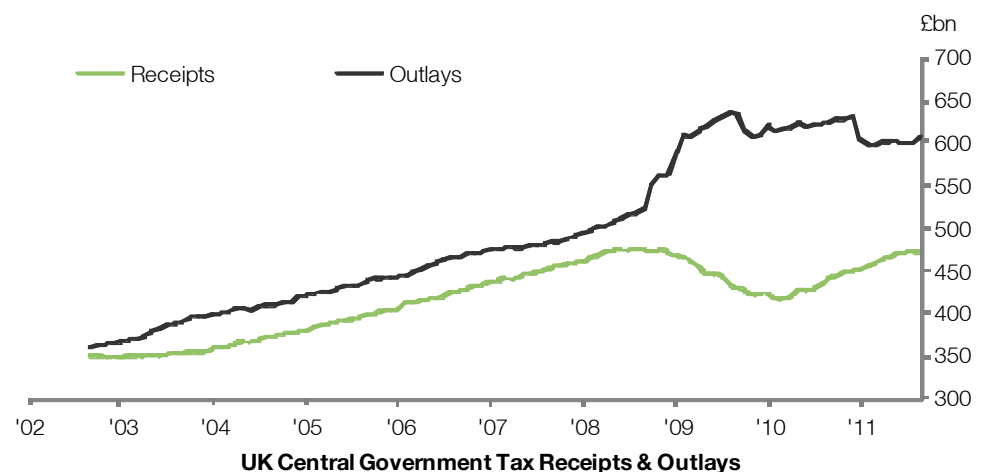
# Taxidermy

## Governments need to reduce their debts. Should they cut spending? Or raise taxes?

If taxidermy is the art of taking previously living things, stuffing them and mounting them in unnatural poses for the amusement of the general public, then the arguments being put forward for increased taxation are going some way to achieving the financial equivalent. Having failed to grasp the nettle on expenditure it was inevitable that politicians in the US and UK would go for the other side of the equation; increasing revenue to fill the deficit gap. And they sort of need to. The gap between tax receipts and outlays is going nowhere.

The truth is that our societies are as hopelessly addicted to taxes as they are to expenditure and we have become habituated to the idea that it is normal to pay away 40%, 50% or 60% of our income to central government. But income tax is a relatively recent invention. In the UK it was invoked as a temporary measure to raise money for the Napoleonic wars in the 1800's. It actually disappeared for a while but came back again. Previously there had been a range of mysterious and quixotic levies based on luxury; taxes on wallpaper, glass and windows were all serially invoked in a cascade of increasing ingenuity. But as the state increasingly penetrated the economy it set in place the transfer of wealth from one set of individuals to other less wealthy (but voting) individuals. Recipients never complain about the transfer of wealth and the victims are legally powerless to stop it.

**Figure 1: UK Central Government Tax Receipts & Outlays**

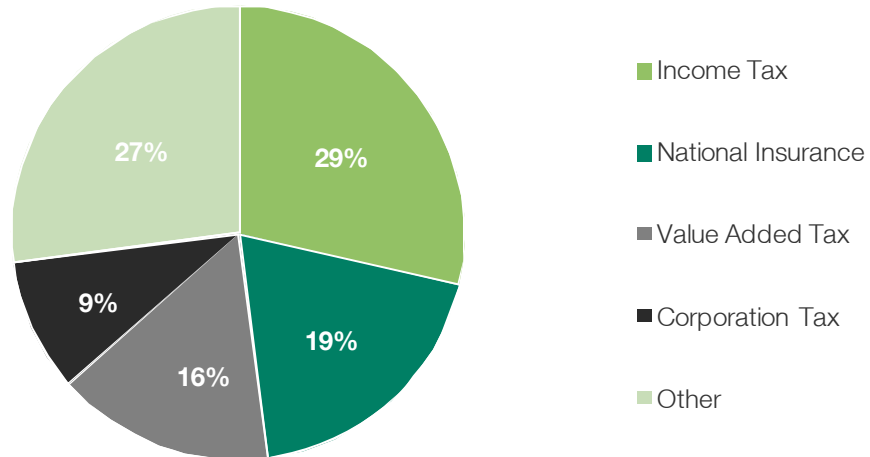


Source: Bloomberg, Office for National Statistics, Old Mutual Asset Managers

Inevitably the desire to raise money to maintain public expenditure opens the highly emotive debate about who is better at distributing services and capital within an economy; is it the state or private enterprise? Nobody seems to be able to decide the truth but there are some powerful ideological arguments either side of the divide. Politicians hungry for easy job creation will argue that the state is best. In more affluent times, government allows the private sector fuller rein. Given our parlous economic state it's interesting to see that politicians are currently voicing a hybrid position; private enterprise should replace the state whilst they simultaneously argue for wealth transfer in the name of fairness and maintaining state-sponsored employment.

US President Barack Obama's latest policies to trim the US deficit include \$1.5trn of tax increases in the next decade to cope with the twin needs to maintain employment and redress the deficit. Our own Deputy Prime Minister, Nick Clegg of the Liberal Democrats, has stated that he wants to oppose reducing the 50p tax rate on incomes over £150,000 because "It would be utterly incomprehensible for millions of people who work hard, do their best for the families, and play by the rules, if suddenly the priority is to give 300,000 people at the very, very top a tax break."

**Figure 2: Treasury Pie**



Source: HM Treasury Budget 2008

The implication is that anyone earning over £150,000 a year doesn't work hard, doesn't do the best for their families or play by the rules, or indeed already contribute disproportionately to the total tax take. Coalition Trade Secretary Vince Cable has gone further in supporting a so-called "Mansion Tax" on homes valued over £2million<sup>2</sup>.

Taxation has been shown time and time again to be an impossibly blunt object with which to dissect a social malaise. For instance the wonderfully named Sir William George Granville Venables Vernon Harcourt, the inventor of death duties<sup>3</sup>, was warned that if inheritors died in rapid succession then the state would take an unfair chunk of an estate. Harcourt, as Chancellor of the Exchequer, waved the objections aside. It must have been of some amusement to his objectors that just six months after accidentally and unexpectedly inheriting Nuneham Park in Oxfordshire in the spring of 1904 he himself died. Death duties were "only" 8% at the time but, in less than a year, 16% of the estate was transferred to the UK government for no particular moral or ethical reason other than that the Exchequer needed the money. The lesson is that taxation simply can't accommodate the permutations of life and the moment you start applying a moral or ethical dimension to it you will be trapped almost immediately by the contradictions.

Of course, this won't stop politicians from pursuing increased taxes with the religious zeal of the self-righteous. In economic terms it is utterly wrong-headed to be reducing consumer's spending power at a time when it is most acutely needed. It would, for instance, potentially be better to increase the minimum wage to target lower earners and reduce corporation tax to compensate companies if you really wanted to put money in the pockets of large numbers

of the working population. Corporation tax ranks fourth amongst<sup>4</sup> the total revenue take which puts it in the "Too Difficult To Tackle" tray. The ensuing low growth (along with other effects coming from the US, Europe and globally) will help send government bond yields down to Japanese style levels in the very near term.

Looking forward, you have to suspect that, as a method of tackling the deficit, increasingly ingenious taxation will fail as an economic policy. Without real deficit reduction (as opposed to reducing the rate of debt accumulation, which is what is happening at the present time) the US and UK will go the way of other high deficit nations. The fear must be that, one day, some political group or other will abandon even these meagre attempts at debt control because the political heat will be just too much. As with other nations, the US and UK will not be immune to the judgment of the markets (in terms of their bonds and currencies). For the time being they are benefiting from the distracting idea that they are not in the eurozone - but after that you won't need a taxidermist to tell you that we are stuffed.

<sup>1</sup> *The Independent*, 17th September 2011

<sup>2</sup> *It hasn't been made obvious who would do the valuation, how often it would be recalculated or how older people "trapped" in large houses would pay.*

<sup>3</sup> *The tax was invented to fill The Exchequer during the agricultural crisis of the late-1800's.*

<sup>4</sup> *HM Treasury Budget 2008*

---

**Old Mutual Asset Managers (UK) Limited**

2 Lambeth Hill  
London, EC4P 4WR, UK

[www.omam.co.uk](http://www.omam.co.uk)

+44 (0)20 7332 7500



**Important information:** Past performance is no guarantee of future results. The value of an investment and the income from it can fall as well as rise and investors may not get back the amount originally invested. OMAM has no house market view and opinions expressed are the views of individual fund manager(s) as at the time of writing. These views may no longer be current and may have already been acted upon. Any underlying research or analysis has been procured by OMAM for its own purposes and may have been acted on by OMAM or an associate for its or their own purposes. OMAM is the appointed investment adviser for Old Mutual Fund Manager's in-house OEIC funds. Old Mutual Asset Managers is the trading name of Old Mutual Asset Managers (UK) Limited and Old Mutual Fund Managers Limited. Old Mutual Fund Managers Limited, 2 Lambeth Hill, London EC4V 4AD. Authorised and regulated by the Financial Services Authority. A member of the IMA. Old Mutual Asset Managers (UK) Limited, 2 Lambeth Hill, London EC4P 4WR. Authorised and regulated by the Financial Services Authority. Telephone calls may be recorded for security purposes and to improve customer service. 08/11/U5990