Tax Heaven: Revolutionising Taxation and Welfare

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REVOLUTIONISING
TAXATION & WELFARE

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WHERE ARE WE NOW? FACING A PERFECT STORM.

The film 'A Perfect Storm' describes the true story of a fishing trawler facing an epic storm.

A group of New England fishermen had fallen on hard times after poor catches. Their captain, played by George Clooney, hired a boat for one last fishing trip of the year.

The trawler sailed out into the mid-Atlantic. After much fruitless searching, they finally struck fish. Turning for home, they hoped to get the catch back whilst still fresh.

Unfortunately, a storm was brewing, and not just any storm. Three separate weather systems had merged to create a 'weather bomb' of unusual intensity. Meteorologists warned of a serious threat to life.

The fishermen faced a dilemma. Should they attempt to land their catch whilst still fresh? To do so, they would need to risk their lives by sailing back, straight through the storm. Or they could avoid the storm by sailing further out to sea. After this detour, the fish would no longer be fresh and they would be out of pocket.

Added to this dilemma were communication and leadership issues. The storm had damaged the radio, making it difficult to get information or call for help. The captain (we will call him 'Clooney' after the actor playing him), whilst charismatic, lacked good judgment. He took the risk and sailed into the storm.

Taking a step back from their immediate plight, it seems odd that Clooney and his men took such a severe risk. Why were they in that situation in the first place? Perhaps, there are two reasons.

First, the seas were no longer as plentiful as they once were. In the 1950s, the Grand Banks off Newfoundland teemed with fish. But overfishing led to a collapse in stocks. Thus our crew needed to go further out to sea, where more bountiful stocks remained.

Second, the fishermen lacked economic security in their lives. They had to fish to keep food on the table. Beyond their own homes, they owned little. The boat was owned by an investor who expected a return and did nothing so dangerous as to head out to sea.

What has the Perfect Storm got to do with the future of the planet? On Earth, we are facing a similar situation to Clooney's character and his crew. There are warnings of a dangerous future for us all. Climate scientists warn of a much hotter planet with more intense storms and rising seas. Should we ignore the warnings like Clooney, or accept the dangers we face?

But even if we accept the warnings, our situation is tricky. You and I don't control the direction of the world economy. There is no single captain of the good ship Earth. Most of us have little idea how the controls of our economy work.

This book is about a particular set of controls that direct our economy – taxation. In this book, we show how to change the tax system to direct the economy to a brighter future. The book also links taxation to other matters such as welfare benefits, property rights, wealth accumulation, environment, energy and housing policy.

A heckler might argue that our interests and actions are our own business. People should be free to do what they want, without the government directing them. Anyway, hasn't the market economy had a good record? We are richer, more secure, and have a lower risk of death than previous times. Poverty is also lower than it was in the past.

But there are storm clouds on the horizon. This book investigates two major issues that threaten our future.

The first is environmental damage. The richer and more populous humanity is, the more environmental damage we cause. Unless we learn better habits, we will damage the one planet that we have.

The second is economic insecurity. Young people are working harder just to stay still. In the 1950s, a single wage earner on average wages could afford to buy their own home in London. [ADD STATS HERE] These days, a couple might never get out of renting. [ADD STATS HERE].

Related, is our third and final issue: how to make the change together. The members of Clooney's crew had different preferences. Some wanted to get home swiftly, others wanted to stay out at sea and avoid the storm. But the fate of the crew was closely linked. Nobody had the choice to exit the boat early. They had to decide together and thus live – or die – together. The fate of humanity is similar. Whatever our individual preferences are, we also face issues in common. We need to understand the controls of our economy so we can direct our economy and our world in a safer direction.

The trawler and the fishermen combine a mechanical system and a human one. It mattered not only how well the boat was working but also how well Clooney was working. So it is with our economy and the political system that guides it. We are all in the same boat.

This book grapples with both economic and political issues.

The economic question is this: Why is there pollution and economic insecurity amidst such wealth? Is there a remedy to these ills?

The political question is this: How can we change course together? We are in the same boat, there is only one planet that we all sit on.

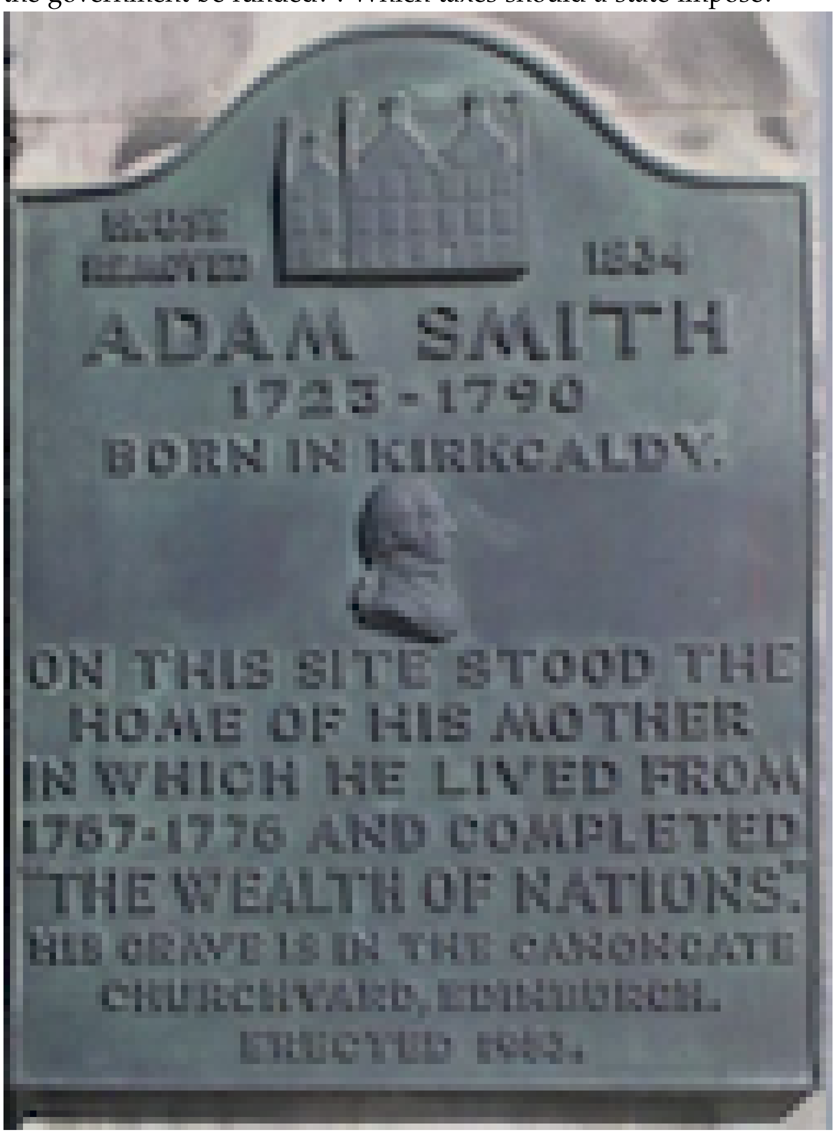
How on earth, did we get into this situation in the first place? We go back in time to the era of Adam Smith and then run the clock forward to see the revolutions of politics, technology and ideas.

PART 1: HOW DID WE GET HERE? REVOLUTIONS IN THE MINDS OF MEN

In the Beginning came Adam

UNDER THE STARRY SKIES, distant in time and space from our present-day fishermen, sits a professor, beavering away at his manuscript. The year is 1773; the location, Kirkaldy, a small town in Scotland; the author, Adam Smith. The full title of Smith's great work would be 'An Inquiry into the Nature and Causes of the Wealth of Nations'.

On this cool and starry night, Smith was writing the fifth and final book of the 'Wealth of Nations', entitled 'On the Revenue of the Sovereign or Commonwealth'. Smith asked, 'how should the activity of the government be funded?'. Which taxes should a state impose?



Plaque marking the site in Kirkcaldy where Smith lived.

The Age of Political Revolutions

Whilst Smith worked by candlelight, far across the oceans, in what was then the British colony of North America, some demonstrators were heaping tea into the sea. The demonstrators' objection: the British state was collecting taxation without giving them representation in the British parliament. Adam Smith himself agreed with the American revolutionaries that the North American colonies should be represented in the British parliament in proportion to the tax they paid. From this dispute, the American Revolution was born.

Revolution was also brewing in France. [In 16xx], Jean-Baptist Colbert, minister of Finance to the King of France, had said that 'The art of taxation consists in so plucking the goose as to procure the largest quantity of feathers with the least possible amount of squawking.' In France, one of the first economists, Francois Quesnay, had argued for a single tax on the value of land to replace all other taxes. The tax never happened, indeed Adam Smith commented both on its economic benefit and its political challenges when he said, with dry irony 'The single tax on land is the tax that does not threaten to discourage industry anywhere' [Check Quote]. By 1789, the geese had not only squawked, they had overthrown the farmer and taken control of the farm. The French Revolution had arrived.

From Rural to Urban Land

Let's take our magic carpet to cross the Atlantic and forward a century in time. A journalist in San Francisco is learning his craft. He is fascinated by a subject which was then still called 'political economy'. He was interested in one question in particular: why was there so much poverty in the midst of so much technological progress? The journalist noted that it was in the biggest, most advanced cities, with the most technological advancement, which also had the worst, most grinding, poverty. His name was Henry George and his book was called *Progress and Poverty*. It became a bestseller, outselling all books in the 1870s apart from the bible. Yet, Henry George is largely forgotten today.

George's work echoed the more turgid prose of banker and great economic theorist David Ricardo. Ricardo had argued that an agricultural landlord contributed nothing to the well-being of society: he merely extracted the surplus from the land once the costs of labour and tools had been paid. This surplus is known as rent. As had been previously argued by Adam Smith, the best tax, therefore, was a tax on rent. Whilst Ricardo modelled a rural economy, Henry George was concerned with urban land. The ownership of urban land allowed the landowners to benefit as society developed, whilst contributing nothing to the increase in land values. George popularised the message that the remedy was to tax urban landlords. He used beautiful words that everyday folk could understand. [Quote now?]

Inspired by Henry George, a woman by the name of Elizabeth Magie invented a board game called the *Landlords' Game*. The game illustrated that without a tax on urban land, property tended to get monopolized and those who owned it extracted rent from those who did not. If, however, landowners were taxed, then a stable and fair (if rather boring) outcome ensued. Later, the game was shorn of the beneficial, but boring, rules, leaving only the case where an unstable and unfair (if at times fun) ruleset remained. Therefore, the original political implications of the game name were lost and the new game was marketed as 'Monopoly'. The goal of Monopoly is to own the whole board and to drive all the other players bankrupt. This might make an exciting game but it was far from a system of widely-spread prosperity. The case for a land value tax is considered later in this book.

War and Progress

Henry George inspired many of his readers, including the young Winston Churchill and British prime minister David Lloyd George. Towards the end of the First World War, there was even a budget which implemented a Land Value Tax, the 'People's Budget'. But due to the resistance of landowners and the difficulties of valuation, the budget was never implemented. Nevertheless, from the late nineteenth century through the whole of the twentieth century, and particularly after the Second World War, the conditions of the poor improved. The curse of slum landlords and destitution was almost banished.

One great milestone in this history of progress was the Beveridge report. Released in 1942 and chaired by Liberal economist Lord Beveridge, it laid the basis for the post-war welfare state. Its aim was to banish the five great evils: 'want, ignorance, squalor, disease and idleness' [Check quote]. After the war, Beveridge's report inspired a social security system, public education, public housing, a national health service and macroeconomic management aimed at ensuring full employment.

World War II had almost bankrupted Britain. Britain had financed the war through borrowing. The public debt ratio peaked at 238% of GDP in 1947. Despite this, post war Britain soon rebuilt itself. It also managed to provide for its people a standard of living greater than before the war. Britain pursued a policy of low interest rates, moderate inflation and high growth. Thus, it cut the burden of public debt to 70% of GDP in 30 years. [Ref: IMF WEO Paper?]These accomplishments are in themselves remarkable. We will explain in more detail later.

Beveridge was successful in his mission to lay the foundation for a comprehensive welfare state. Yet, some of his principles, especially the third, were unevenly applied. Beveridge's reforms helped to reduce the prevalence of the five great evils and transformed the previously hellish conditions of the poor. But we have not achieved heaven on earth. There are still great evils facing us: the destruction of the environment, the lack of affordable housing in many towns, great inequalities of wealth, and the risks of automation. This book will explain why these evils arise and how they can be fixed.

The Global Machine and the Global Mission

We are now in the present day. The subject then called political economy is now called economics. Great container ships cross the oceans. Aircraft zig-zag the skies. Massive machines in far-off lands churn out phones, which everyone is looking at. Many people live with more consumer comforts than in the past. Some things are cheap: it is relatively cheap to fly off to sun-kissed beaches on foreign shores. But some things are very expensive: it is expensive to buy a flat in London for example.

This great machinery of commerce is devoted to two purposes: to give people what they desire (or at least, what they can be encouraged to buy), and to make a profit in so doing. The commercial machine is in many ways smooth. But there are rumblings of discontent. In 1848, the 'spectre of communism' overshadowed the world, according to Marx. Today, the danger of environmental destruction, runaway technology and a state run by and for the superrich to enrich themselves still further, overshadows this machine for happy fulfilment of our consumer desires.

In America, a man promises to 'drain the swamp'. This man later would become president. It would be natural to take these words to mean that the army of smart-suited lobbyists, that aim to direct the ship of state to favour their interests, would be sent packing. Nothing of the sort happened. Indeed, the swamp got ever marshier. The poor, who had seen nothing much of forty years of economic growth in the US were increasingly addicted to prescription painkillers. In the United Kingdom and the United States, people stopped living longer.

This was by now a truly global civilisation. And scientists were warning that something truly global was wrong. In a conference room, a group of scientists called for radical shifts to stop burning fossil fuels in a couple of decades. The great machinery of commerce, which had since the end of the Second World War been devoted to giving us more and more stuff, would need to be turned around to a new purpose.

To turn around this great global machine – this supertanker of consumer commerce – we need to apply not only the great resources of the state but also the dynamism and capacity of the private sector. We need to harness the profit motive for the good of the planet. And for that, we need to tax the damages that individuals and companies cause to the living planet. In this book, we seek to use the tax system to do so, not only by changing the incentives of the private sector in one country, but also by ensuring that other countries have a reason to follow that lead.

The reforms that we are proposing will transform the prospects of early adopter countries so that others will have no choice but to follow that lead.

The Prices of Flats and of Flights

It's now a wet November evening. Let me introduce Peter and his wife, Lucy, who are shivering in their North London flat, pressing refresh on their email program and looking at their phones. They are waiting to see whether their offer has been accepted on a two-bedroom flat in a rundown neighbourhood of the city.

An advert flicks up for a getaway flight to somewhere sunnier. If they can take the time off, then they can get away to a nice sunny island for a week. The small flat they are purchasing is, by normal standards, inordinately expensive. They will be paying off their mortgage until they reach retirement age. But the flight is cheap: they can book it for less than one day's wages each.

To Peter and Lucy this is the usual way of things, although they don't like it much. Their friend Mel pointed out to them that the world is running out of time to tackle one of the major environmental problems facing it, climate change. Lucy feels a certain amount of guilt in the back of her mind for taking a holiday and the associated carbon emissions but is convinced by the low cost of the flights. When buying a roof over their heads is so expensive and so stressful, any normal person would need a little relief. They book the flight.

Are the Prices Right?

This book is about the prices of things, and how the prices of things is influenced by the taxation system. Houses and flights already have some taxes on them. If you live in a house, you pay Council Tax. And if you take a flight, you pay Air Passenger Duty. Putting a higher tax on houses will *reduce* the purchase price of the house. That's because the value of the house depends in part on the obligations associated with it, taxation included.

This book does not argue for environmental taxes primarily to change the behaviour of consumers. Rather, it seeks to change the economy to provide goods in ways that do not damage the living planet. Sometimes, this will be difficult. It's hard to design aeroplanes that do not burn oil products. But technological change adapts to market need. And if zero-carbon planes cannot be designed, then perhaps those who fly should pay for the capture of Carbon Dioxide from the air elsewhere. The tax on flying, and other activities that produce greenhouse gases, should be enough to encourage people to capture those gases from the air if they cannot be eliminated directly.

The price of things needs to be just. A just price of things requires a just tax system. A just tax system will cause people to pay for the damage they cause to the environment. A just system will also ensure that nobody gets rich merely by owning some of the limited things of life, such as land. In short, justice and social benefit are the same, fairness and efficiency merely two sides of a coin. That is Tax Heaven. It is to such a tax system that this book is devoted.

There's a corny old joke about the man that asks for directions and gets the response "Well, if I was going there, I wouldn't start from here". It's not just the final state of affairs that must be just, but also the approach of getting from here to there. In the later parts of the book, we show how to transition in a fair way to a just tax system.

Bringing Back Self-Respect

Further down the street from Peter and Lucy lives Fred. Fred is on benefits. He once took a job, but he found that once this happened, his benefits were cut off. There was a gap between his new wage and the benefits coming in. Thanks to this, he didn't have the money for the rent.

The UK has rolled out a reform known as 'Universal Credit', which integrates four income-related benefits into one. The 'benefits withdrawal' rate (in effect the income tax on additional income) on Universal Credit is 63%. This means that you lose two thirds of the extra income you get. [Some of the problems with the new system include a delay in payment of benefits whilst administration takes place.]

It does not have to be this way.

In the next section we define the five major questions that this enquiry seeks to answer. They are:

1. What would an economy fit for our children look like?
2. What are the Economic Conditions for Widely-spread and Sustainable Prosperity?
3. How Can We Define a Better Tax and Welfare System
4. How To Make The Change
5. What Benefits would we Get?

PART 2: THE FUTURE – AN ECONOMY FIT FOR OUR CHILDREN?

Are you looking for a new economic model for your country?

This book is addressed to economists, scientists, politicians, business people, other professionals, and interested members of the general public who are interested in this problems.

Many people, across the west, whether they are rich or poor, are starting to lose hope. The poor are losing hope because their economic situation is often precarious. The well informed are starting to lose hope that our society can fix its critical issues such as climate change. The super rich are building bunkers and preparing for the worst. This book provides hope that our societies can fix our big problems. This book gives us justified hope. Justified hope that humanity can continue to solve our problems.

An economy that is good for people and for the planet is one that is functioning well. Whilst there are things for us all to do, there are opportunities for development and growth, including in rich countries.

What would an economy fit for our children look like? A good society promotes the wealth and happiness of its citizens. Thus, we argue for a society and economy that defines, preserves or creates, and fairly distributes natural and humanly-created wealth. Happiness implies a different metric than mere activity: humans need both security and purpose. The challenges of the future give us our purpose and will undermine our security if we do not face them with full commitment.

This chapter constitutes a summary of the book as a whole.

WHAT ARE THE ECONOMIC CONDITIONS FOR SUSTAINABLE AND WIDELY SPREAD PROSPERITY? (CHAPTER 3)

This book is about the economic conditions for sustainable and widely spread prosperity.

The economist Adam Smith wrote perhaps the most famous book on economics, 'the Wealth of Nations' more than two centuries ago. He was writing at the time of three revolutions: the political revolution in America and France, the industrial revolution that was just beginning in Britain and then Europe and America, and the intellectual revolution that he himself played a part in.

Since Smith's day there has been tremendous technological progress and economic growth. But we still have problems. We have economic insecurity and pollution.

Why, given great technological and economic progress, do we still have problems? Why, midst so much wealth, are many of our lives so precarious? In the 1960s, it took an average person in the UK on average wages four years wages to buy their own home. Why now does it take an average person on average wages ten years buy the same home? Many of us are just about managing when we should be prospering.

If we have all the technology to solve our environmental problems then why are we not solving them? The 19th century writer Henry George's book 'Progress and Poverty' asked a similar question. Why, given technological progress, did we still have so much poverty? George argued that it was the private ownership of land that caused poverty.

These days we have less absolute poverty in richer countries, but rather a sense of economic precariousness and lack of progress. Our environmental problems are becoming increasingly critical. Why is there environmental pollution, despite having the wealth and technological ability to prevent them?

Our economic system is not allowing us to take full advantage of the technological progress that we make. We seek the answers initially in economics.

ECONOMIC THOUGHT

Economics is the study of activities that are, at least in part, motivated by financial gain or that involves resources that are inherently scarce. Economics used to be called *political economy*. This term comes from Ancient Greek. Political in an older sense means 'in relation to the *polis*'. *Polis* in turn means the city-state, the name for the political organisation in ancient Greece. Economy comes from two Greek words *Oikos*, meaning household, and *Nomos* meaning law. Therefore, *Oikonomos* means household management and, in English, the term *political economy* comes from the notion of household management of the state.

Classical political economy – the works of Adam Smith, David Ricardo, John Stuart Mill and Karl Marx – was written in prose. Modern economics is often written in maths.! Classical political economy dealt with the economy as a dynamic process and did not shy away from grand statements about divisive topics such as how the economy distributed its gains. Thus, the works of political economy by the great authors always had questions of taxation at their heart. What is an efficient and fair taxation system given what we know about the principles of political economy? Thus at the heart of political economy has always been the question of just distribution and of taxation as a means to remedy the situation.

This makes political economy – and now economics – powerful. Also, it means that economics has implications for the financial interests of everyone. One can believe an economic theory for scientific reasons, but one might also support some theory because it furthers one's own interests. This makes political and economic discourse somewhat fraught. It also means that there is a suspicion that the corrupting power of self-interest may affect the balance of those economic theories that are thought authoritative. In this book, we aim to reconcile classical, neoclassical, Keynesian and modern system dynamic economic thinking to give a more authoritative approach.

In our chapter on economics, we define some classical economic problems. How are prices determined? How does the economy distribute the gains from economic progress? Does self interest and the free market provide a desirable outcome?

These questions are related not only to economic processes – for example, production and competition – but also to taxation and the structure of private property. What assets can be owned? And, who in fact owns the assets? And how much tax should they pay for owning assets or for engaging in economic activity? Desirable economic outcomes depend not only on economic activity but also on the taxation system and the system of property rights.

ADAM SMITH'S MODEL

We have a market economy with competition, growth and technological progress. Adam Smith, in his famous work *The Wealth of Nations*, set out an economic model of how economic growth could lead to widely-spread prosperity. He argued that the division of labour leads to higher levels of productivity.

If an entrepreneur makes an improvement in production processes, he can lower his cost of production and still sell at the price of his competitors. In other words, he can make a profit. In the short term, therefore, the advantages of his improvement accrue to him. Thus, the profit motive provides an incentive to make improvements.

His competitors may notice the improvement that he has made and replicate it. To capture market share, they will lower their prices towards the new cost of production. There might be a price war to capture customers. After the competition has taken its course, we will be left with a different situation. The price of the good concerned will have fallen to just above the new production cost. The new beneficiary of the technological improvement would be everyone who purchases the product. Technological progress, the profit motive and competition would lead to widely spread prosperity.

RENT!

So why do we have these problems of pollution and precariousness? We identify two phenomena described by the great economists. Economic Rent and Economic Theft.

Adam Smith's model relies on certain assumptions. A production process, once improved, can be replicated. There must be enough market participants for competition to work. If there is only a single monopolist or if entrance to the market is expensive then competition will not work as described. The beneficiary will be the owners of the single monopolist or the incumbent firm. Similarly, if the process relies on some factor of production that cannot be replicated, for example, land, then the beneficiary of the economic progress will be the landlords.

Imagine I am a landlord. Once I own some land with property on it, I can sit back and enjoy the flow of income, without having to work. This flow of income is rent. Rent goes up, as wages increase.if I own a big monopoly with no competition, I can also own a permanent flow of profits that competition will not touch.

We term these two forms of property income 'generalised rent'. Generalised rent is a permanent flow of income associated with an asset that cannot be replicated. Generalised rent is a permanent financial surplus received by the owners of properties in valuable locations and the shareholders of large companies. We argue that generalised rent leads to expensive housing, stagnating wages and wealth gains for the already rich.

So the limited things would be rationed by taxes rather than by private property, so that everyday people have a stake in the common resources and land doesn't become so expensive that individuals cannot afford their own homes.

WICKED EXTERNALITIES

We haven't dealt with pollution. Usually, damaging other people or their interests (for example, through injury or theft) is illegal. But some economic activities which damage others are still legal. Driving a car, which pollutes the environment and could harm pedestrians if there is an accident, is legal and normal, but nevertheless, damaging to others' interests. Small, indirect damages from many independent sources can add up to a lot in total.

When one person or company's behaviour damages another we call this 'economic theft'. So for example, if I throw my plastic waste into the ocean, it can then damage fish and other marine life. My careless action has stolen from the future of the ocean.

What seems acceptable when societies are small may nevertheless be unacceptable when societies are larger. For example, Newfoundland fishermen could fish without constraints when their boats were small and their numbers low. There were plenty of fish. However, fish stocks are not unlimited. There is a limit on how many fish can be taken before it damages the fishery. If too many fish are taken, then the fish don't get a chance to reproduce, and the fish stocks collapse. This is what happened in Newfoundland. Fish used to be so plentiful that the sea teemed with life. But after the collapse in the fish stock, many fishermen went out of business.

The result of these economic effects is that we have too much pollution, not enough genuine wealth and economic growth that benefits the rich.

Wicked externalities, such as climate change, are damages caused by our actions that affect others remote in time and space, without effective governance systems to constrain them. For the planet as a whole, this model is catastrophic. This book shows a route out of this economic situation. Growth, where it is in relation to consumption, needs to be dematerialised or physically circular: it needs to minimise the impact that the growth has on the natural world. We will come to how to achieve that a little later.

Economics needs to account for these external damage. Taxation should also correct the market, so those who damage the environment pay for the damage that they cause. Such a tax system would tax bad things, not good things. The physical use of natural resources should be taxed, and the circular use of those resources is thereby encouraged. So, with a proper tax system, the beautiful things that require care, like the natural environment, would be preserved.

So we've seen that taxation seems to be important in our economic model because it sets the economic incentives for the private sector. This leads on to our next question.

HOW TO MAKE THE CHANGE? PUBLIC POLITICAL ECONOMY (CHAPTER 4)

Our fourth question: how can we actually change the tax systems? Economists have been aware of rent and externalities for some time. Yet, taxes which would correct these economic distortions have only been imposed occasionally and partially. Why haven't corrective taxes been imposed?

Here we make the case for a simple 'change equation'. The perceived benefits must overwhelm the resistance. However, there is another problem. Nobody has made a sufficiently passionate and positive case for these taxes. This book aims to correct that.

One great milestone in the history of progress in the UK was the

Beveridge report (1942). Seventy-five years ago, liberal economist William Beveridge presented his report for a new welfare state. It laid the basis for the post-war welfare state. Its objectives were to banish 'want, ignorance, squalor, disease and idleness'. Beveridge argued for universal benefits, as of right. This can be contrasted with the system of means testing that has since developed.

The Beveridge report shows a possible way forward for welfare. Before the second world war, the five social evils of Want, Squalor, Idleness, Disease and Ignorance ravaged the poor in Britain. The second world war destroyed many buildings, homes and businesses alike, and increased the government and external debt. But yet, the post war government managed to create a comprehensive welfare state where none existed before: a health service.

Three principles guided his report (Beveridge 1942: Part 1, paragraphs 6-9).

- *Radical*: From first principles, without fear or favour to social class or other interest groups.
- *Comprehensive*: Dealing with poverty, disease, bad housing, unemployment and a lack of education.
- *A liberal social contract*: No means testing and so no stifling of incentives; cooperation between the state, individuals and firms.

PRINCIPLE 1: A FUNDAMENTAL REVIEW

First, he argued that World War II and its aftermath was 'a time for revolutions, not patching'. He offered a radical approach, informed by the experience of the past. He would not be restricted by the interests of one group or another. In short, his report would be *radical* (working from first principles) and prioritise the *common interest*.

We also aim to look at tax and welfare from first principles. We will then apply those first principles without fear or favour.

But are we at a revolutionary time? Can we change a complex system like tax and welfare from first principles, or is 'patching' the only realistic possibility? We will assert that change is possible if it is beneficial, fair and practical, and communicated well so that these aspects are evident.

One does not make fundamental progress without thinking about what a system should do and what it should be.

We also need to consider the motivation for, and the barriers to change. One barrier is the worry that some people will be made worse off by any changes. We need to ensure not only that the final state is fair but also that the transition between the current system and the new is also fair.

PRINCIPLE 2: SOLVING GREAT EVILS

Second, he argued for a *comprehensive* solution to the five 'giant' social problems of the poor. His report dealt primarily with want (poverty) and disease (poor health). The other three 'giants' were ignorance (lack of education), squalor (poor housing), and idleness (unemployment). Accordingly, his report laid the basis not only for the UK's postwar welfare (or social security) system but also the National Health Service, public education, housing policy and a system of macroeconomic management aiming for full employment.

We still have Beveridge's giant social issues to some degree, but we are also faced with new problems. This book, like Beveridge's report, is devoted to five great societal challenges which face us now:

- *Widely-Spread Wealth*: Inequality of income and wealth, and especially that caused by arguably unfair means; tax avoidance and evasion; dominance of large mega-corporations with market power enriching the rich and wielding political power. Dealing with the challenge of increasing automation of work so that everyone has an adequate income and plenty of free time.
- *High Rent on Land and Resources*: Unaffordability of renting or purchasing homes, and the cost of importing fossil fuels.
- *Pollution and Other Environmental Damage*: Climate change, ocean acidification, plastics, over-fishing and habitat loss which all threaten the future.
- *Debt and Economic Imbalance*: Re-balancing the economy away from borrowing and asset inflation, and towards balanced growth and wealth formation.
- *Tax Evasion and Avoidance*: Can a tax system be designed that is simple and yet difficult to avoid?

We need to be passionate about the benefits that reform will bring. We consider these in the next section.

PRINCIPLE 3: A SOCIAL CONTRACT ALIGNING REWARD AND CONTRIBUTION

Our new welfare system should not disincentivise work and should encourage service and contribution. We will study in detail Beveridge's third principle to see if, and how, a better welfare system can be created.

This involves the *integration* of the tax system with the benefits system so there is not a separate system of 'means testing'. This function can be carried out through the tax system. This suggests the case for a system with a universal component: we call this a 'citizen's dividend' (a form of basic income). Furthermore, we argue for an integrated skills training and work experience system. These two proposals are outlined later.

There's an overarching concept too, which we term policy entrepreneurship. That is, we should break out of the monopoly of thought imposed on us by neoclassical economics and neoliberal economic ideas. These forms of entrepreneurship imply a new growth model for everyone, one that is not based on increasing financialisation and debt issued on limited assets but rather the development of productive industries solving our collective problems. We deal with the potential benefits of our proposals in the next section.

PRINCIPLE 4: MINIMISING RESISTANCE TO CHANGE

To Beveridge we add our own fourth principle, that the proposed changes should be prioritised: maximising the benefit and minimising the resistance

Resistance to taxes is associated with concentrated losses on specific groups. These groups can easily mobilise to resist new taxes. We can talk about two salient group: poor people and companies. Let's focus now on corporate lobbying. Companies can target their own financial interest in just a

But taxes change the nature of what activities are profitable. So taxes, which could change the nature of these agents (for example, converting an oil company to a renewables producer) cannot be imposed because the very same agents resist the taxes as they oppose their interests. But these interests would change if the nature of the company was to change from oil to renewables. So we a have catch-22 situation. We can't change the companies without the tax. But we can't impose the tax without changing the company, since they resist politically. Instead, we need forms of tax that don't face such resistance but which lead to the transformation of companies in a positive direction.

HOW CAN WE DEFINE A BETTER TAX AND WELFARE SYSTEM? (CHAPTER 5)

Tax is the means by which we pay for government services. this book is devoted to how to pay for public services and social protection in a world characterised by 'wicked externalities', 'generalised rent', and international flows of money and assets.

But this book isn't really about government.

Rather it is about the use the taxation system to ensure that the *private sector* has the right incentives. So there are two, distinct, systems that are in scope of our book. The first is the entire private sector. his book is about how the private sector can contribute to the well being and the good of society. If the private sector does not have the right incentives, it will not produce the right outcomes. Therefore, it is a book about economics. If the private sector is not to harm our general well being, then an effective tax system needs to be in place.

We wish not just to minimise the costs of taxation, but rather to aim for taxes, where possible, that are actively beneficial. Good taxes would shape the profit motive towards the needs of people, communities, and the living planet on which we all depend. Here, we seek a tax and social security system that is not only fair and practical but also beneficial to everyday people, our country and our world.

The central concern of the book is the use of the tax system for public benefit: to solve the critical challenges facing our societies including climate change, poverty and the complexity, avoidance and evasion in our taxation and welfare systems.

TAX IN PRACTICE: AVOIDING AVOIDANCE AND EVADING EVASION (CHAPTER 6)

One further challenge is taxation in the context of international flows of income and money. It would be nice to tax unearned wealth accumulation as well as poor everyday people.

One key challenge to taxation is working out a means of taxation that can tax wealth and flows of income across international boundaries. International tax avoidance leads to multinational companies and rich individuals failing to pay their fair share for society's upkeep.

Generally, the issue is as follows: One cannot (it is said) tax big companies or rich individuals because they will simply move their money abroad. Furthermore, we might even wish to reduce our taxes on companies to encourage them to locate in our country. This is problematic because it tends to lead to companies paying less and less tax.

Such a challenge also applies to the taxation of fossil fuels. If we tax emissions that are produced in the UK, this might encourage UK-based producers to move outside the UK. If instead, consumption of carbon-intensive goods is taxed, imports of goods produced abroad would be in scope, but exports would not. This would be helpful for a number of reasons. Firstly, it would give a true picture of the emissions that a country is responsible for due to its consumption behaviour. Secondly, it creates a true incentive for exporting countries to decarbonise their economy. Thirdly, it encourages production processes to be improved, rather than simply relocated abroad.

Taxation of wealth also faces similar issues. Taxation theory aims to identify a base of taxation that is unresponsive to the tax. So in taxing wealth, we could argue for taxation of assets rather than taxation of wealthy individuals. Land is a straightforward asset to tax in this way. Land cannot just move out of the country.

Taxing corporate wealth is more difficult because a corporation is a more fluid and mobile than land. In this book, we suggest two radical strategies.

The first approach is the taxation of profits calculated as UK sales minus UK costs. This approach encourages companies to locate their costs in the UK. The higher the tax rate, the more operations would be moved to a UK base.

The second approach is an apportionment of multinational wealth based on where the sales of the companies are located.

Thus both for environmental damage and for wealth, we use consumption as a relatively fixed tax base.

WHAT IMPROVEMENTS WOULD IMPLEMNTING OUR PRINCIPLES BRING? FOUR FORMS OF WEALTH

So what improvements could such proposals make? We argue that they could enhance genuine wealth at the level of the individual, community, nation state and planet. There are four crucial benefits of a better taxation system to wider society. We call these the four realms of value: households, communities, nations and the world.

The first skill based personal and social entrepreneurship.The second issue is state capitalism entrepreneurship. This involves both the state and capitalists. The third is municipal land value entrepreneurship, as has been seen in Singapore and Hong Kong. Finally we can suggest public good entrepreneurship: we suggest that the private sector be turned over to public good provision. The obvious example is green entrepreneurship, but we also suggest ways that companies can tackle other global issues such as the lack of good antibiotics.

IMPROVEMENT 1: SECURE INCOMES, PRODUCTIVE JOBS AND ECONOMIC POWER (CHAPTERS 7 and 8)

The current social security system is highly insecure: benefits are taken away from people when their conditions change, leading them often to go into arrears with their rent or other payments, and often leading them into debt. The current social security system also discourages work, as benefits are withdrawn as income increases (in the Universal Credit system at a rate of 61% for every £ increase in income). A better system in which benefit would not be withdrawn so rapidly as income increases, would encourage people to increase their skill level, would be well integrated with the taxation system and would also support those who enhance their communities in ways other than simply earning money (for example, by caring or raising a child). It would also allow division of labour with minimal taxation between individuals in communities (so eliminating the tax advantages of being a company relative to an everyday citizen).

To achieve this improvement, we need to simplify the existing income and means-tested benefit system. Rather than the current system of means testing benefits, there would be a single system of basic income and taxation. A 'simplifying' basic income payable to everyone in society would be combined with a simplification of the system of income taxation, so that a standard rate of 40% is applied to all income up to the point when someone reaches the top 1% of incomes. Furthermore, there would be citizen wealth funds, and assets would be granted to individuals based on how much tax they paid. There would be a 'target minimum level' of wealth and individual's tax would build up this minimum level of wealth. We have a SIMPLIFIED INCOME TAX, BASIC INCOME and WEALTH FUND.

Case Study: Income and Corporation Tax: USA in the period 1945–1980

The United States in the post war showed the advantage of redistributive income taxation, including high tax rates on companies. The top rate of income tax was often over 70% in that period, and taxes on companies were also higher than at present. Because everyone's incomes were not widely different, this meant that normal people could not only afford consumer goods but also everyone had a chance to buy the limited positional goods such as land. Since the top rate of tax was high, and since income tax is the largest and most important tax, this meant that the average tax rate paid by people on average earnings was lower. We discuss this is parts 6 and 7.

IMPROVEMENT 2: AN AFFORDABLE HOME IN A PROSPEROUS COMMUNITY (CHAPTER 8)

Achieving economic security for all. The second priority is an affordable home for all. British governments have massively mismanaged the taxation of housing and business properties. By appropriately taxing the value of the location (land), in a way that is convenient and fair for all, we make it possible for most people to enjoy the economic benefits of owning their own home. An optimal tax system would encourage community action, so that 'community entrepreneurship' allows communities to develop their value and capture the fruits of this development. How do we achieve this, given how expensive homes already are in South East England?

Well, the first thing is to capture location rent increases for public causes. What does this mean? This means that the property taxes: council taxes, business rates and stamp duty should be rolled up into a single tax. This should be a tax on property with the *value* of tangible investment deductible. So that means a house is a value, so you shouldn't be charged on this. The residual should be allocated between the local community, the municipal authority and the central government. Taxing property values rather than property per se would stabilise the current property values. We have a LAND VALUE TAX payable in cash or deferred until sale or death.

Case Study: Land Value Capture in Singapore and Hong Kong since independence

Singapore shows what has been termed the 'property state' (Haila 2014): it shows what is possible when there is a 'prosperity loop' between investment in public infrastructure and public rent collection. In short, as the government makes infrastructure improvements, those increase the rental value of the land, and those land value increases then accrue to the government. Hong Kong also shows the advantages of this approach: before a new metro line is built, land near the new stations is purchased at pre-announcement cost and so society captures the land value benefit of the new infrastructure [Purves]. We discuss this is part 8.

IMPROVEMENT 3: A PROSPEROUS AND WEALTHY COUNTRY (CHAPTER 09 and 10)

The second priority is a prosperous and wealthy country. The current taxation system does not encourage productive wealth formation. In fact, it encourages those sorts of companies that *extract* wealth from the country and discourages those who wish to invest in the society. A better system would encourage people who invest in *real assets*, but discourage purely financial investment. In short, a good tax system encourages a balance of trade. It discourages foreign investment in a financial sense whilst encouraging investment in a real sense. An optimal taxation system would involve a collaboration between state and the private sector, so the gains of research and development investment are shared between both. And an optimal social security system would involve some funding from sovereign wealth funds, including personal accounts, so that the people and state accumulate assets to support them in hard times.

For this, we need to provide an incentive for companies like Dyson to locate into the UK. We suggest the following: a *higher* corporate tax but calculated as follows: Sales – UK Wages – UK Investment.

In other words, the tax should *encourage* UK companies to invest in the UK. We call this a DYSON TAX. The financial system should be encouraged to lend to real businesses.

Case Study: Financial 'Repression' in the UK in the period 1945 – 1980

One great anxiety is about *debt*. There are basically two forms of debt that concern people: public (or government) debt and private debt. High public debt pressures governments to 'cut the deficit' through 'austerity'. Yet in the past, the best way to reduce the burden of public debt has been not to worry about it: or rather to use different strategies. In the three decades after the second world war, the UK reduced its public debt to GDP ratio from over 250% of GDP to 70% of GDP. It did this not through austerity, but rather through growth, inflation, monetisation of some debt, and low interest rates. We consider the fiscal benefits of such strategies later in this book.

IMPROVEMENT 4: A CLEAN AND SAFE GLOBAL ENVIRONMENT (CHAPTER 12)

The final priority is the environment. We start with the most important part of the tax system, the system of environmental taxation. There are a number of major environmental problems facing us, most notably climate change and ocean acidification, but also including the prevalence of plastics in the ocean, habitat destruction, road congestion, over-fishing, rare resource consumption and conventional air, water and land pollution. Using environmental taxes faces a few challenges: they can be unpopular, hard to design, encourage 'off-shoring' of dirty forms of manufacture and bureaucratic. Finally, because sometimes demand for damaging products can be unresponsive to price, a high environmental tax may be necessary. But high environmental taxes may be unpopular, disruptive or unrealistic. Also, individual country actions are not enough. Instead, we need action that is global. But there are no functioning global institutions. Thus, we look for solutions that can be implemented at a national level, which *and* which encourage other countries to follow the lead. Such solutions should be within international laws and rules as well. We show how those potential issues can be overcome.

Because it is so important, the main priority is not to raise additional revenue with this taxation source, but we do intend to ensure that the private sector has the correct incentives. To accomplish that, we start with a higher carbon tax on electricity production. Electricity production should have an incentive to be carbon neutral. We achieve this with a tax on carbon inputs with a subsidy on electricity production. Simultaneously, we also provide low-cost loans from the public loan board. There will be prizes for rapid roll-out of new technologies and national targets for the roll out of low-carbon electricity. We have a CARBON TAX.

Case Study: Environmental Taxes in Scandinavia, Switzerland and the UK

Three European countries show that a carbon tax can work exactly as planned. Sweden, Switzerland and the UK all have a carbon tax. Sweden was one of the first to introduce its carbon tax and the per capita emissions of Sweden are now among the lowest in Europe. Similarly, Switzerland has also introduced such a tax. The UK introduced its carbon price floor more recently, and it has seen a large fall in emissions. Most notably, we have seen a drop in the use of coal in electricity generation. Other environmental taxes include charges for plastic bags.

SUMMARY OF Proposals (CHAPTER 14)

We will set out how, on a consumption basis, *taxing* the environmental damage that people cause is sensible, that we should tax unproductive and unearned wealth, and finally, we should tax luxury consumption using the income tax system to ensure it is progressive.

We also have some reforms for the benefits and training system. We suggest a dividend for everyone, a cheque in the post – and to integrate the tax and benefits system, replacing means testing with taxation (since it achieves the same thing, taking money away from people as they earn more). We also suggest an active benefits system for training people in high skills. We suggest the accumulation of wealth across the poor, rather than the government having the responsibility to support them. Then, when people pay their tax, some of that tax would be set aside as a contribution that will fund the purchase of assets, a return to a contributory tax system.

Finally, we suggest changes to the financial system. Allied to our tax on wealth is a tax on lending on unproductive wealth. Thus, we encourage investment across the economy. We use the financial system to actively promote the capture of land rent for public purposes. We suggest particularly low-cost loans for the building a new cost infrastructure, in this country and around the world. Finance is particularly international and lending can ensure that everyone gets enough energy.

PLAN OF THE BOOK

The Prelude asks what we would do faced a perfect storm, right now in the present day.

Chapter 1 took us on a tour of the revolutions of history: economics, politics and technology. to bring us to the challenges of the present day's challenges in the context of the past.

Chapter 2, which you have just read, gives an overview of the arguments of the rest of the book as they apply to our future.

Chapter 3 takes the reader on a tour of desert islands to illustrate simple ideas of economics in this book.

Chapter 4 builds a conceptual model of collective action, vital for the biggest problems facing us.

Chapter 5 considers tax in principle. *Beneficial*, *fair*, and *practical* are three general categories which provide us with a framework for assessing any tax or system of taxation.

Chapter 6 considers tax in practice. We look in detail at tax avoidance.

Chapter 7 with Inequality, which is driven not only by differences in merit but also by tax evasion and avoidance, and by unfair processes of asset price appreciation.

Chapters 8 deals with Welfare and Work.

Chapter 9 looks at land and housing is increasingly unaffordable in many cities.

Chapter 10 considers the corporation tax system.

Chapter 11 considers the financial system.

Chapter 12 deals with Climate change and other environmental issues, which threaten the future of our living planet.

Chapters 13 contain our proposals and our quantitative modelling of them. Chapter 14 Concludes the book with a call to action

PART 3: DESERT ISLAND POLITICAL ECONOMY

The purpose of this section is to take you on a whirlwind tour of some important ideas in economics and the history of economic ideas. We shall introduce these ideas through stories on a set of islands, which we will call The Economic Archipelago (the 'Tea Islands'). (In the subsequent chapter we will introduce these same ideas more formally using a different analogy: the cake.)

3.1 Growth on Great Island: Adam Smith's Model

The largest island in the Tea Islands is called 'Great Island'. On Great Island live a few hundred people. Everyone does the same thing, a bit of everything. Half the day is spent fishing (including maintenance of the boats and nets) and half the day is spent gathering nuts and berries. This yields 250g of fish and 250g of nuts and berries. In total, 0.5kg of food which is equal to their dietary needs. In this economic fable we will demonstrate Adam Smith's model of growth through specialisation.

Specialization and Trade

Then a small group of fishermen discover something. They decide firstly, that they are *only* going to fish, and not worry about gathering berries. Whilst they enjoy nuts and berries, they argue that they can catch enough fish and *trade* some of the fish they gather for nuts and berries. They also split up tasks between themselves. Some of them make nets, others build bigger boats. They can catch more fish by splitting up tasks in this way. By collaborating and specializing they can double their productivity. Where before they could only make 500g of food per day, now they, collectively, can produce 1kg of food per day.

They now have choices. The first option is to work all day (8 hours) and sell the surplus, either saving the excess or spending it on some luxuries. The second option is to cut down working hours by working only 4 hours per day. In the shorter working day they can still produce enough food to live on. In both cases the fishermen in the firm have higher hourly wages than before - twice what they were making before. These higher wages reflect the higher productivity.

So the improvement was generated by the fishermen and their initiative, and they are the beneficiaries of the new ways of working. The economy has grown, but at present the new prosperity has gone entirely to the fisherman that initiated the improved ways of working. The price of fish relative to berries is unchanged. One kg of fish still sells for one kg of berries.

Competition

So at first, the benefit of improvements are captured by those that made the improvement. They get to live a life of luxury. And everyone else is pretty much as before, except that they notice the specialised-fishermen getting richer and richer.

Soon some other folks notice what the fisherman have done and give it a try. And then some more fishermen pile in. Fortunately the seas are plentiful. Once each has replicated the new improved double-productivity setup, they can each sell fish. But something strange happens. Given the people only want to buy a certain quantity of fish, the fishermen undercut each other in order to win market share. The price of fish in terms of berries starts to fall.

The Labour Theory of Value

To what price should the price of fish fall to? It continues to fall until the point at which, in the new circumstances, it only just makes sense for workers to go fishing in the new fishing-conglomerates. In short when the wages from fishing in the new improved setup equilibrate to the wages just going gathering. In other words, the price of fish relative to berries will fall until it makes the same sense for someone to fish as to go collecting berries. This assumes of course that there is some value in eating some berries, perhaps for a varied diet.

So now, the cost of fishing is expected to fall. In the new circumstance perhaps, 1kg of fish (taking one day to collect) buys 0.5kg of berries (also taking one day to collet). Given the new cheaper price of fish relative to berries.

Widely Shared Prosperity?

So at the end, people fish for a day to get 1kg of fish and perhaps go collecting for a day for 0.5 kg of berries. 2/3 of the people fish, and 1/3 of the people collect berries (a change from half-half before the imrpovement in capabilities.) The total average food production is 2/3+1/6=5/6 or about 0.82kg. Thus the real wages per day have increased as 0.5kg per 8=hour day to 0.82kg of food per 8 hour day.

This is shall we say the basic model of division of labour and competition. Let's now extend this model to the situation where there is scarce land which is privately owned.

3.2 Rent on Private Property Island

Our fisherman is considering a change of direction. He has heard that there are two new islands, only recently discovered, which sounds like a paradise. Rabbits run free and are easy to hunt. Fishing is rather laborious whereas hunting rabbits sounds much easier. Our fisherman sets out to visit the first island. The first island is one of private property.

On this island, there is a man, lets call him 'Man Friday' living on it. He is well abrest of the laws of property. He defines himself the owner of the property. He arms himself to make sure that nobody else can take any of the property. He prepares to charge rent to anyone who turns up. Thus we will call this island 'private land island'.

Then a new man turns up, we can call him Robinson Crusoe. This man has been used to living at sea in a fishing boat. Every day he fishes, he catches 1kg of fish, which, we can assume are very nutritious.

Crusoe arrives at the island which is full of rabits which are easy to hunt. If he is to work a whole 8-hour day, he can now catch 8kg of rabbits. Let's say that a rabbit is just as nutritious as a fish, and the work is just as pleasant. In fact, he only needs 1kg of food to live on, so he can work one hour per day and relax reading books the rest of the time.

After the second day of fruitful hunting, Man Friday turns up to say hello. Fortunately through a twist of fate, they all speak the same language. Friday is very happy that Crusoe has turned up. He invites Crusoe round to dinner. It's a very beautiful dinner: rabbit en croute. Friday has many beautiful items on the wall, won from many years of selling rabbits to passing tradespeople. He even has a beautiful gun and half way through the meal, he gets it out of the gun holster to show Crusoe, places it on the table to show him, and then puts it back in its holster.

Dessert is served. Friday has a family of servants who help him. Friday is saying how he is glad that crusoe has joined the island. Half way through the desert, Friday gets to the point. "Oh about the rent" he says. "Would seven per day be ok?"

In a moment, the pleasant world of Crusoe disappears. He had not even considered that Friday would charge him rent. There was space enough on the island for all. But Crusoe had few options. The best profession he had found up to now, a fisherman, earned 1 kg of food for a full days work. Living on dry land seemed attractive (at least he was not subject to the storms). He had thought that he could work only one hour per day. But now he realised that his working hours would not change. The eight hour shift of fishing to get one unit of fish is the same as the eight hours he would have to work to get eight kg of food in the new situation, of which seven would go to his landlord! He would still work the same hours, and get the same pay. Admittedly the new situation was a little better as he was not subject to the storms and salt-corrosion of his boat, but it was not the bliss that he previously envisioned.

It's interesting to note that the net wage after rent of our new arrival depends actually not on the conditions of the island, but rather on the conditions in his next best option, which is to go fishing. Suppose that fishing made 2kg of fish per 8 hour day (0.25 kg per hour). The landlord, observing this, would need to charge only 6kg of rabbit per day in rent, since Robinson Crusoe could always do better fishing otherwise. This is odd and worth repeating: the well being of someone here depends on the options that they have available elsewhere.

Thus we could see perhaps that the abolition of traditional peasant rights in England during the enclosure acts could be the fundamental cause of poverty in big cities thereafter. Without the option to be a peasant, there was no options for workers to earn any sort of wage. Therefore the wages paid by industrial capitalists need be enough to keep them alive, but no more - subsistence wages.

The landlord can extract *rent* constituting the surplus over wages (in this case the net resoirces kept by Robinson once he has paid his rent).

Differential Rent

Imagine the island is split in two, one half is owned, the other is not. On one side of the island, rabbits are plentiful, and 8kg of rabbits per day can be hunted. On the other side, rabbits are less plentiful and only 4kg per day can be hunted. The landlord rents out both plots, but the rent charged on each can differ. Assuming for now that the wage that an unemployed person can make is still 1kg per day when fishing. Thus the landlord can charge 3kg of rabbits for residence on the less productive plot and still 7kg of rabbits per day for residence on the more productive plot.

Absolute Rent

Let's say that for some reason there's a series of storms the people on the islands find it hard to catch fish. The landlords however have some spare resource - stored dried food - that they have accumulated over many years. They sell this food to the fishermen. In exchange the fishermen sell their boats to the landlords and rent them back. Now there is no rent-free way of earning a living. In this situation, land and other ways of earning a living are absolutely scarce. They have been bought up by the wealthy landlords.

We can consider two possibilities: the first is that there is a shortage of workers. In this case, there will be some level of scarcity in labour and therefore wages will be kept up. The split between the revenue going to the landlords for renting a boat and labour will depend on the

Now of the 1kg of fish, only half a kg is retained, the other half is paid as rent for the boats. The residual wages are not now set at what the fishermen can earn in a rent-free existence, but rather the minimum that will keep them alive.

Capital

Let's say that Robinson sets aside some of his wages not to live but to invest for the future. He works for a bit and then creates some rabbit traps. He has to invest his time in the traps but after making the traps, his productivity is doubled from 1 rabbit per hour to two; or from 8 rabbits per day to 16.

It takes him one day to build the traps. The traps double his daily productivity to 16 rabbits per day: it increases his productivity by 8 rabbits. And the traps, when in use themselves last 10 working days (80 hours) before they have to be completely replaced.

Does this investment make sense? Let's work it out. Basically there's an investment of 8 hours of time, and this leads to 8 extra rabits per day for 10 days, in other words 80 extra rabbits. I give up 8 rabbits in the day to construct my trap, and I get back 80 rabbits. Let's say that I borrow the resources to make the traps, so I borrow 8 rabbits to pay the rent and feed myself the day I make the traps.

Thus my profit is 72 rabbits (assuming I continue to work a full day) per 10 day cycle, just over 7 rabbits profit per day, once the cost of my investment is taken into account.

At last Robinson Crusoe is happy! He is a great believer in hard work. He is working full days to pay the rent. He will continue to work full days. He can invest his time and create the traps and then after having paid back the time invested, there will be a surplus too! He can sell the spare rabbits to passing trades people or to Man Friday. And he can build up assets.

We are assuming that Crusoe has some financial buffer, some wealth to tide him over for the day that he is building his trap and therefore not hunting. If rent is payable daily, he might be able to delay paying rent, he might be able to borrow some rabbits or other resources to pay rent, or he might invest his own stock of wealth until the investment pays back.

So everything is going swimmingly well, he invests the time and he makes a surplus and soon enough he's selling the spare rabbits to passing trades people and building up a store of value.

But there's a catch. Friday comes round, observes what is going on. He takes some photos. And soon enough some adverts go up in the Archipelago Gazette, the local newspaper for the islands. It's only with a passing ship that Crusoe sees them. The adverts say the following: make a fortune hunting rabbits! Earn 16 rabbits per day. He also reads the small print: requires 8 rabbits investment to make traps. Rent: 14 rabbits per day.

14 Rabbits! He's only paying 7 at the moment! What's coming? Sure enough there are some visitors at the island and they come around, friendly enough. The next day Man Friday invites Crusoe round for dinner again. . . . "About the rent". . . he says. "I know you are enjoying staying here". He continues. " But the market is changing. Market rents are going up. I had an offer the other day for someone to pay double what you are paying. Of course, I prefer to go with you so I won't chuck you out as long as you pay what the market is saying. It's only 16 rabbits per day. You still make a healthy 2 rabbits profit (actually one after paying for your investments but let's skip that).

Note that it seems that *property* is the fundamental problem here. That is true. But as we will see, abolishing property causes its own problems. . . .

3.3 Overhunting on Open Access Island

Let's now imagine another island. On this island there is no property rights. Anyone can hunt for rabbits anywhere. And like the island just mentioned, there is no landowner! Everyone comes to the island.

In the beginning, everyone was happy. Wages, 8 rabbits per day, or one per hour, made everyone happy. The problem this time was that too many people came. Since land was not owned by anyone, everyone hunted the rabbits, and in the end too many rabbits were taken from the natural environment.

Because everyone cared for themselves and not for other people many more people came to the island. And those people started to deplete the common pool of rabbits on which everyone relied.

One person hunting for rabbits depletes the stock of rabbits that everyone relies on. There is an ecological collapse. Soon there are many fewer rabbits left. People start to have less food to eat. Those that can, leave.

Whereas on the island with private property, people are poor, but there's no mismanagement. People do work too hard however!

3.4 Inequality on Special Island

Let's say now that hunters vary significantly in their skill level. There's still a limited quantity of land, and a limited quantity of rabbits. It's just that some people are much better than others. If there had been unlimited rabbits or unlimited land, this doesn't seem to be much of a problem. But if there's limitations it seems to be more of an issue. The successful hunters increase the price of land, and they also pressure the rabbit population squeezing out more of the rabbits for themselves so there are fewer for others. The taxes we imposed do help a bit. They mean hunters need to get rich by hunting ability rather than by merely owning land. But in a limited environment, the good hunters don't just benefit from their own hunting, they also impact on the others. They raise the marginal price of land, and so make it more difficult for large families. And they hunt rabbits so that there is less to go around for the others. This justifies what we call progressive taxation. Progressive taxation means taxing people that make more, more heavily.

3.5 Economic Justice on Dream Island

What good are we aiming at? One of the islands on our archipelago is an island of our dreams. The fruit is bountiful, the water is clean, the people are happy. Everyone has a house or can build one with their own money. Fisheries and forests are managed well. Some people are richer than others, but the difference isn't huge, and the people are rich or high status are those that have contributed the most to society. The community collaborates to ensure that the political system is not corrupt and governs the society well, the citizens trade with other islands and each other. There is work for all, but no-one has to work very long hours. The financial system supports beneficial activities, for example clean power and a recharging system for electric cars. Financially, people are secure with investments in the local factory, which, whilst its mostly robotised, provides everyone with a dividend to spend on the products that it and other factories produce.

What has this fantasy island got to do with our life here and now, and in particular our taxation system? Tax, we claim, can encourage the private sector towards this heavenly state. And it is not only tax and the social security system which we propose to reform, but also some elements of the financial, education and pensions systems. We do not however consider these systems in full: that we must leave to others to consider.

Now what can we say about tax on this island? Well, in simple terms, tax is fair and fairly simple and straightforward for everyone to understand. But the tax system in important ways, supports the rest of the economy, not only in how the revenue can be spent but also in the ways that the tax system creates the incentives for the economy to function correctly. The two main ways that the taxation system can be used are generally *redistributive* and *environmental taxes*. We will get to our dream island again but let's go back to the other islands in our archipelago.

Getting to Dream Island

Let's now work out our solutions to the problems that we have encountered. It's easiest to solve the problems before they get started: to set things up right from the start.

The first solution is a land value tax: a tax on rent. The landlord is taxed according to the surplus of each piece of land. He makes no money. There's no such thing as the landlord any more, really. Land becomes free to buy but the person that occupies it has to pay rent to the central authority.

What does the central authority do with the rabbits? There's two options: firstly the government could provide public services. Secondly, they could give the rabbits back to everyone, per person.

What about over-hunting? Well if rabbit hunting is a concern then a limited number of permits could be issued. Hunting rabbits could be constrained. Or put another way, a tax could be levied on hunting rabbits.

On the propertied land, If the rabbits don't run freely between then it can be expected that the landowners/renters will themselves look after the rabbits on their own plots. Therefore a land value tax plus property solution with the taxes paying for service.

Alternatively, if the rabbits do run freely between plots, there will need to be a solution that constrains hunting.

3.6 Appendix: Further Issues

- Monopoly (could add to example earlier)
- Urban Land and Urban Land Rent

Appendix to chapter 3. THE ECONOMIC CAKE (Late draft)

In the last chapter we introduced an archipelago of islands and showed the different economic issues that come about. In this section we formalise these arguments in another way, in relation to the analogy of making a cake.

To illustrate clearly the issues that our society faces, we often use the analogy of the economy as a cake.

We can generally classify the big economic problems into six main groups:

1. How big is the cake? The questions of *growth*.
2. How big a slice of the cake does each economic actor get? The problem of *distribution* of income and wealth between classes and individuals.
3. From what is the cake made? The problem of *allocation* of real resources to make the economic cake.
4. Does the cake as a whole rise to its full potential? – The problem of achieving full employment and sufficient *demand*.

5. How much can we charge for our cake slices? The *price of goods*.
6. How much is the cake shop worth? The *price of assets*.

Tax policy intersects all six of these issues. We want to design tax and welfare policy that leads to a successful economy in the long and in the short term, that allocates resources appropriately, and that leads to a just and appropriate distribution of income.

A3-1 Growth: How big is the cake?

Growth is the problem of 'how big' the economy is, how much wealth and prosperity there is. First we have to define the problem. What should we measure? Francois Quesnay defined the 'tableau economique' which was the originator of the modern concept of Gross Domestic Product, which is the total value of goods and services produced in an economy. We will stick to real income as a measure of economic success, following Adam Smith in his Wealth of Nations, perhaps the first systematic approach to working out what makes the economic pie bigger. Whilst Smith's perspective (and that of growth theory generally) is about increasing the income of an economy, we might also consider the question of the stock of wealth in an economy. By wealth in this context, we don't just mean financial claims, but rather the wealth of the whole country or world.

There are, broadly, three proposed solutions to the problem of growth: accumulation, division of labour, and capability more generally.

Growth can be driven by accumulation: more capital; more people (population growth); or more nature ie the extraction of more material energy or other materials from the earth. In each of these cases, we are explaining more 'output' from more 'input'. How much of economic growth can be explained by more input? Solow defined his famous growth model where he considered how much of economic growth could be explained by capital and labour accumulation. His result: accumulation could only explain a small amount of economic growth. He named the residual 'technology'; but in fact this residual consists of a number of factors which we now consider.

Adam Smith made use of the principle of division of labour in his Wealth of Nations (Smith 1776). By dividing up the manufacture of pins into many steps, each step could be more productive. Smith's competitive approach could be contrasted with earlier Arab economist Ibn Khaldun, considered the division of labour as a way for cooperation to enhance the goods provided in a society (Olah 2018). Division of labour makes each step of the production process more efficient, requiring less labour for a given level of output.

Whilst a 'labour theory of value' cannot explain all the differences in prices between goods, labour is generally the most important element in the prices of goods. As Samuelson, quoted in Blaug (Blaug 1997) puts it "The operational significance of a one factor model is the importance it gives to technology". Translating this into simple English, as labour is the most important factor, using less of it can raise real incomes. When we divide labour, we increase efficiency. Two people doing separate parts of a more finely divided production process is more efficient than one person doing both tasks. We can also say, therefore, following Smith, that increasing the *size* of a market can also increase wealth, because a larger market, with lower transportation and exchange costs, can divide labour more finely. This is also an argument for free trade.

We can also say that technology is a public good, created by R&D and science. Finally, we should talk about capability more generally. Charles Babbage argued that the economic success of a society was dependent on a 'capability triad': production capabilities, business organisation and economic governance (Hilton 2017). Therefore success requires a certain amount of activism by government: to promote capability in industry, good management and good governance.

Implications for the Tax and Welfare System

What are the implications of all this for taxation policy? Smith himself argued that a good tax system should minimise the discouragement that a tax causes to economic activity.

We can say ourselves the following things:

1. Tax should minimise the barriers to division of labour; and should not discriminate in favour of companies over markets between individuals;
2. Tax should encourage the accumumation of skill and physical capital investment[1]
3. Tax should encourage the development of capability.

[1] this latter point is not uncontroversial given increasing automation, and depends on wide ownership of capital

A3-2 Distribution: How big a slice does each person get?

The final big question that we consider is that of distribution. Distribution typically refers classically to the distribution of the economic cake between those that own land (landowners), those that own companies or other non-land wealth (capitalists) and those that only own their own working time (labour). We covered this in Chapter 1.6, so we will only make a few more comments here.

It is important to distinguish between justified and unjustified Wealth. Justified wealth consists in wealth that is derived from work, the creation of some product of value (or at least wanted) in society - the provision of goods and services. Unjustified wealth consists in effectively extracting the wealth of others. Such wealth is not acquired by the addition of anything valuable to the economy, but rather is gained from endowments or second-hand value creation.

Who Really Pays A Tax? Economic Incidence of Tax and Spending

Another important aspect of distribution is who pays a tax. Taxes are not always paid by those who are the immediate tax payer. In general the theory of incidence suggests that taxes are paid by the most inflexible factor: e.g land, other monopolies.

But public spending also does not always benefit economically the initial recipient. If public services are shared over some area where high quality land is scarce, then it will be the landowner who benefits, not the direct individuals who are tenants. Whilst the advantages of living in an area may go up with better public services, if landlords can charge higher rents in so doing, then the benefit of increased spending may go on increased rent. The Henry George theorem states, that under certain conditions, the beneficiary of all public spending is the landowners. This effect can be seen in practice with a new railway link. In fact, in Hong Kong, new links on the metro are financed by purchase of land near new stations. This provides another justification for taxing the unearned increment on land value.

Persistent Profit from Companies

We have already discussed land in some detail. But we should also consider taxing other forms of profit, from companies. Some situations are natural monopolies; others are government created types of monopoly, and finally the dynamics of some production and sales processes naturally favours larger firms.

All situations where an individual or company has some non-replicable advantage can make something similar to rent. Profits can be competed away, rents are permanent. So we sometimes see the phrase 'rent' used in other situations than land, to mean the permanent component of profit. Warren Buffett makes this explicitly: he seeks companies that have a 'moat' to their 'castle', the castle being the profits made and the moat being the barriers to other companies competing away their profit.

Taxes on profits, especially persistent profits, therefore make a lot of sense. We need to find a way that these profits taxes can't be taxed away. Finally some firms such as Amazon make a return without making profit at all, by capturing market share they force out the opposition creating a global form of monopoly. So we will need to find a way to tax corporate wealth independent of profit. We cover these these topics in Part 7 on Corporations and in our proposals (Part 12).

A3-3 Allocation: From What Should the Economic Cake Be Made?

Governments influence the allocation of economic activity two main ways:

- First, governments spend money, therefore directly allocating what is done. They can also lend themselves or direct lending of the financial sector.
- Second, governments create the systems of tax and regulations which guide and directs the private sector.

In both senses, it's important that public goods are taken into account.

Economists often talk of value, by which they usually mean *private value*, which is the benefit generated by someone producing goods and services; and the benefit the consumer receives from buying them. Economists also speak of 'public goods' as those which have various characteristics. The first is that we can't avoid consuming them for better or worse. Also, consuming them does not preclude others from doing so (they are non-exclusive). Some public goods have neither of these characteristics, yet are still provided publicly.

All these reasons provide justification for public goods to be created and shared. Taxation is a way of funding those public goods. However, tax and spending is not the only way of providing public goods. Charities, civic society, individuals and culture can all provide public goods, and the provision of private goods and services as a whole can also be seen as a public good. For example, a locality where there are lots of easily available shops and other services is a kind of public good, because those private goods assist each other in benefiting the people who live there.

Implications for the Tax and Welfare System

Creating the right incentives is key to influencing people to behave in a beneficial manner, and the tax system is largely a system of incentives and disincentives. Strangely, the current system incentivises activities we don't want and disincentives activities we do want. To improve people's choices, we have to change these incentives. We should tax activities that are harmful to others or to the natural environment. This will both reduce/discourage the negative activity and make the actor 'internalise' the harm done by the activities. It will help create a fair playing field for less harmful competitors. There are two types of harmful activity which could be taxed:

- Activities that harm others or the environment: in these cases activities should either be banned (now or in a forward-looking sense) or taxed;

- Activities that harm the individuals themselves such as smoking or excessive sugar and meat consumption: here we need to create a benevolent environment for the individual that does not encourage the harmful activities. This includes having the right incentives especially for the corporate sector (e.g. a sugar tax impacting the composition of breakfast cereals).

A3-4 Demand: Does the cake rise to its full potential?

Tax and Welfare are important. They are the principal tools by which governments raise revenue to provide public goods and support the poor. However, taxes must be justified on some basis, if they are to exist at all. The common answer is that tax is needed to pay for common services.

More generally, taxes are needed because two classes of goods exist in society: private and public. Private goods are those provided by the market economy: i.e. by individuals and companies when acting in a commercial capacity. Public goods are those that benefit us all, like a secure country and public infrastructure. We need taxes to pay for and regulate public goods. The tax system is intended to raise revenue for the provision of public services.

But this is not the only viewpoint on the primary purpose of taxation.

MMT

Modern monetary theory (MMT) argues that the purpose of taxation is slightly different. The purpose of taxation according to MMT is to mop up money that is created by public spending. This is an unusual perspective because most people believe that the government needs to tax or borrow money before they can spend it. From the perspective of MMT by contrast, money is simply a collection of tokens acceptable in the payment of taxes and created by public spending in the first place.

The purpose of taxation within MMT is to control inflation. If more money is issued than there is demand for, the value of that money will degrade relative to the real economy. This means, that even with an MMT perspective, there presumably needs to be some taxation. MMT supporters generally believe that the government can and should run a fiscal deficit but that this deficit is limited by the effect on inflation rather than some requirement for 'austerity' to keep the public debt down.

So, even proponents of MMT believe we need taxation. But taxation is not the only way to fund the government. There are many options, including fees for govt services, charging rent etc. But the usual options are taxation, issuing bonds, or printing money. On a basic level, we need to tax roughly as much as the government spends. There could be a fiscal deficit, but it should be of a moderate level in normal times.

Fiscal Deficits

The MMT perspective is similar to thar of 'functional finance' as described by Abba Lerner. According to this perspective, the purpose of the government deficit is to keep the economy running at full capacity (Lerner 1943). Government debt will take care care of itself as long as the economy is growing. This is a perspective born out by the post-war experience. (See part 10)

What we are dealing with here is the problem of the correct amount of (effective) demand. Effective demand is really the amount of spending power that agents have in the economy. The government can influence this in two ways: through fiscal and monetary policy. Fiscal policy is the overall budget balance of the government. When governments borrow more than they spend, this increases the budget deficit, which also increases the spending power of those in the economy.

Monetary policy involves changes to interest rates, which effects asset values. It also effects the exchange rate. In low-interest rate environments, fiscal policy is particularly effective and monetary policy less so ('pushing on a string' in Keynes's vivid phrase).

Thus these two forms of macroeconomic policy (fiscal policy and monetary policy) can both be used to help guide the economy, and solve the short term problem of effective demand i.e., 'how much does the cake rise'.

Our goal here is not to discuss fiscal policy specifically: we assume here that the overall fiscal balance (the difference between spending and taxation) will be determined correctly. Our scope here is the long term matter of *how* to tax, not the short term matter of *how much* to tax.

Implications for the Tax and Welfare System

So what are the implications of the macroeconomics of effective demand for tax policy? Firstly, tax policy, in redistributing income and wealth, can increase effective demand and growth. Second, management of the public debt is vital and should be considered in more detail, both from a fiscal perspective and from the point of view of the effects of interest rates on other asset classes (and therefore the interaction with taxes in these areas). In short, low interest rates increase the asset prices in other areas, and that effect can be mitigated by taxes in these areas. So reducing interest rates can be combined with a land value tax and higher taxes on companies.

A3-5 Selling Cake Slices: The Price of Goods

Modern economics as taught tends to consist at an elementary and intermediate level of the marginalist analysis of Alfred Marshall. (At an advanced level it also includes the more complicated and mathematic treatment of Leon Walras's 'General Equilibrium' analysis. Here we focus on partial equilibrium)

What does this analysis consist of? And what is the relation to classical analysis? Let us consider John Stewart Mill's writing (as mentioned in Mark Blaug's book) because his theory shows that the later classical and neoclassical theory of price determination are equivalent. The classical theory is in some sense just bringing out special cases of the neoclassical theory. But those special cases are important. They are the distinctions that really make a difference.

OK, so let's first describe the neoclassical (Marshallian) theory. he neoclassical theory is very simple to describe: price is set at the intersection between supply and demand.

As the price goes up, the amount demanded will, in general, fall. It goes down because fewer people are willing to pay.

The supply curve represents the amount of a particular good that will be supplied by firms at different price levels. So as the price of the good increases, it is in general assumed that there will be more firms able and willing to supply the good, and more of that good can be supplied.

Classical Theory in Neoclassical terms

The classical theorists also had a theory of price and they focussed mostly on the supply side of the coin. Mill suggests three separate possible outcomes: the first when supply is in inelastic, the second when there's a completely competitive market and finally the last, when there's some diminishing returns, i.e. that the cost of production increases when the amount required increases.

The first case is the easiest. Imagine there is a completely fixed supply of something. For example, there's some plot of land in a desirable location. None of the locations around it are quite the same, and in any case, they are in limited supply also. Since the supply is fixed, the demand for that land is determined by the price that the market is willing to pay, and not by any cost of production (since there is no production: it's fixed in supply)

The second case is also straightforward. Imagine that there is a product that has a fixed cost of production and is made by a large number of competitive producers.

The final case is of diminishing returns. Imagine that there's some good, let's say oil, that is easy to produce in some places (say Saudi Arabia), but hard to produce in others (deep water drilling and oil shale). In the easy places, the cost of production is low, in the hard places the cost of production is high. In this case, the price of the good will be determined by the cost of production of the marginal producer, which is in turn determined by the demand schedule.

So the price of oil is determined by the cost of producing a marginal extra barrel of the market-demanded amount of oil. Of course the market demanded price of oil is itself dependent on price. That's why we intersect the demand and supply curve to see what's the price of oil. [Maybe change the above to grain instead??]

Implications for Oil

Imagine we had a closed economy with a single government. The oil market shows the two types of taxes that could be imposed. A land value tax would be a tax on the surplus profit from owning some piece of land when oil is on. It does not shift the point of intersection but rather merely taxes the net profit of producing oil.

A3-6 Selling Cake Shops: The Price of Assets

Now we mentioned that ownership of land gives rise to a surplus. But what about the value of the land? What would that be? We can consider therefore ownership of land as conferring that surplus. What should the value of that set of surplus flows be?

One method for analysing this is known as discounted cashflow analysis. This computes the value of a set of cashflows according to interest rates seen in the economy. So for example the value of a piece of land that pays £5000 per annum might be computed as 5000/r, where r is the long term interest rate. So for an interest rate of 0.05, the total value would be 5000/0.05 or £100,000. At a lower interest rate of 0.02, the value wold be 250,000.

What about if the value increases in time? Let's say that the rent goes up by 1% per year. In this case, the formula again wold be very simple a/(r-g) where g is the growth rate and r is the long term interest rate

A3-7 Beyond the Cake: A New Economics

In order to understand why the system is working the way it is, we need to take a look at the the tool-kit used to build it: mainstream neoclassical economics.

Mainstream economics treats the world as being full of rational people, all looking to best maximise their own personal utility. This utility maximising tendency is the engine behind the flows of demand and supply that interact in efficient markets and influence price levels that then help distribute scarce goods in a manner. However, people are not always rational, and markets are not always efficient.

What does that mean for this brand of economics then? Clearly, a lot is missing.

Here we highlight three missing aspects: time, space and life.

Time

Time is important because much economic activity is about storing value for the future. An example in simple terms would be when an individual stores financial assets (such as money) in a bank and the economic system grows these funds in investment opportunities and ensures that society, as a whole, increases its stock of wealth. That's the theory anyhow. One important factor in economics is ensuring that all this works effectively.

Space

Space is important for two reasons. Firstly, each square metre of earth's surface is unique. It cannot be replicated. Thus, ownership of such a piece of land represents a monopoly in that it cannot be replicated. Secondly, we all share in space. This means we all share in generating public goods in the space around us. This includes those created by the public and private sectors. We also share in creating public bads in the space around us, such as pollution.

Time and space interact with real estate. Since land is an infinitely lived monopoly (each piece of earth's surface is unique and lasts forever, for all practical purposes anyway), it has special features in terms of low interest rates. In other words, land is a long-lived asset and it becomes very valuable in low-interest rate environments. This was demonstrated in the follow up to the financial crisis.

Living Systems

Life is the third class of elements missing in mainstream economic thought. Living systems are fundamentally different from non-living systems. Living systems are typically in a state of homeostasis rather than equilibrium. This is a steady state which requires active maintenance and energy input. For example, it takes energy to maintain a constant body temperature of 36.7 Celsius. Biological systems also require certain environmental conditions and cannot exist beyond certain ecological limits. Ecological economics considers that human economy is embedded in nature and it argues for a sustainable economy that would also exist in a steady state.[2] So life is not only a crucial element to our planet that we need to preserve, but also a rich set of understandings of the fundamental nature of things. So

[2] This alludes to an ecological / steady state economics approach. See: `http://www.steadystate.org/discover/definition/`

just like 19th century and 20th century economics often uses analogies from the physical and engineering worlds, we need a new set of understandings based on the nature of life itself.

Human systems develop *capability*, and this capability is embodied in individuals, companies, networks and whole societies. Understanding capability both for private and public ends can allow us to progress further.

PART 4: Public Good Economics

This book is about economics for a certain type of world. In this world, there are some goods that can be added to, either in quantity or quality; there are some goods that are fundamentally fixed; and there are some goods that can be degraded or destroyed. By 'goods' I mean broadly useful natural or artificial things. These positive, limited or negative things can apply to both public and private goods. We need an economics that not only considers the parts of the economy that are additive (growth economics) but also those that are fixed (distribution economics) and those that are 'subtract-able' (environmental economics).

Environmental economists also distinguish between goods that are *excludible* and non-excludible. And also those that are *rival* versus non-rival. Related to rival-ness is *subtract-ability*. So pure public goods are non-rival and non-excludable. Club goods (for example, watching a pay-per-view sports match) are non-rival (it doesn't cost anything for someone extra to watch it) but excludible. Common pool resources are rival but non-excludible. They are also subtractable. [VERY CONFUSING, EXPAND AND REWRITE]

Introduction to the Topic: Types of Goods

In economics, we are familiar with the concept of private goods. A private good is one owned by individuals. Those individuals can exclude others from the use of the good. The individual can maintain or augment the good. The value of the good is not particularly influenced by the action of others. In technical language, the private good is excludable (others are not permitted to use it unless the owner lets them) and rival (the use of the good by one person prevents its use by another person). The good is also additive – we can add to the good.

However, there are other sorts of goods as well. For example, they are public goods, common pool resources and club goods.

Public goods such as knowledge are non-rival and non-excludable. The use of knowledge by one person does not prevent its use by someone else. Usually, knowledge is also non-excludable. For instance, we can't prevent people from learning about science.

Club goods are those that are non-rival but excludable. For example, if I were to watch Premiership football on Sky tv, it does not prevent my neighbour from doing so. But Sky can charge me for the privilege of watching Premiership football, and prevent my neighbour, who doesn't pay, from so doing.

Common pool resources are typically non-excludable or at least, difficult to exclude. But they are generally either rival or subtractable. For example, a fishery can be overfished. The fishermen are subtracting from a renewable resource. If they fish too much, the fishery will be depleted and there may not be enough fish to breed and thus replenish the stock of fish. So one fisherman is taking fish from what by definition another fisherman cannot take. In other words, fishing is a rival activity. The fishery in total can either be open to anyone or may have access control through permit. It's this access control that is vital to maintain the fishery.

Appropriation versus Provisioning

In relation to common pool resources, Elinor Ostrom distinguishes between appropriation activities and provisioning activities. An appropriation activity is to take benefits from a common pool resource. For example, a fisherman taking fish from a lake. A provisioning activity preserves or enhances a common pool resource. For example, an investment in maintaining the fish stocks through providing breeding ground or controlling access to the lake.

Sometimes, the provisioner and the appropriator may be the same person. For example, if the lake is privately owned, the owner can maintain the fish stock (provisioning) and also take fish out of the lake (appropriation). In other cases, this is impossible. So for example, it's impractical for a fisherman to own parts of the open ocean.

On the other hand, sometimes the rights to appropriation of resources can be privately owned. Take for example, a city. The quality of life in the city and in particular, the value of land in it, is generated by the collective action of the residents, municipal and national governments. The value of a piece of private land is not solely determined by the actions of the owner of that land. For example, if the municipal government invests in a new metro line, this will increase the value of the land near the metro stations. Or if the local authority removes litter from the area and the local people improve the attractiveness of their gardens, it will also increase the land value. Thus, the landowners are, in effect, the appropriators of value and the government and other members of the community provision that value.

This book argues that value does not solely reside in private goods but also resides in public, common pool and club goods. Individual action to maintain and enhance these goods is not solely motivated by financial considerations. However, actions by companies and other private corporations are primarily motivated by financial gains.

Therefore, if companies and individuals are to behave in the public interest, they need to have private financial interests that align with the public good. Hence, one of the principles of this book is to correct for negative externalities. Where a private action negatively impacts common pool resources, a private actor needs to pay a fee for his action to compensate the public for the damage caused. This fee discourages the private actor from damaging the public resource.

Marketable Assets as Rights to Appropriate

When we talk about private property, by definition, this involves the rights to exclude others from that property. This is almost the definition of a private property. So we can have private property over private goods (for example a car/automobile) and we can have private property over club goods (for example, the rights to transmit Premiership football on TV). Private property can also encompass the rights to exploit public goods. As just mentioned, a piece of land in a good location appropriates the value created by the community in terms of public infrastructure, pleasant environment, government provided goods and services, etc.

The financial value of an asset can be modelled as the excess of the rights to appropriate public goods over the cost of provisioning those goods.

Do owners of assets also have a responsibility to provision public goods that they benefit from? It is an unfamiliar notion in the modern day. However, in feudal times, assets often implied responsibility as well as rights. Even today, we can see a residual of this kind of thinking. When purchasing a private house, the land underneath the house can come with a legal covenant to give responsibility of the landowner to assist in repairing local churches should they need maintenance. Another example is the responsibilities and duties of care associated with various activities. For example, the constructor of a new nuclear power station has responsibilities to keep the power station safe and to decommission it at the end of its life. Of course, it is more familiar to us that assets are taxed, rather than having specific resposibilities attached. But often neither is the case. The Duke of Westminster, who owns much of central London, pays little tax, as there is no direct land value tax and his profits and the inheritence from one generation to the next is protected by a legal trust.

The value of an asset in marketable terms is therefore, generally in excess of the financial value of the flow of rights over flow of the responsibilities. In some sense, therefore, you can see that where those rights to exploit public value are not equal to the value contributed to the society, then such private property lacks legitimacy. Going back to our previous example, the Duke of Westminster's ancestors provided services to the British monarch of the time and in exchange were granted substantial land ownership in what is now central London. But the current Duke of Westminster does not himself provision the metro services that creates the land value that he charges in rent.

Discussion of the justice of land rent, however, leads us to a quandary. The ownership of an asset that exploits public value more than it contributes to public value can itself be purchased. The asset (i.e., the net flow of rights over obligations) might be lacking justification, but the money used to purchase the asset may well have been legitimately earned. Thus, taxing or nationalising the asset without compensation may be unjust because it appropriates the original money used to purchase the asset. We discuss ways to resolve this conflict later in this book.

Example of building and then selling a house: Imagine that an individual built a house. He uses his own labour to do so and once the house is built, he sells that house. The house is situated in a location distant from major population centres such that the value of the land on which the house stands is negligible. In a broad sense therefore, the individual has made or provisioned an asset, the house, and he can extract money from selling that asset.

Example of land: Imagine another possibility. In this case, the individual works to purchase a house in a desirable location. The work he puts in is in another area – for example, he drives a bus. He saves money and uses that money primarily for the purchase of the land on which his house stands.

Secondary Wealth Accumulation: The second house goes up in value. The location, which was already valuable when he purchased the house, becomes even more valuable. This increase in wealth has not been directly earned by the individual's work but rather was due to a new metro system that was installed by the municipal government close to the house.

Fair Land Taxation: A new tax system should deal fairly with all these three situations.

Let's think now about the transitional justice implications of a land value tax. Those arguing for a land value tax would point out that the value of the land has not been created by the private landlords that we mentioned. Nevertheless, the value of land purchased initially and augmentation of that value has a different status from the point of view of justice. The initial money had been earned fair and square whereas the increase had not. A tax on land value increase is more just than one on the original purchase price.

Collective Action

Climate Change has been described as a 'super-wicked' problem. What does this mean? It has characteristics of wickedness plus more.

Two Traditions in Political Science

In this section we will describe the theory of collective action. there are two major traditions in political science. The rational choice perspective and the cultural perspective. Rational choice sees politics as the interaction between rational agents. Whereas cultural studies sees particular ways of behaving as being enduring, defined by 'culture'.

The two perspectives are perhaps a dual to one another. For rational choice requires some sort of consistency of preference, interest or behaviour. And it is this persistence that creates the cultural continuity that is the subject of cultural studies. So onwards, now, with the rational choice approach to collective action.Much of what follows is, I suppose, related to the rational choice literature. But we will also consider the cultural studies tradition.

The Prisoner's Dilemma

The two most famous fables are known as the prisoners dilemma and the tragedy of the commons. The prisoner's dilemma considers two prisoners in a tricky situation. The outcome of the game depends on what the others do. They have two choices to grass up the the co-defendant or to stay quiet. If they both grass, they get a long sentence. But if they cooperate they will get off with a small sentence. However, if one of them cooperates then they will

The Tragedy of The Commons

We've already met the tragedy of the commons in our earlier parable on our Tea Island Archipelago. Where access rights are unlimited to a common resource, that resource can be overwhelmed. Say we have a common and everyone has rights to graze on the common. Unless the rights to graze cattle on the common are controlled, it's likely that the common will be overgrazed. Why? Each person sees only the benefit of grazing, whereas the cost in terms of the reduction in the grazing that others can do is shared over everyone else involved.

The Logic of Collective Action

The logic of collective action also covers whether groups will act in their collective self interest. Let's say a group of individuals has some collective interest in some matter. Will that group act in its own interest? Mancur Olson's Logic of Collective Action studies this question. His conclusion was that groups do not always act in their own self interest. Unless they can motivate the members of the group to car about the things that they all have in common then individuals behaving selfishly will not necessarily uphold the interest of the group.

Olson suggests that it is only when the group can coerce its members or when there are members of the group with a *concentrated interest* where action to protect the interest of the group is likely. When everyone has only a weak stake in their collective good then little action is likely.

Evolutionary Game Theory

The prisoner's dilemma produces different outcomes when repeated. When games are repeated, different strategies can evolve. If an agent has defected in one time period they are less likely to be trusted in the next. Furthermore another playing entity can punish or reward past behaviour. In this context the so called 'tit for tat' strategy is considered a good one. Tit-for-tat punishes a past indiscretion. The 'generous tit-for tat' usually punishes defection, but also occasionally, generously, does not.

Collective Individualism

A trite oversimplification of the ideological clash of the cold war would be this. On one hand was (*individualism*). Under individualism the *market* determines outcomes and is the interaction of *individual preferences*. (there might be some voting process too, but this is viewed as non-core to the political system). In the collectivist system, the government determines the outcome. In addition there is a certain enforced conformity. New ideas are not welcome.

I want to describe a sort of synthesis. One synthesis is the distributed ownership of collective property such as land. In this we see the ideas of Henry George.

Another is an individual approach to *collective* provision. Consider a community bakery. On one hand this could be considered a provider of private goods. But on another it's a provider of a sort of public service. the community needs a bakery. It doesn't need two bakeries (unless it is a rather big community).

So what determines prices? Well in a small community, it's more likely that the community will determine a 'fair price'. The goodwill of the community is important. The community gets together and knows each other. They can decide to go elsewhere or set up a new bakery if the prices are too high or the quality too low.

These two examples show that if there are pervasive and important public goods

'As if' Altruism

Another useful way of thinking was described in the *Social Limits To Growth* by Fred Hirsch. Hirsh's book is famous for the idea of 'positional goods'. Unlike goods that are augmentable, positional goods are those that are essentially fixed. Later in the book, Hirsch describes a decaying moral legacy. He describes 'as if' altruism. As if altruism is a tValue of your vote

We can distinguish between the scarcity of a vote and the scarcity of free time.

Diminishing Returns

The world is not homogeneous. Imagine plots of land. You have a choice of what plots of land to farm. It makes sense that you would farm the easiest, most productive land first. Thus, as agriculture is expanded, the deployment of additional land suffers diminishing returns. As land area is expanded, the productivity of the new plots is less than those of the existing plots. Diminishing returns are a product that firstly the world has variability and secondly prioritisation. If we take the best plots first, then inevitably the ones left are less good.

Diminishing returns can also be found in a different context. Let's say we can add one factor to a process: for example labour power, but another factor is fixed (for example perhaps there is a limited number of machines).

PART 5: TAX IN PRINCIPLE

5-1: Why Tax?

It seems blatantly obvious that the authors of this book - **Tax Heaven** - would be in favour of taxation. Taxes are, as we have argued in the previous chapters, a valuable method to pursue a variety of social objectives. In fact, they are probably one of the most important tools at the disposal of governments, despite the negative press that surrounds their use.

It's time for a PR campaign. Death and taxes may be inevitable, but taxes do not have to inevitably negative. The careful design of taxes can minimise the negative impacts, such as regressive impacts, poor behavioural incentives or evasion. The importance of the implementation and planning process cannot be understated. Nor can the importance of effectively communicating the intended purpose of the policy. The optics of policy design are key to minimizing resistance, and maximising success.

There are, of course, those for whom the very mention of tax inflames strong passions. These passions exist across the political spectrum. Staunch libertarians claim that taxation is the blatant theft of private property, while social democrats often consider taxation to be a moral matter in the redressing of the unfairness of the free market. Emotions can, therefore, run high in debates on the purposes of taxation, and there often appears to be little common ground. This can make discussions of the philosophical basis of taxation somewhat difficult.

A precondition for successful design is, therefore, the comprehensive understanding of the purpose of the policy in question. In the case of taxation, this would be to answer the following questions: why and what do we need to tax; and what do we hope to achieve. It's helpful when trying to communicate the purpose of a new tax to try and answer these questions both about taxation in a broad sense, and the individual policy itself. To what target and at what level do we set the tax; to who do the proceeds go; and what behaviours are affected by its application. It is only when these questions have been fully considered that effective tax policy can be created. We will outline our principles in this chapter for effective tax design, standing on the shoulders of giants in the field of economic theory to develop our assumptions. Ensuring that the policies that we create fulfil the requirements of being 'practical, beneficial and fair' is also a priority of our work; and is something on which we will expand later in this chapter.

Why Do We Need Tax?

The first question that must be answered is why we should tax at all. Taxes are traditionally unpopular policies, often seen by the public as a 'tax grab' on private assets and wealth. It seems then prescient to give an overview of the key positives that taxation policies can have.

The simplest answer to this question is that tax is imposed so as to fund public spending. This government spending usually takes the form of investing in public infrastructure or on social provisions like housing, healthcare and education. The investment in these public goods is often only economical on a large scale – it's not often that one individual can be responsible for a public park. The pooling of resources allows for these public goods to be supplied to a cross section of society that would otherwise be unable to access them.

It's worth stating that the provision of public goods does not only come from governmental sources. Artists, writers, community activists and philanthropists can all be said to provide public services of their own. Cafés which offer public restrooms, private enterprises which fund local newspapers, and institutions such as charities all provide public goods and services. However, the benefit of governmental provision lies in its ability to prioritise and maintain these services through democratic decision making, rather than relying on private benefactors.

But why doesn't the government just print money to pay for these goods? The reason lies in legitimacy and inflation. Money is effectively an IOU of value from the institution that has issued the currency. If the government prints and spends money as it chooses, the legitimacy of this 'IOU' becomes compromised. Put more simply, if the government printed money on an unmanaged scale, this might cause inflation which would devalue the currency already in circulation. This can lead to, in extreme cases, hyperinflation and fiscal chaos, whereby money loses its worth making it increasingly difficult for subscribers to pay for their goods. This would also limit the ability of the government to invest in public goods. Without a solid basis of assets, a public body is unable to guarantee that it will be able to pay for goods on a long-term basis. This is, then, why tax revenue is so important.

There are several other ways in which a government can raise revenue. However, we identify taxation revenue as one of the core methods of supplying a government with the necessary funds for its activities. This is in line with Beveridge's principles of needing tax as part of a comprehensive policy package of funding ongoing public service.

As we have hinted, it may also be that one of the reasons for taxation is to maintain the fiscal order and control inflation. The difference between tax revenue and spending is a large component factor of the economic growth and inflation paradigm. This theory is not a focal point of our analysis. However, the macroeconomic influence of the public spending balance, and deficit, cannot be understated. It is important that Governments manage this ratio, for reasons of international credibility in their fiscal strategy, the ability to source debt financing for public projects, and the extent to which fiscal policy can be used to boost a national economy after a recession.

Another reason proposed for using taxation is also to emphasise the 'social contract' between a citizenship and their government. This is effectively a 'deal' by which the government is contracted to enact the aims and goals of those that they represent. Taxation could therefore be thought of as a method of enforcement of these designated responsibilities. It is, admittedly, not always the case that this is explicitly recognised by members of the government, but the 'I pay for your salary' argument can go far when shoring up a citizen's right to complain or to lobby for the specific actions of a representative body. By establishing this stakeholder-shareholder model, we change the status of the citizen in society to the decision maker, and natural recipient of any 'dividends' from natural wealth. We also change the status of the landowner to a consumer of national resources, rather than the owner themselves. The shift in dynamics here may have considerable impacts on future resource management in the UK.

As touched on, there are also several social objectives that can be achieved with the careful implementation of taxation. Redistributive policies are a large component of this public spending, sharing the wealth that is created in a collective society through income, housing and healthcare provisions. Another reason that taxation can be useful is to correct for monopoly pricing and externalities, or to change behaviour in some way that is designated as socially beneficial. Behavioural economists have only very recently, in terms of economic history, started to explore the nudge and norm-changing effects of taxation. These theories will be explored later in this chapter.

Of course, noble objectives remain mere concepts until they are realised. In the world of policy, it is sometimes best to think of these as akin to 'spectres' that haunt the messy reality of designing and implementing policy. In doing so, we draw from Derrida's ideas of the influence of justice in law – never actually achievable but rather existing as an influencing ideal that pushes the development of law (Glendinning 2016). The same can be said for the objectives of taxation. The ability for tax to tackle inequality and social bads will only ever be as good as the practical reality of such policies in practice. We will expand on this later in the chapter. However, important to take from this is the significance both of the influencing ideas and also of their implementation.

Deciding What to Tax

Taxes can be applied to a range of goods and services. We will, going forward, term these targets as the 'tax base'. Ranging from the financial (e.g. financial surpluses (e.g.(net) imports, profits, incomes over some threshold), to the consumed (e.g. luxury expenditures whose demand is insensitive to price), there is broad scope for the tax base of a potential policy.

Deciding which tax base to use can often be determined by the objective of the policy. Raising revenue is predominately achieved through income taxes. Taxes can also be used to for redistribution in society, such as when they are applied to the unearned increment on scarce resources that are fixed or limited in supply, or monopolised e.g. land, fossil fuels and endangered fish. Taxes could also help disincentivise environmental and health bads. These are activities that damage our common space. Such taxes may also help redistribute some or all of the surplus of those individuals, companies or geographical areas who are gaining financial assets.

Overall, the are four different types of activities that we could tax:

1. `Rents: Land, Property, Resources`
2. `Finance: Money Balances, Bank Balance Sheets, Transactions.`
3. `Environmental Health and Social Damage: Fossil Fuels, Transport Fuels, Greenhouse Gas Emissions, Alcoho`
4. `Cash Flow: Income, Profit, Capital Gains, Value Added (sales).`

But how do we decide which tax base to use. One solution is to create a decision framework based on selected principles of justice and benefit. We define these as the preconditions of practicality, benefit and fairness, which will be elaborated on later in this chapter. The questions that we can ask ourselves to build this decision framework will help shape the ultimate design of the tax policy. This could apply to the schedule of assets that we decide to tax.

The first order of deciding the tax base could be based on efficiency. By asking the question of whether the private value of a good reflects its social value, we can identify the tax base. Where private value is greater than social value, taxes would then be levied to the extent where these two values are equivalent. If there is a need for more revenue after taxing this value difference, we could then prioritise efficiency by taxing things that are fixed in supply. Such a mechanism would avoid the distortionary incentives that taxation can have on income or wealth.

We could also choose to select this tax base on grounds of equity. By focusing on tackling private value inflation, we would begin to reduce the rate of growth of inequality in the UK (Piketty 2014) by reducing the windfall gains associated with the returns on capital and wealth, as opposed to income. In doing so, we could preserve justice in the system. However, care must also be taken to ensure that existing asset values are not changed so dramatically as to cause injustice in the transitional process. One way in which to achieve this is by focusing these taxes on future increases in private value above the social value, rather than on the existing allocations.

What are the Objectives of Reform?

It seems then that what we choose to tax, and at what level, depends on the purpose of the tax itself.

If the goal is to reduce inequality, then taxes can be applied to private assets and income. Such taxes target the accumulation of wealth to both recapture societal contributions to its formation, and to ensure inequality does not grow extensively. Some argue that these taxes target oligarchy and monopolistic control of assets. We define *Oligarchy* as 'rule by the few', specifically by the rich, which can be an issue due to the disproportionate power that can be associated with a small number of wealthy people controlling the majority of a nation's assets. Assets can often be synonymous with political power, which some postulate as being a negative for society. For example, such oligarchic groups could have a distortive influence on the tax code so that it better suits their interests. This may pose problems for the majority.

Another area where the tax system could potentially be used to benefit society is with the environment. Environmental taxes can help to ensure that the global environment is not damaged by our economic activities. Pollution is often considered a negative environmental externality. It's good for society to internalise these costs, and thereby reducing them. By adding a cost to these 'negative externalities' with a tax, the taxing 'bads' helps to reduce their output.

It is not just in the levying of the tax that this mechanism can be beneficial. Ensuring that the beneficiaries of the tax, i.e. where and on what the revenue is spent, correspond with the stated social aims behind the tax policy can bring a 'double dividend' of impact. For example, taxing polluting fuels and using the revenues to subsidise clean energy could potentially accelerate the development and implementation of clean energy provision in a country. Moreover, if a tax looks to have regressive impacts (i.e. hits the poorest in society at a disproportionate level, such as income tax), the revenues from such a tax could be given as a rebate to those most negatively affected to ensure that the policy retains political viability, as well as a broadly positive impact. We see this in the form of modern welfare benefits in the UK, despite the well-publicised problems in the system. These will be explored in a later chapter which explores the history and functionality of the UK welfare system.

5-2 Historical perspectives

Much of economic theory has considered what an ideal tax system should look like and how the practical application of these principles would function.

Adam Smith is perhaps the most celebrated economist to have considered this subject. He postulated that there were four axioms of taxation, which were that taxes should be convenient, objective, low cost both in terms of the direct costs of their administration and the discouragement they cause to others, and that they should be levied proportionally to an individual's ability to pay. In 1776, Smith (1776, Book V, Chapter I) argued that:

"Good taxes meet four major criteria. They are (1) proportionate to incomes or abilities to pay (2) certain rather than arbitrary (3) payable at times and in ways convenient to the taxpayers and (4) cheap to administer and collect."

A tax on land rents is also mentioned by Smith as an example of an optimal tax policy, writing the following;

"Both ground-rents and the ordinary rent of land are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own. Though a part of this revenue should be taken from him in order to defray the expenses of the state, no discouragement will thereby be given to any sort of industry. The annual produce of the land and labour of the society, the real wealth of the great body of the people, might be the same after such a tax as before. Ground rents and the ordinary rent of land are, therefore, perhaps, the species of revenue which can best bear to have a peculiar tax upon them"

David Ricardo (1821), Henry George (1879), John Stewart Mill (1848), and Alfred Marshall (1890) have also argued for the advantages of taxing land rent. Developing on this concept, Ricardo put together a model of different land qualities and their respective qualities and rents. He recommended a tax on landowners rent to ensure fair management of the limited land resources in the UK. Henry George also recommended a tax on land rent, extending Ricardo's reasoning to urban land. He noted that the speculators always would win, at the expense of everyday people, if land values were not regulated through taxation. Frank Ramsey (1927) extended the argument to commodities in general, developing a formula for optimal taxation such that those commodities most inelastic in supply or in demand should be taxed the most. His work argued for the inverse elasticity rule: the amount of taxation payable on a commodity would be proportional to the sum of the reciprocal of the demand and supply elasticity for that good.

Meanwhile Arthur Cecil Pigou (1924) developed the idea of taxing negative externalities. These externalities can be defined as situations in which an economic activity damages actors who are external to the transaction concerned. A pertinent example would be pollution. The polluter pays principle has now become a major part of environmental policy theory, with major institutions like the IPCC and the World Bank arguing for the importance of a carbon tax in managing global emissions. Closer to home, political institutions such as the Green Fiscal Commission in the UK have analysed, and recommended, carbon taxes as a way to reduce environmental bads. These findings are similar to those of the Mirrlees review, and indeed the Government currently applies a 'carbon price floor' as a method by which to achieve this.

On wealth and inequality, there is a substantial body of work on the impact that taxation can have. Keynes' Polish contemporary, Kalecki, argued that taxation of wealth would increase effective demand and therefore economic growth without stifling incentives (Kalecki 1937). And more recently Piketty (2014) has shown the consequences for the growth in inequality if wealth and high income are not sufficiently taxed.

There have also been several contemporary reports into taxation in practice. The UK was the source of the preliminary exploration of what was to be the basis of the modern welfare state. Beveridge's comprehensive plan for a 'cradle-to-grave' tax and welfare system was ground-breaking in its day, planning to use progressive taxes to discourage and to pay to ameliorate the five great evils he identified. More recent updates on modern taxation in the UK have included the Meade Review on direct taxation (Meade 1977) and the Mirrlees Review into taxation (J. A. Mirrlees et al. 2010), (Mirrlees et al. 2011). The former recommended a cash-flow taxation system of taxing consumption, findings which were echoed by the Mirrlees study. This study found that applying a deduction for the normal cost of capital could achieve comparable results, alongside a raft of other land-based taxes (such as a land value tax/proportional property tax) to replace business rates and/or council tax. There have also been similar reviews in Canada (Carter et al. 1966), the United States (Bradford 1977) and, more recently, in Australia (Henry 2010) and New Zealand (Evans 2011).

Standing on the shoulders of these giants, we can derive two general principles. First, that the allocation of capital needs to account for the total costs and benefits to society, rather than just to the private profit of an individual. This involves a rethink of what property rights actually entail and will enable taxes to be used to enact broader social aims. Using taxation to internalise the *externalities* that result from economic action will therefore ensure that the total benefits and costs are incorporated into economic decision making, which in turn will combat the inefficiencies and market failure of allowing these to persist.

Secondly, the importance of distributed ownership of and returns from assets becomes clear. Any taxes that are implemented should prioritise the minimisation of any inequalities that might result. This, in turn, means using taxation and regulation to manage the ability of an economic actor to assume monopolistic control over private assets and exploit *economic rent*. If we convert this into economic language, we can say that the priorities for any taxation system should be to focus on externalities and rent.

5-3 *Principles for Taxation*

In our introduction, we discussed the core questions that must be answered if taxes are to be used effectively. Rather than being understood as an important tool for social progression, taxes are relegated to an inevitability, a necessary evil, and a yearly burden. As the old saying goes - there is nothing so certain in life as death and taxes.

But, even if we assume that taxes are a necessary evil, then we must establish some guiding principles on how they should be applied. If we accept the idea that taxes should be focused on the two broad economic aims of managing economic rent and externalities, then the next step becomes to establish how exactly these policies should be designed to do so. Key considerations include the political acceptability of said policies, and the careful design of their implementation and structure to minimise any unwanted and unanticipated impacts.

By doing so, we create a framework that serves to sense-check the policies that have been put forward. As our starting point, we have chosen three core characteristics which we suggest that all taxes should possess. These are as follows: that taxes should be *beneficial*, *practical* and *fair*.

In other words, we are prioritising any new policies being "without harm", "just", and "functionable". To any one fed up with policy-wonk, the clarity of such definitions is evidently important. For this purpose, we will walk through the expanded definitions of this criteria below.

Beneficial (Not Harmful)

To be beneficial is to do good overall. There are multiple ways in which different taxes might be said to 'do good', and people may fairly disagree on what 'good' means. However, all taxes must have some legitimate claim to be beneficial. Most would agree that a tax is beneficial if it pays for valued public services. For example, taxation that pays for our National Health Service, our emergency services, our roads, schools and public transport, is generally considered necessary and beneficial. This is evidenced by a recent survey of British citizens (PWC 2017) which found that the majority would be willing to pay more tax if it leads to improvements in the quality of the NHS.

More contentiously, taxation may be said to be doing good by redistributing income (or at least ensuring that the rich contribute more), helping to alleviate poverty, and reducing large wealth disparities. The proceeds of tax may be also used to ensure a minimum standard of living by providing an income 'safety net'. This is evident in countries which have adopted the 'welfare state' ideology, whereby taxes levied on income are used to create a cushion for those at the lower income spectrum.

Taxes can also be used to discourage antisocial and harmful behaviour by individuals and companies. They may do this by compelling those who cause harm to society through their economic activity to pay for that harm. A contemporary example is a carbon tax, which might be imposed on companies whose actions damage our natural environment, and health, by polluting the atmosphere with carbon dioxide. Such a tax would encourage companies to find less-polluting ways of doing business. Taxes which operate in this way are often said to 'internalise' social costs by forcing economic actors to pay for harms they cause. By taxing harm, it encourages companies to include these costs in their decision-making process. The taxes gathered could also be used to undo some of the harm caused, such as by subsidising non-polluting sources of energy or investing to alleviate the problems caused by pollution.

Related to these other purposes, taxes might also serve the purpose of rationing scarce resources. One oft-used definition of economics is 'a science which studies human behaviour as a relationship between ends and scarce means' (Robbins 1932). Taxation can be used to fairly ration resources which are inherently limited, such land. Of course, if tax is not used for this purpose, land will still be limited. Instead the private sector, specifically, the existing owners will ration the resources through increasingly higher prices (rents), and in so doing provide unearned value or income to those who control them. Taxation can be used to ration economic rents from resources which are common or publicly enhanced so that the entire country benefits.

Fair (Just)

There are three ways in which we think taxes must be fair. These are by maintaining consistency, progressivity, and transitional justice.

As seems obvious, the first condition is that taxes must be fair by being consistent. Identical persons, companies and situations should be treated identically. There should be no special exemptions or 'sweetheart deals' for favoured individuals or companies. This seems obvious. In practice however, this principle is often flouted by powerful companies.

Related to this idea of fairness are concepts of accountability and transparency. Taxes must not just *be* fair but must be *perceived to be* fair. Taxes should therefore be clear and transparent, such that it is apparent to everyone what the proper tax burden should be for each income bracket. These issues are particularly topical in Britain today. In early 2017, the Parliamentary Public Accounts Committee expressed concern that HMRC's 'lack of transparency' concerning high net worth individuals 'has eroded public trust in a fair tax system' (Committee of Public Accounts 2017).

Another, perhaps more controversial, kind of fairness concerns *progressivity*. A progressive tax is a tax in which those who have more, pay more. UK income tax is thus a progressive tax as richer citizens pay more proportionally than poorer citizens. We think that this is fair and thus we believe that taxes should be fair in the sense of being progressive. However, this viewpoint is not without controversy.

Fairness is also relevant to our discussion of economic rents and land values. When land values increase because of work performed by society as a whole, by our definition it would be fair if all citizens benefit. It would seem unfair for only some people to benefit. Similarly, it would seem unfair if only a few people benefited from the country's natural resources - resources which were not created by any person, but which form part of national wealth.

Finally, fairness is necessary in the transition from the existing system to the new system. This is necessary not only for reasons of justice, but also the political feasibility of the reforms: if they are seen as unfair, they would be unpopular.

Practical (Functions Smoothly)

If a tax was fair and intended to do good, but couldn't be implemented without requiring masses of paperwork, or prohibitive costs, or extreme social controls, then no matter the benefit, it would not be justifiable. Taxes must be practical to implement.

When considering whether a tax is practical, we might consider how close it is to a theoretical ideal. Ideally, a tax should be simple to implement and administer. It also should have low collection and compliance costs. This means that it should not cost the government huge sums to collect, and it should also be simple for taxpayers to comply with. The less paperwork, time-consuming research and confusing the rules involved, the better. Taxes which are automatically collected are more practical in this regard than those which require excessive amounts of form-filling and record-keeping.

One pertinent drawback from over complication of tax policy is tax evasion. This has been a particularly hot topic in recent years. There is a difference between tax avoidance and evasion. Tax avoidance is the *legal* dodging of tax; tax evasion is the *illegal* dodging of tax. A tax which is easily evadable or avoidable will not be practical because it will not function to increase public funds. It may also require significant resources to be wasted chasing up non-complying 'tax cheats'. It is also important to avoid an international 'race to the bottom' where countries compete to reduce tax rates on companies and the super-rich. Ensuring that taxes are as smartly designed as possible, within a holistic policy package, will help to reduce this risk.

Another aspect of practicality is predictability. Individuals and companies must be able to predict future expenses in order to manage their financial planning. In a similar vein, taxes must be clearly defined so that taxpayers can plan their affairs while knowing exactly how much tax they can expect to pay. This scenario emphasises the need for steady transitions and well communicated policies when applying any policy change.

5-4 Principles for Welfare

It would be remiss of us to ignore the public services to which this tax revenue is allocated. The most significant of these, outside of healthcare, is welfare. The modern welfare state, conceived by Beveridge in 1942, looks to protect individuals from 'cradle to grave' (Beveridge 1942) by redistributing income from taxation to those who are most in need.

We can therefore define the three key functional requirements of the welfare system as follows:

1. To provide a 'safety net' to ensure that everyone is guaranteed a minimum standard of living, regardless of their personal circumstances or earning potential.
2. To ensure that people with specific needs (e.g. the disabled and their carers) have sufficient resources to support themselves.
3. To pay a state pension to those over state retirement age.

It is arguable that there are a number of secondary and tertiary benefits to this, including creating a stable political environment by managing inequality, providing education and healthcare to increase the labour quality of the UK economy, and indeed moral arguments which can be made about the need for developed economies to look after the weakest in their society.

For example, the UK's comprehensive system could be said to empower low income and unemployed workers by providing them with education and a minimum standard of subsistence by which they can then move back into the labour force when they are ready. Where the system fails is in encouraging workers into productive and fulfilling roles, and in protecting those at the bottom against social censure. Other social security systems manage these issues differently, and manage to avoid the common criticisms that plague commentary around the UK welfare system.

5-5 A Framework for Reform

Principles in practice

How to think about these principles in a practical sense? As mentioned above, ideals remain ideals until they are successfully realised. We therefore recommend thinking of these concepts – practicality, benefit and fairness, with mind to the ideas of Derrida's justice referenced before, haunting the proceedings of change. Practicality, benefit and fairness become therefore ideas to chase after when designing any new tax policy, and they refrain from becoming restrictive principles which limit the development of any policy. The perfect should not become the enemy of the good.

This is what the conditions of practicality, benefit and fairness are. No system will be perfect, but the strategic design of any new policies to prioritise clearly defined purposes and visible benefits sits at the heart of their success. Incorporating this conception of these principles into a framework for guiding reform is our final task in this chapter.

So, what does all this mean for our new tax system? Having discussed historical ideas of what we should tax, outlined practical considerations for why we should tax, and touched on the guiding principles that should lie behind the design of any new policy, the clearest takeaway is that there is a lot to consider! It's no wonder that tax has a bad reputation. The complexity of designing a successful policy lies in the sheer number of considerations that must be made to try and achieve the multiple goals of raising revenue, tackling social norms, managing monopoly and preserving equality; all while circumventing a Kafkaesque scenario of bureaucratic nightmare.

However, we can find our way out of this maze. By rearranging and summarising the above into a clearer, decision tree format, we can begin to pull together the threads of a decision framework that we can use to link tax in principle with that in practice.

It's clear from above that consideration of taxes can be subdivided into establishing the objectives and targets of the policy, and the guiding characteristics of the policy design itself. In our framework, we term these distinctions as the functional and non-functional requirements of the tax system. We outline these clearly below.

Functional requirements of Tax and Welfare System

In simple terms there are three major functions of the tax and welfare system:

1. Raise Revenue: (Pay for government services)
2. Ration Scarce Factors and Economic Bads: (Share limited resources, minimise environmental and health harm, and ensure the economy develops beneficially)
3. Correct Mal-distribution: (Redistribute income fairly, provide a safety net for those in need; help people into work; and ensure that the distribution of income is equitable).

Non-functional requirements of Taxation System

Similarly, we can consider there to be three main non-functional requirements

1. Useable: (Simple, with clear justification, objectives and low compliance and collection costs.)
2. Economically Efficient: (Non-distortive, applied to a secure tax base, and with low capacity to evade/avoid.)
3. Equitable: (Transparent, fair, and internationally Cooperative)

Non-functional Requirements of Welfare System

We can also apply a similar mindset to the use of tax revenue in the case of the welfare system.

A welfare system should be:

1. Useable: (Simple, integrated, value for money, with the use of modern Technology)
2. Efficient: (Providing incentives for work, and skill development)
3. Equitable: (Fair, Without Stigma)

Theory Of Change

How do we change the tax system? We need to maximise the effect whilst minimising the resistance to change. It's this sort of system that can maximise the good that can be achieved. This is true in two areas in particular: in environmental/energy policy and in housing policy. If you want to have a big effect, you need a big incentive. But big incentives have losers and, therefore, suffer political resistance. In other words, we use financial incentives to promote wider forms of entrepreneurship for public benefit.

What can individuals and groups do to promote a better tax and welfare system? Economic justice campaigners seek to eliminate the evident unfairness of the current taxation and benefits system. Environmental and housing tax campaigners seek to use the tax system to make the private sector work for greater public good. Simplicity campaigners seek a simpler, more usable system. Tax Heaven combines these motivations to argue for a fair, beneficial and simple tax and social security system. It provides a rallying point of key ideas that could be implemented immediately.

Tax Theories of Change

How do we change a system like tax? This book deals with tax reform in two approaches. The first is a 'blank slate' approach. This considers how we would define a tax and welfare system in an ideal world where both efficiency and fairness are achieved easily.

The second approach takes into account issues of improvement and transition. In other words, what practical politically feasible changes could be made right now to make the system more beneficial and fair?

So what does practicality look like? Often in policy, it is synonymous with political feasibility. Previously, we mentioned the idea of political realism and transitional justice. Changes must not seem both unfair and have obvious losers. Fairness will be often perceived to be a matter of *transition* as opposed to the sort of a perspective we might have when trying to create a tax system from a 'blank state' (as we do within this book).

The tax system seems to change through top down directives, through the intervention of the chancellor of the exchequer of the time. This approach means that the tax system often changes with the agenda of 'budget day' announcements. Of course,the secrecy around these announcements is to a degree necessary: if agents know how the tax system is going to change, then they may be able to take steps to avoid the taxes. A better approach would be to conduct a strategic tax review, much in a similar way to the strategic defence review.

Any discussion of taxation and welfare needs to consider *political realism*. What is political realism? It's recognising that some policies are politically easier to implement than others. In the context of taxation and welfare, we need to consider *transitional justice* and in particular not make any major groups worse off (except those that had previously benefitted unfairly). So, for example, it might be argued that a 100% land value tax is appropriate in certain locations, but to impose such a tax immediately would be unfair on those people who had recently purchased a house in the last year in a high land value area.

So what would it take to make change happen? I argue here that we need:

1. Political desire for change, a broad public consensus that there is a wrong that needs to be righted.
2. A shared narrative understanding of the principles on which any new plan might be based
3. Proposals that people could rally around
4. Communication of this plan
5. An opportunity
6. People ready to take advantage of this opportunity when it does arise.

How do we create that narrative? Well, this book is a contribution to it. It is very important to build a narrative that works for everyone in society and caters to the different ways that people live in the world and contribute to their economic lives.

The first principle of the Beveridge report was that 'revolutionary times need revolutions not patching'. We do not at present have the luxury of a fresh start. But we are starting to live in revolutionary times. Tax and welfare justice and simplification and their benefits in tackling great challenges facing us are, we suggest, good places to start. This book aims to provide some policies to help escape from a possible hell of environmental destruction and inequality. It gives us the means to complete Smith's goal of widely shared prosperity in a beautiful and secure planetary home. And it shows that our responsibility to our nation and our planet is not only personal but also political. We seek a Tax Heaven to preserve what we have, and to ensure a more heavenly future. Our quest is to search for tax heaven, that is a tax and social security system that is beneficial, practical and fair. In order to achieve that, In order to predict the effects of the tax system, we will need to expostulate a theory of how the economy works. We will need to define in turn the benefits as well as the costs that could come from a tax system. We will need to work the a system that is practical, and just. In order to actually change the tax system, we will need to develop a theory of how political change might happen. Finally we will need to work out how realistically how we can get from where we are today to where we wish to be.**

We must reclaim our minds and awaken to the story we have been told about how the economy works. We must see the evidence of the consequences, and realise that there are alternatives. We must start to tell a new story.

Previous Frameworks and Guidelines for Successful Reform

According to Bird and Oldman (1990) there are eleven main aspects that need to be considered for a successful tax reform. In this section we take Bird and Oldman's categories, and specify them for this particular book, in the order that they are covered in this book:

1. *Taxation theory*: Taxing rent and externalities, taking account of the theory of optimal taxation (both its classical formulation and the recent additions).
2. Macroeconomic situation*: Balance of payments, trade deficit.
3. *Attractiveness of proposals to politicians and voters*: A reform should be attractive to voters and to specific politician types. There should also be feasible policy pathways to achieving the reform.
4. *Political realities*: Interest of voter groups, popular notions justice, Interest of powerful groups.
5. *Institutional inertia*: Capture proposals for overcoming this.
6. *Administrative realities*: Including the existing tax system, making taxes easily calculable, and making the system as automatic as possible.
7. *Empirical evidence*, for example: effect of incentives at work; Interaction between work, experience, education and salary; effect of environmental taxes on damage; effect of health taxes on health outcomes; effect of taxes on finance.
8. *Robustness to changing times*: We look at the changing nature of work, and consider the dynamic effects of our tax proposals.

9. Local knowledge*: Legal nature of tax system; specific problems of UK system tax and economy (regional balances, dysfunctional house prices etc.).
10. Produce beneficial results: See modelling chapter.

Feasibility of proposals

Malcolm Torry in his recent book 'The feasibility of citizen's income' (Torry 2016), considers desirability of an unconditional per capita payment to all citizens and then distinguishes between, and analyses, seven different types of 'feasibility':

1. Fiscal
2. Household financial
3. Psychological
4. Administrative
5. Behavioural
6. Political
7. Policy process We cover these notions of feasibility in our evaluation of these proposals in part 14.

Principles of Transition

Transition

Any new tax system will involve a transition from the existing to the new. Working out such a transition is as important as working out where the direction of a tax system should eventually go. Such a transition should be fair and politically feasible and also it should demonstrate the viability of the policies implemented by proving to a sceptical public their value. In order to transition from the current system to one that works more effectively in a fashion that is smooth and politically feasible, we set out some suggestions on principles of transition.

Principle 1: Visionary

The desired state and the objectives of the move should be clear .

Principle 2: Packaged Change

The change in the tax system should be packaged into a policy proposal that can be implemented in the current system.

Principle 3: Political Feasibility: Rhetorical

The change should be expressible in simple and compelling arguments.

Principle 4: Political Feasibility: Few Losers

The change should create a few losers, in other words, they should not be significant, well organized groups that lose out. If there are losers, then those losers should be disarmed by the rhetorical purpose of the policy.

Principle 5: Expert Assent

The change should have experts willing to support it. These experts should be credible and authoritative.

Summary

The following table shows both the final strategic objective and the intermediate/transitional one.

Policy Area	**Initial, Intermediate Approach**	**Final Objective**
Income Tax	Simplify rates structure, make existing benefits universal and add in means testing using tax system instead of benefits means testing.	Income tax is only paid by the upper half of individuals
VAT	Remove Exemptions, SImplify	Transition to a profits tax based on UK sales
Carbon Tax	A system that gives general incentives based on a high implicit carbon price that does not raise significant revenue	A high carbon tax used for general revenue
Money Balance Tax	No change from existing system	Electronic deposits are taxed at approximately 5% per annum with a significant tax free personal allowance. Cash are registered and are time limited and a small fees are paid on withdraw

Policy Area	Initial, Intermediate Approach	Final Objective
Citizen's Dividend	Use existing benefit rates that simplify the system and reduce conditionality.	In the long term, build up a personal sovereign wealth fund to pay individuals are larger citizen's dividend
Guaranteed Training and Employment	Short term, high quality master craftsman level courses for specific groups to optimize the system	Long term, rolling out the guaranteed training to all sections of the population

Paths forward

Taxes and benefits create incentives for good or ill. It's vital that these incentives are well-aligned with the interests of society as a whole. An improved tax and welfare system should include the functional and non-functional ideas above to promote total wealth in society. A well-designed system would reconcile the seemingly competing objectives of equity and efficiency with the minimum of compromise. Effective communication and steady implementation could also satisfy political objectives through clearly demonstrating the economic, social or environmental objectives that a policy was designed to achieve.

The summary table below outlines what we think are the general characteristics of an *ideal* tax system:

General Characteristic	Function	Non-Functional Requirement
Practical	Raise Resources for Government Services (MMT: Validate Money);	Useable; Low Cost; Simple
Beneficial	Ration Scarce Collective Resources and Bads; Macroeconomic Management	Economically Efficient
Fair	Distribute Collective Rents Fairly; Correct for Maldistribution of Income and Wealth	Equitable

By using this framework, we can more clearly evaluate past and create new tax policy with a view to promoting equity and efficiency. This framework of principles is, in our opinion, an essential evaluatory criterium for strategic tax reform.

However, it is not enough to have strong principles behind the design of tax policy. We must maintain the idea that tax is in strong need of a PR campaign. One such method lies in clearly tying outputs from tax revenue to the purpose that they are intended to tackle. This, for example, could be using revenue from a carbon tax to act as a 'green investment' funding source. Another could be in opening up the discussion around the idea, mentioned previously, of a shareholder-stakeholder model of society. By asking the question of who exactly the stakeholders and shareholders are in society. and who should receive the 'dividends' from different forms of wealth, the path may be opened to more fundamental change in the UK tax system. One final suggestion could lie in highlighting success stories from other countries and constituencies, where tax policy has been received positively from the communities it affects. In our next chapter, we will explore these ideas of implementation and functionality, as we move on to how these principles are applied in practice.

PART 6: TAX IN PRACTICE

6.1: The Existing Tax System

Ok, ok. So, we get it's important for taxes to be well designed. We get that they should be applied strategically, to tax bases that are not disproportionately impacted by their implementation. They should be efficient; they should be fair; and most of all they should be part of a system that provides the greatest amount of benefit possible from the revenue raised.

We also established that the core purposes of taxation could be reduced to three streams: revenue-raising, behaviour influencing, and to redistribute rents and income fairly across the population. That taxes could be useful in achieving these goals is a theory that economists and political theorists alike have ascribed to.

But is this the reality in the UK today? With one of the oldest tax-and-welfare systems in the world, and well-established norms that facilitate its implementation, it would appear that the UK should be in a good position to translate these principles into successful practice.

In this chapter we take this claim and analyse it. We look at how the tax system operates in practice and prove the significance of the claims we made in the last chapter. After taking a look at each of the characteristics in turn, we'll be able to evaluate the extent to which taxes are significant in the UK context.

We'll also take a look at the ways in which taxes fail. As our framework designates, simplicity and practicality are core components of any taxation system that we deem to be successful. When large scale evasion or avoidance occurs, this is a failure of the system. We therefore lay out a tax avoidance streams. Information is, after all, power. By clearly outlining the methods by which evasion and avoidance occur, we hope to create a tool for the citizen and the policy maker alike to hold individuals accountable.

Taking a systemic perspective of the UK tax and welfare system can be helpful in determining where the pressure points lie. Tax and welfare are two sides of the same policy coin. One cannot be fully analysed or appreciated without the other. Although in our later chapters on inequality cover the UK welfare system in more detail, here we take a step back. We look at these policy tools in a holistic manner, gauging the overall levels of spending and dependency of the benefits system within this current system.

6.2 *Revenue and reasons*

##Tax in Practice

The UK tax system consists of approximately 26 different taxes, with a significant range of tax bases exploited. In total, £594 Billion was received by the HMRC in 2017/18 (HMRC 2019). With national GDP in 2018 recorded as £2.033 trillion (ONS 2019), this translates to an overall tax burden of 29.2%. Of these, income taxes made up £180 billion, national insurance contributions equated to £131 billion, and VAT to £125 billion. This demonstrates how concentrated the UK's tax base is, with over 73% of total receipts raised from these three taxes alone.

Even within these concentrated bases, those responsible for the bulk of income tax are an increasingly diminishing number. According to Full Fact, the top 1% of earners were responsible for 28% of overall income tax revenues (fact 2019). This number is of significance when it comes to the economic mentality behind designing tax policies. Retaining an attractive enough tax environment for these top earners is a core priority of government tax bodies and is one of the more important considerations behind 'practicality' considerations in this space. A top tax rate of 100% may be attractive to some enthusiastic tweeters, but is, in reality, limited in application. Ensuring that significant rates of tax are balanced against the risk of tax evasion and avoidance, and capital flight, is a priority for policy makers.

Overall, the proportions of total tax receipts received by HMRC in the UK has remained mostly stable since the 1980s (HMRC 2019). The key changes of note have been the transition of the significance in revenues contributed by indirect taxes, and their replacement by consumption taxes such as VAT.

The wide range of tax bases has, however, remained, making the UK tax codes one of the most complex in the world. The UK tax code is now 12 times the size of the King James Bible, itself not exactly a nightstand novella, standing at 22,000 pages on last measurement (Martin 2016). This is due in part to the Tax re-write project, which converted previously archaic and disorganised laws into plain, comprehensible English. Indeed, complexity and length can be unrelated. The 'shorter' US tax system is often thought of as more complex than that of the UK. However, it remains that the burden of administration and interpretation is still significant, and there is substantial political support for simplification of the tax code.

This complexity also has consequences for the HMRC itself, which is the second-largest government department in terms of staff numbers. The administrative cost of running this organisation is not in-significant, running at £3.3 billion in 2016-17 (NAO 2017).

Part of the reason behind the complexity is due to the range of purposes which the taxes are intended to achieve. Raising revenue for government spending is clearly the objective of income tax and national insurance contributions. VAT, to regulate and nudge spending choices. Carbon and environmental taxes, to change behaviour and regulate pollution. And the levels of child tax credits, income allowance and housing provision clearly indicate the goal of redistributing income in the UK.

As it stands, the tax system already makes a significant contribution to these three goals. Taxes pay for the majority of government spending; taxes already redistribute income significantly; and taxes on activities that are harmful to the environment and to health have been levied to discourage those activities.

However, the tax system is not the only way to achieve these outcomes. By issuing bonds or imposing user charges, public services could be funded. Regulation to ensure high quality, readily accessible education, the strong protection of worker's rights, and changes to property rights could also help to lower inequality. As for behavioural incentives, education and cultural change could be highly influential in reducing unhealthy behaviours, with legal prohibitions applied to those bads which are seen to be overwhelmingly harmful. Environmental objectives could also be achieved through government investment and stringent regulation, rather than market-based instruments.

This is most clear when the tax system fails, and these goals aren't achieved. Some objectives are too important to leave to the market, especially when it comes to regulating social and environmental bads. Moreover, relying on tax revenue can be difficult when the system is as complex as it currently is. Increased complexity raises the risks of tax avoidance and evasion for the wealthiest of earners. We'll cover these later in the chapter.

#Welfare in Practice

But what about the flipside? As we've touched on already, the stated objectives of Beveridge's welfare state were to create a comprehensive system that employed tax revenue, government policy and moral authority to tackle the five great evils in society. Today, that is achieved through the welfare system. Allocating funds to people of diminished capacity, low income and the elderly creates a safety net for the UK, a minimum standard of living that people can count on. In theory.

According to the Office for Budgetary Responsibility, the UK public sector is estimated to have spent £771 billion in 2016-17. Within this, around £484 billion was allocated to the 'welfare state'. Here, we define the 'welfare state' broadly to include 'health, education, social services and housing, as well as social security and tax credits'(Office for Budget Responsibility 2018). The rest of the spending was on defence, and debt repayments for the government.

Of the money allocated to the welfare state, some £217 billion was spent in providing the last two components of this. This social security and tax credit spending equated to some 28% of total public spending in that fiscal year (Office for Budget Responsibility 2018). In other words, this was around £8000 paid out per household in the UK.

In fact, the UK welfare system is so comprehensive that at some point in an individual's life, they will most likely receive one or more payments from the state. These are most commonly in the form of child tax credits or child benefit, and state pension payments into retirement age. Over half of families in the UK receive income from one or more welfare payments in the system, with the majority of these payments (59%) going towards pension obligations. Together with personal tax credits, mainly targeting families with dependents, and housing benefit, these three areas combine to make around two thirds of total welfare spending. Job seekers allowance, despite its infamous status, made up only 1% of the total spend on social security provisions in total. The figure below expands on this spending.

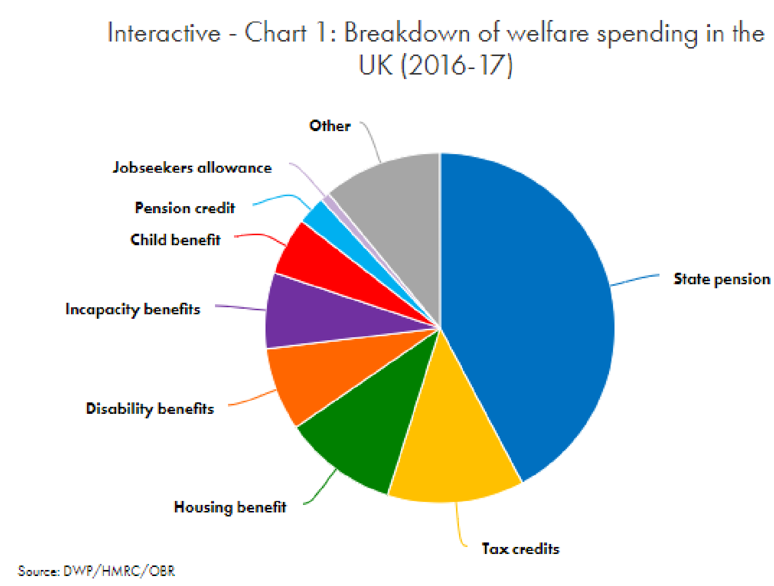


Figure 1: 5-1-taxrev

As the figure above shows, most of the expenditure on welfare is directed towards people in retirement, sitting at 40% of total rev-

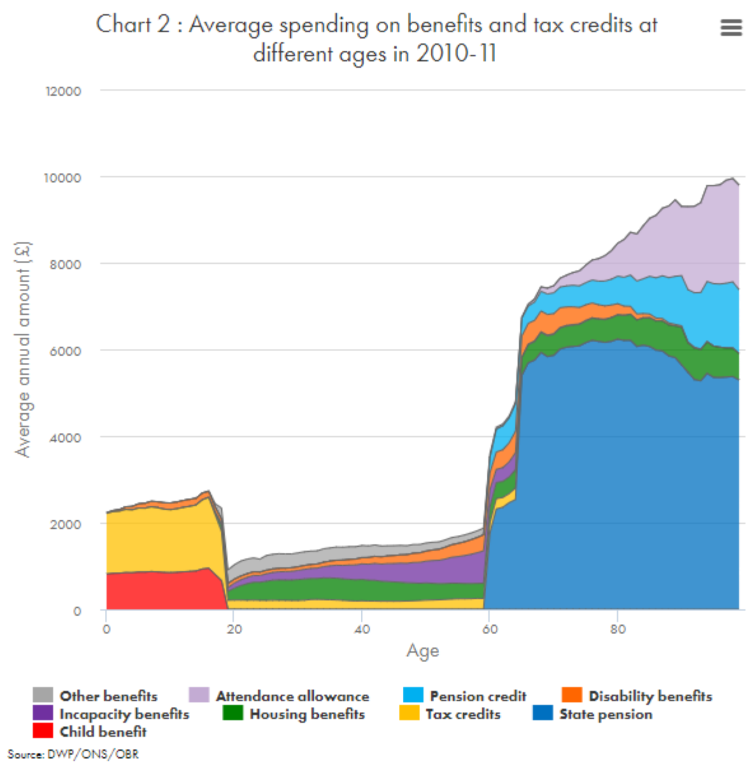


Figure 2: 5-2-taxage

enue. Despite recent policy changes to raise the retirement age, with an aging population this portion of welfare is set to increase. The rest is divided amongst those on disability and incapacity benefit, families and low-income people. These benefits are either on a contributory basis, i.e. pension payments that are dependent on National Insurance contributions), or non-contributory, such as the basic state pension. These benefits can also be awarded on a means tested basis, i.e. housing benefit, or be universally applicable, like universal credit.

As we outlined in the previous chapter, there are three key purposes to the UK benefits system: to provide a safety net for all individuals at the bottom of the economic system, to care for specific special need issues, and to protect individuals into old age with a state pension. There are obviously flaws in the reality of achieving these goals, most of which will be expanded on in our inequality chapter.

However, we can summarise by whittling these down to administrative costs and errors, and issues with inequality and delivery. Food bank use in the UK has risen 13% in the 2017-18 period alone, following a 6% increase the year previously (The Trussell Trust 2019). This is due in part to rising costs of living and in administrative issues to do with the roll out of universal credit, which has left many people behind in their payment schedule. This will be expanded on in more detail in the chapter on inequality, but it's important to recognise that there are also issues in the implementation of these welfare ideals in practice.

#6.2 Bugs in the System

##Identifying the issues

There are several problems with the UK tax and benefit system as it stands today. These are issues that we can categorise into a few groups as follows: administrative and compliance barriers, tax avoidance and evasion, and public acceptance of taxes.

A broad complaint about the tax system is to do with its complexity. As mentioned in our introduction, the over-complexity of the uk tax system has led to high administration and collection costs, as well as a number of unwanted consequences to do with progressivity and loopholes built into the system. The extensive number of exemptions and loopholes which exist in the system can really be described as government expenditures, masked as tax rebates. These mainly serve to complicate the system and should usually be removed.

Moreover, it could be said that despite its length, the system lacks ambition. As it stands, the tax system doesn't take significant enough advantage of the opportunities it has to change consumer behaviour. Only about one sixth of existing tax revenue is raised from taxes which are aimed at behavioural change. Given the potential for taxation to be used to create behavioural norms and effect social change, this is a missed opportunity.

Administrative Issues

The complexity of the current tax system is made more so by the number of loopholes, exemptions and tax-credits that it offers on a variety of different criteria. It is difficult for the average citizen to comprehend the full extent of the tax system as it stands. Many employ professional services like accountants and lawyers to comprehend its details. Clearly, citizens cannot hold politicians to account when they don't understand the system. It is clear then that politically influential groups may have a great deal of influence in shaping the tax code.

It is also difficult for the government to administer the policies. The HMRC is one of the largest government departments, costing over $3bn annually to run. The challenges faced by monitoring and enforcing a tax system which covers over 65 million individuals, with over 26 taxes applied on direct and indirect tax bases, with what is often a manual data-management process cannot be understated.

Moreover, due to its complexity, there are several interplays between different taxes that distort behaviour in an economically inefficient way. The entire existence of 'tax advice' firms shows that there are economic resources engaged in avoiding tax instead of producing goods and services, and therefore there is a loss of value to society.

The issues that surround implementation are also significant offshoots of the system's complexity. Unintended consequences of taxes can arise from weak communication and poor implementation of new policies.

##Public acceptance

The perceptions of tax as an inevitable evil do not aid in its implementation. Fears of government tax grabs and regressive impacts can mean that even the most well-designed policies in principle can, in practice, fail. It is important to consider the communication strategy as well during the implementation process, and to clearly designate where the revenues raised from said taxes are allocated to.

A paper published by Demos, a cross-party think tank, suggests a number of ways that taxes can be designed to make them more politically acceptable to pay. An overriding comment is that Voters and citizens are increasingly wary of bureaucratic 'black holes' of spending; an issue that came to light in the MP expenses scandal over the last decade. Finding that taxpayer's money had been frittered onto, amongst other things, expensive duck houses was a factor in lowering the legitimacy of government control over this tax revenue.

As the authors themselves describe, "Government appears as a black hole into which resources disappear" (Mulgan and Murray 1993). This paper designates three mechanisms by which taxes can be made palatable to a voting public.

Firstly, taxes should be 'hypothecated'. By this term, the authors mean that taxes should be clearly linked to the output that they will be directed towards. We can see this in the case of carbon-tax theory, which a number of studies have examined to determine the most politically viable avenues to allocate these new revenues to. A recent study by the Oxford Martin School found that how the design of carbon pricing reforms incorporated this issue was directly linked to their longer-term success (Our World in Data 2018). An overarching finding was the visibility of revenue use was a key factor, which could materialise in the form of green infrastructure investment, tax rebates and consumer subsidies, or even direct transfers to households. The latter methods have the benefit of tackling the potentially regressive impacts of carbon taxes which, as a consumption-based tax, can target poorer households more significantly than richer consumers.

By 'regressive' this means that the burden of the tax falls more considerably on the poor, than on the rich. Even though in absolute terms, the latter may be paying more, as a percentage of disposable income. Taxes like VAT, National Insurance, Vehicle Excise Duty and council tax fall under this category. British Columbia is an example of success in this respect, having directly rebated households with the proceeds from their nascent carbon taxation scheme. Public acceptance rates of this scheme have thus been maintained. Compare this to the poorly communicated fuel levy placed in France towards the end of 2018, and the resultant 'Gilet Jaune' protests, and the importance of clear communication about the purposes to which a policy is put become clear.

The figure above correlates the height, or price, of carbon prices in governments with public trust in government and politicians. Carbon tax rates are positively correlated with trust in politicians, and negatively correlated with perceptions of corruption (Our World in Data 2018).

The second recommendation from Demos' paper was that voters 'should have more influence on spending choices... spending should be decided by referendums' (Mulgan and Murray 1993). This is potentially a way to bypass allegations of corruption and low public trust. However, the administrative cost of such a system is not to be dismissed.

Thirdly, local spending should be tied to local taxes, so that high levels of visibility can be maintained for local voters. Councils should

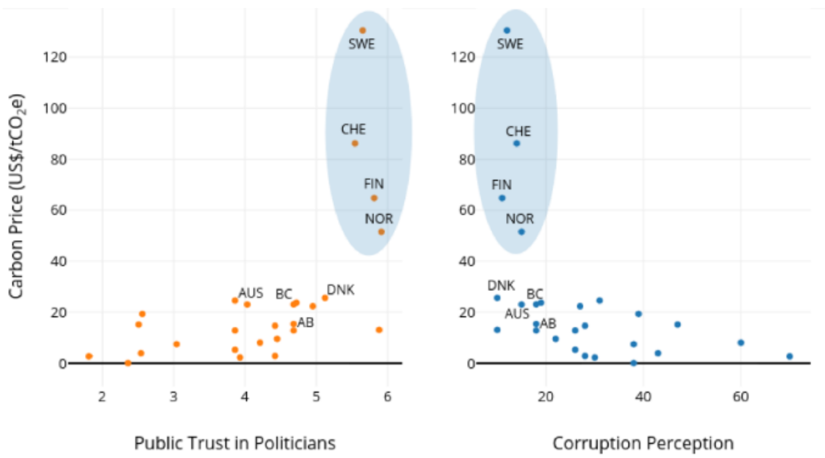


Figure 3: 5-3-taxtrust

be allowed to determine local spending to an extent that is agreed on by their electorate. This would allow the level of autonomy and connection to the application taxes needed to maintain elevated levels of commitment. This feeling of buy-in is not only important on the lower income levels of UK society, as we shall explore in the next section on tax avoidance. Citizen buy-in is an important factor for ensuring sustainability within the system.

##Tax avoidance strategies

"Tax", as said Theresa May in 2017, "is the price we pay for living in a civilised society (Houlder 2017). Speaking in the wake of the tax avoidance scandal that implicated a number of well-known celebrities, including Jimmy Carr and Bono, the Prime Minister spoke for a cross-party majority when she attacked those who evaded and avoided tax. However, with the large number of reliefs, loopholes and rebates that exist in the over-complex system

As it stands, the HMRC relies on self-reported income, and could therefore be termed an honesty scheme. There are regular check ups, used to incentivise people into truthfully reporting their income. However, the sheer scale of the enterprise, combined with the ability for wealthier individuals to use complex taxation schemes, means that the administrative body is often playing catch up with enforcing these regulations. The system's loopholes encourage avoidance and has not, until recently, strongly punished evasion. Richer individuals and companies are incentivised to pay advisers to avoid tax legally (or even illegally). Large companies can take advantages of variations in tax treatments between different countries ('tax arbitrages'). It must be said then that changes in a single country's tax policies cannot prevent this alone. However, simplification of the tax system in the UK could help at least in making this clearer for officials and the public, aiding in identifying those entities which engage in tax arbitrage practices.

The HMRC has started to tackle tax avoidance more strongly in recent years, with 'tough new legislation and demands that they pay disputed tax up front' (Houlder 2017). Recent prosecutions and stricter controls have closed off many of the avenues that were once common place for large multinationals and wealthier individuals. The world of tax evasion and avoidance is smaller, and mostly plays closer to the letter of the law – layering the available relief schemes available from the government. It still remains, however, that there are a significant number of tax-saving ploys that allow and encourage high-net-worth individuals to mitigate their tax liabilities.

Knowledge is power. Especially when it comes to tax evasion. It therefore seems relevant to outline the most common methods of tax evasion and avoidance that high-net worth individuals engage in. The HMRC itself regularly publishes a breakdown of the tax evasion and avoidance strategies which it is aware of (HMRC 2018).

1) Tax Havens
2) Shell companies
3) Equity swaps
4) Avoiding capital gains tax
5) Evading estate tax/inheritance tax
6) Shell trust funds
7) Incorporating
8) Payments in kind
9) Life insurance borrowing
10) Real estate borrowing

#6.3 Conclusions

It is clear then that from this chapter, the tax and benefit system does not operate in practice the way it is laid out to in principle. The best laid plans of mice and men can fail to fully enforce behavioural taxes on a wide and mobile tax base, as the old saying goes.

It's important then to draw out some recommendations for how policy makers should be adapting the tax system to combat these implementation issues. Communication, clarity and enforcement are all aspects of this transition.

What is taxed should be concrete and objective. It should not depend on the honesty of those declaring the tax and it should not penalize the honest relative to the dishonest. The tax system should not contain 'tax arbitrages' and should not allow for dishonesty. This would help to combat both the issues of public acceptance and administrative complexity. The costs and time-commitment of administering such a system should never be excessive. Streamlining the tax code to simplify the number of tax rates, directly tie benefits to the purposes of taxes that are applied, and a limited number of exemptions should be available. Above all, the tax and benefit system should be capable of being easily understood by the public.

In terms of public acceptance, the purposes and targets of taxes should be well communicated and clear. As outlined in the previous chapter, following clear principles when taxes are created so that they are practical, beneficial and fair is essential when ensuring that they will be successfully launched. Tax should either fall on things that don't go away when you tax them (e.g. land) or things that you want to go away when you tax them (e.g. fossil fuel use sugar consumption).

It is important that the tax and benefit system works. As we've shown, income tax and consumption tax revenue are the life blood of public services like the NHS, the educational system and for social security. There is buy in on the welfare side. Most individuals in this country will benefit from a public payment of some kind, from healthcare to child benefit to the state pension, in their lifetimes. Creating the same level of connection with the taxation system is an essential component of the system's sustainability. These key mechanisms by which the UK raises revenue, redistributes income, and nudges people towards the right choices have been neglected and left to rust, out of date with the times we live in. There is no shortage of popular support for reform. Indeed, consensus seems to be on the side of the need for improving and simplifying the current tax and welfare system.

As we will explore in the coming chapters, in more detail, things are changing, but not significantly enough. Proposals put in place that aim to move towards a universal credit system have ignored the need for changes to be practical, beneficial and fair. HMRC's tightening up of tax evasion has yet to fully solve the problem. And destructive behaviours have yet to fully be targeted through the use of taxation. There is still a significant way to go with realising our principles in practice.

PART 7: INEQUALITY

Summary

- When assessing inequality, we can consider whether it is harmful and whether it is justified.
- People build material wealth through primary and secondary wealth creation. Primary wealth creation is wealth that is earned through wages or acquired through inheritance. Secondary wealth creation is generated by investment of primary wealth.
- Those who have great wealth are able to grow it through secondary wealth creation. Those without (in particular those who pay rent), have little income for secondary wealth. They may also see their primary wealth decrease through wage stagnation and decreases in the real value of wages.
- Piketty found that under capitalism, returns on capital wealth will tend to grow faster than wages. This implies a structural advantage for those who already have secondary wealth. One reason for this is pseudo-investments.
- Wealthy people are able to put money into unfair pseudo-investments,which do not lead to overall growth, such as land or monopolies.
- Wealthy people also benefit unfairly from lowering of interest rates,leading to increases in asset values.
- Britain has a severe wealth and income inequality problem.
- Inequality is correlated with many social problems, such as higher crime rates, lower life expectancy, poor health outcomes, poor educational attainment and lower social cohesion.
- Inequality also poses risks for democratic representation and economic growth.
- Judging from US data, people want a more equal society (more like Denmark)
- Income tax has an important redistributive role. It is effective in reducing income inequality and the top 1% income share.

7.1 Why Does Inequality Matter?

Have you ever walked through Knightsbridge in London, and watched as expensive cars parked outside of designer shops? And turned your head to see homeless people beg outside? In this chapter, we will look at how wealth and income are distributed in Britain. As we will see, the distribution is very unequal. But what to think? Is it a problem that some have so much, while others have little?

Figure 6.1 - A Street Scene In The UK

Many would say that this state of affairs is morally wrong and should be addressed through policy change and taxation. Others might ask how this wealth were acquired, and warn against discouraging productive activity. We generally have a strong sense that if someone has worked hard for something, then they have earned it and should be able to keep it. If everyone has the same opportunity to build wealth and rich people gained their wealth through hard work, sacrifice or ingenuity, we might conclude that the rich deserve their wealth, no matter how great. That is, we would be considering whether the wealth disparity is *fair*.

Aside from fairness, we also have to consider whether there may be serious and undesirable social ills associated with an unequal distribution of wealth. Does inequality lead to undesirable outcomes for people and society? Does it lead to social problems, such as more crime, poorer health and shorter life expectancy? Is it a threat to representative democracy? On the other hand, are there social benefits to inequality, for example, does it encourage innovation and the creation of new luxury goods which may eventually be enjoyed by the less wealthy? Does it motivate economic growth? This kind of questioning is an assessment of potential *harm* or *benefit*.

Thus in evaluating the status quo, we must take a two-pronged approach;

- Benefit or Harm: Consider whether there are benefits or social ills associated with disparities in wealth and income, aside from whether or not those disparities are fair and just.
- Fairness: Consider how income is received and how wealth ac-

cumulates in the hands of people in Britain. Then we can assess whether this wealth accumulation occurs via fair or unfair means.

But before making this assessment, we should take a step back. We have talked about 'wealth' and 'riches' on the assumption that we all take these words to mean the same things. In fact, the word 'wealth' in its common usage can refer to very different things. We break down our interpretation of this in the next section.

7.2 *What is Wealth?*

In its most broad sense, wealth refers to anything of value to people. Thus based on this rather broad definition, 'wealth' can refer to things which are quite intangible. Social connections, charisma, political influence, the rule of law and safety. These are all desirable, at least to most people. People often use the term 'wealth' to describe things which are personal and irreplaceable, such as a family heirloom, or even simply family or friends. Such things have little or no 'exchange value' (i.e. they can't be sold or can't be sold for any great amount), but they may have great personal value.

Some things of great value are what we might term 'social goods' because they are not privately held by one person. Social goods may also include effective public transport, parks, clean air, a free press and even a feeling of community. These are a kind of wealth, in that they are valuable, but they are unlike privately held wealth because they are enjoyed by the many and most efficient when used for a large number of people, rather than on an individual basis. An obvious example is clean air. In a world in which the air was too toxic to breathe, the rich might be able to afford clean air piped into their homes. However, this would be a diminished life for everyone, including the rich as they would need to employ an expensive, labour-intensive process compared to simply having a clean atmosphere which all could enjoy.

Another example is safety in South Africa. The degree of crime is so bad that drivers regularly have their cars stolen while waiting at stoplights. Wealthy people can avoid being the victims of crime, by locking themselves away in secure enclaves, surrounded by high walls and security systems. The public social good, that of public security (usually provided by an effective police force) is lacking in South Africa. The rich can protect themselves; the poor cannot. However, despite this relative privilege the wealthy still have a diminished quality of life, resulting from the restricted freedom of movement and a fear of becoming a victim of crime. Perversley, the fact that social goods are valued by everyone can put them at risk in a way that is not the case for goods which are held privately. This is because when people personally own wealth, they are often very concerned about protecting it. People tend to be less actively concerned about wealth held commonly with others, as their tie to the social good is often less tangible.

It is this 'private wealth' that we are focusing on in this chapter, but social goods are mentioned here because they are so important for quality of life, and because as we shall see, inequality of private wealth is linked with the loss of some of these social goods. More specifically, we are narrowing ourselves to discussion of privately held material wealth, thereby excluding immaterial or intangible forms of wealth. However it is worth noting that having material wealth often enables the attainment of immaterial goods of great value. For example, a materially wealthy person may buy access to a top school for their child, which provides that child with access to a good education, and good social connections and may lead to lucrative and powerful work opportunities. Similarly, paid entry into expensive elite social clubs offers valuable networking opportunities. Material wealth can buy time, unique experiences, unpaid internships, physical attractiveness (to an extent) and worryingly, political influence. Perhaps the only thing material wealth can't buy is love and happiness - though many will still try.

How do people build material wealth?

Well, there are many ways, both legal and illegal, but we will confine ourselves here to the most significant legal means;

Wages

Earning an income through some form of economic activity, such as working as an employee or a self-employed trader, or creating something and selling it. People who earn just enough income to meet their needs probably won't build up much wealth in this way. Someone with a high income and low living costs can build up wealth much more quickly.

Inheritance

Receiving inheritance or a gift through wealthy relations. Great family wealth can often be passed down and increased over many generations.

The above two ways in which people acquire wealth might be termed 'primary wealth creation'. They concern how a person without any wealth might first acquire it.

Once a person has some wealth, there are a myriad ways in which to use it so as to increase wealth further. This can be called 'secondary wealth creation' and includes the following actions, among others:

- Investing in companies by buying stocks and shares or some other financial instrument. If the company does well, then the investor will increase their wealth through dividends or by selling the stock when it has higher value.
- Investing in savings products (which invest on a person's behalf) and pay interest.
- Buying land or property and selling it once it has increased in value (possibly also receiving rent income in the meantime)
- Investing directly in a business

From the above list, it's easy to see how those who are already rich can get a lot richer. They don't have to build up wealth through labour or invention. Owning wealth opens up a raft of secondary wealth opportunities, and it allows one to take bigger risks. The wealthy are also likely to invest their riches profitably because they can afford to pay advisors and wealth managers to locate investment opportunities and to minimise tax liabilities on their behalf.

Are advantages like these really enough to propel the rich into ever-increasing rates of wealth-accumulation? Ever increasing global inequality suggests that this is so (OECD 2015). To demonstrate this further, we take a look at the extent of wealth and income inequality in Britain today.

7.3 Inequality of Wealth

The British Context

Whilst we have not yet reached a second Gilded Age, in Britain, we do have severe wealth inequality. According to the figures from the Office of National Statistics from 2012 to 2014, the richest 10% of UK households hold 45% of all wealth, while the poorest 50% own just 8.7% (ONS 2015a).

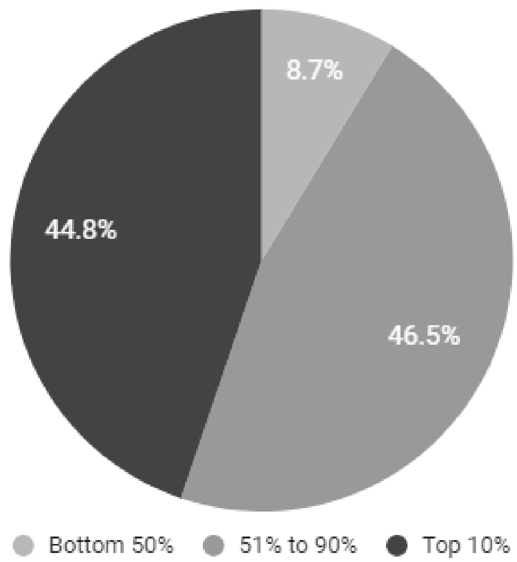


Figure 6.2: Distribution of Household Wealth

Particularly striking is the fact that the richest five families in the UK are wealthier than the bottom 20% of the population (Dransfield 2014).

Here are a few notable facts about the UK wealth distribution:

- Bottom 10% of households have total wealth of £12,550 or less.
- Median total household wealth is £225,000.
- The top 10% of households have a total wealth of over £1m.
- The top 1% of households have a total wealth of £2.87m+.

The below chart shows the distribution in a finer grain, allowing us to see the share of wealth held by the top 1% in British society (ONS 2015b).

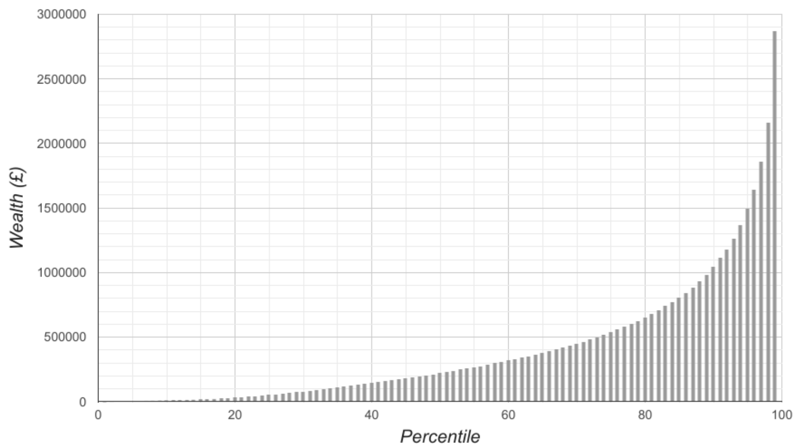


Figure 6.3: Household Wealth Distribution by percentile (2015)

This wealth inequality continues to increase.

The Role of Property

ONS figures from 2012-14 show that while the total proportion of wealth held by the top 1% remained steady at 13%, the next 9 per cent richest households, increased their share to 31.2 per cent of total wealth. This was up from 30.1 per cent two years previously.

The inequality increase occurred entirely in net property wealth, during a period of house price rises (ONS 2015b). This indicates that a large part of the growing wealth of the richest in Britain, is due to their ownership of property, rather than wage income or business income.

A 2014 Credit Suisse report confirmed the findings. They found that the top 10% in the UK have become wealthier since the financial crisis because of value increases in assets. They also announced that Britain is the only country in the G7 group of leading economies where inequality has increased this century (Treanor and Farrell 2014).

7.4 Inequality of Income

We have discussed wealth inequality, which is the vast discrepancy in the ownership of assets, such as property, cash and investments, held across Britain. There also exists a less severe, but also worrying, form of inequality. This is inequality of income.

Income may come from a variety of sources, such as interest on savings, wages, dividends, cash benefits (such as State benefits) and rental income. Some of this income may be taxed. Measures of income inequality generally consider inequality in disposable incomes (after benefits and after direct taxes). The below flow-chart shows the various stages of household income;

Figure 6.4: Household Income after Tax, Benefits and Housing

Disposable income may be measured before-housing-costs (BHC) or after-housing-costs (AHC). When considering income, it is important to be precise about the kind of income being discussed. For example, when looking at income inequality, we can see that there is more inequality in income after-housing-costs than in income before-housing-costs, because poorer households tend to spend a higher share of their income on housing than those higher up the income distribution (McGuinness 2016).

In the below chart (IFS 2014), we can see how the share of pre-tax household income going to the top 1% has increased over time.

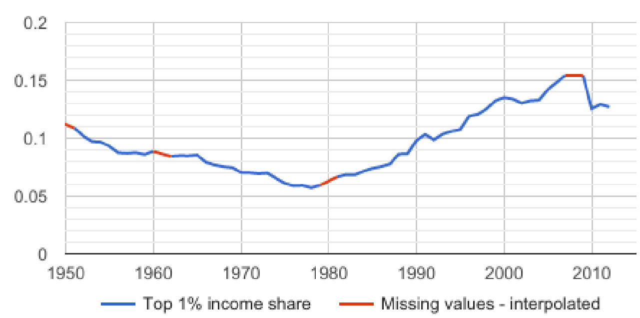


Figure 6.5: Share of top % pre-tax income in the UK

The top incomes of the top 1% appear to be 'racing away' from the remaining 99%. Data suggests that income inequality within the bottom 99% is remaining reasonably stable or possibly slightly decreasing, while the income shares of the top 1% is increasing.

There exists, of course, a relationship between income inequality and wealth inequality. Income leads to wealth when it is saved up and when it is used to buy assets. Wealth also generates income as shares generate dividends, savings generate interest and property ownership generates rental income.

Households with great wealth often also receive high incomes. However we can easily imagine someone who has great wealth in the form of property, investments and bank balance, but who has little income (perhaps a retiree). Similarly, someone may make a significant income, but have debts and high outgoings, so they don't build up wealth (perhaps a young person on a high salary). The effect of

Figure 4: Image

a sudden reduction in income or unexpected expenses would have a dramatically different effect on each of them.

Broadly speaking, we have seen:

- Wealth distribution in the UK is very unequal and getting more so.
- Income distribution is also very unequal but less so than the wealth distribution.
- The top 1% income share is increasing quickly.
- Wealthy people tend to be on high incomes. Those with little wealth tend to be on low incomes.

Understanding the above graphs and figures requires us to look behind the figures and consider how different groups earn and use their income. At the lower end, there are those who earn their income through labour, and who must pay housing costs. They have very little disposable income and are unlikely to have much income available to invest in secondary wealth generation. They may have seen their wages stagnating (Khan 2016), while the real value of their wages decrease (Tily 2016). At the other extreme are those who have high incomes and are able to make additional income through purchasing assets. As we have seen, value increases in assets, (particularly property assets) have driven an increase in the wealth of the very rich. With assets comes income through dividends, rent and capital gains. This appears to be contributing to growing inequality of both wealth and income.

Quoted in the Financial Times, the general secretary of the Trade Union Congress, Frances O'Grady put the situation starkly;

> *"The economy is paying people too little for hard work and too much just for sitting on wealth. It is making Britain more and more unequal, with those who are already rich moving even further ahead of the typical family (Giles 2015)."*

7.5 Effects of Inequality

But is this inequality in itself really such a problem? If we could ensure that all citizens have their basic wants covered, does it matter if the rich are getting richer? Surely dealing with absolute wealth in this way and ensuring a basic standard of living is a more important focus than the relative wealth between rich and poor?

It is clear that there is a strong view amongst some circles that inequality is not a problem as long as the poorest have their basic needs met.

High wealth and income inequality matter for a host of reasons. It causes subtly damaging changes in the way people interact with each other and participate in society. According to the Equality Trust, income inequality is correlated with low civic participation, lower voter turnout and lower levels of cultural activity (The Equality Trust 2014). There is even evidence that inequality may affect personality (The Equality Trust 2017). Research comparing US states found, despite adjusting findings for state and person-level socio-demographic factors, that people in less-equal states were 'less agreeable' than those in more-equal states (Vries, Gosling, and Potter 2011).

A World Bank study on inequality and crime rates reported a strong correlation between violent crime and inequality, both within and between countries.

Inequality and Empathy

Psychologist Paul Piff has conducted research (Piff et al. 2010) on a phenomenon called the'empathy gap'. In his experiments, test subjects were artificially placed into social hierarchies. Piff and his colleagues concluded that increased wealth and status in society leads to increased focus on oneself. This, in turn, leads to decreased compassion, altruism and ethical behavior. The opposite is also true. Piff's work suggests that poorer individuals tend to be more generous, charitable, trusting and helpful, compared with their richer counterparts. A related study by Keltner et al, found that 'lower-class individuals' displayed more compassion and sensitivity to the distress of others than their upper-class counterparts (Stellar et al. 2012).

Social class and wealth, therefore, appear to be correlated with qualities like compassion and empathy. This may be exacerbated by increasing physical segregation in where the rich and poor live. Poor, rich and average households became less and less likely to live next door to one another between 1970 and 2000 (Dorling, Daniel 2007) suggesting that socioeconomic separation has been accompanied by geographical polarisation.

Surprisingly, there is even evidence that inequality may affect personality. Research in the USA compared less equal US states with more equal states. After adjusting for state and person-level sociodemographic factors, de Vries et al found that people in less equal states were 'less agreeable' than in more equal states.

Inequality and Social Problems

Epidemiologists Wilson and Pickett collated a breadth of transnational research comparing inequality and a variety of social measures. Their results were striking. They found that over a wide range of areas, including health, education,social mobility, social cohesion and foreign aid, increased inequality leads to worse outcomes. See, for example, their findings below comparing health and social problems, with income inequality, across rich countries (Wilkinson and Pickett

2017). We can see that the US is highest in income inequality and highest in health and social problems.

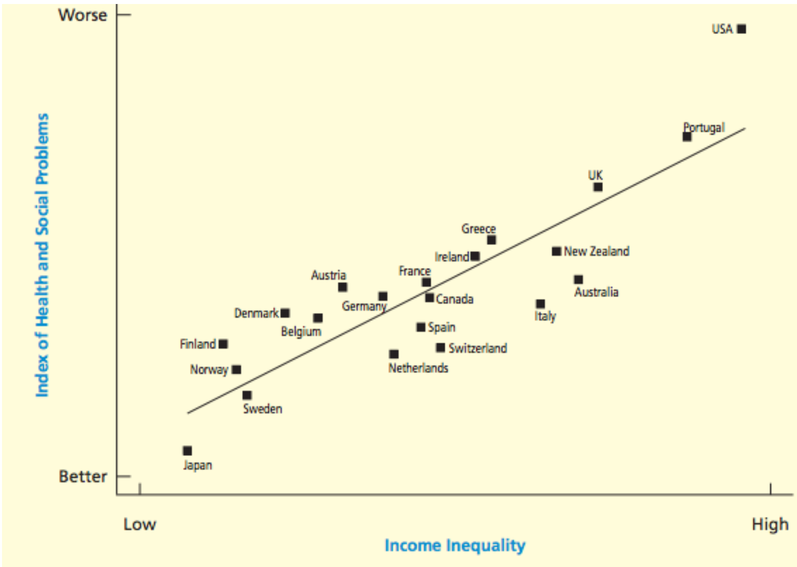


Figure 6.6: Health and social problems related to inequality within rich countries

3

Their message for policy-makers was plain:

"(A) clear warning for those who might want to place low public expenditure and taxation at the top of their priorities. If you fail to avoid high inequality, you will need more prison and more police. You will have to deal with higher rates of mental illness, drug abuse and every other kind of problem. If keeping taxes and benefits down leads to wider income differences, the need to deal with ensuing social ills may force you to raise public expenditure to cope ." (Wilkinson and Pickett 2010)

[3] Wilson and Pickett's research has been criticised on the basis that their findings show relationships of correlation, rather than causation. However the researchers note that many of the causal processes linking inequality with social problems are well established from other research. They argue that the key insight from their work is that the connection can be seen repeatedly in countries worldwide.

Inequality and Crime Rates

In a study on inequality and crime rates, Lederman et al. found a strong correlation between violent crime and inequality (Lederman, Fajnzylber, and Loayza 2002), both within and between countries. In their view;

"The correlation reflects causation from inequality to crime rates, even correcting for other crime determinants"

Simply put, this means that inequality causes high crime rates, and not vice versa. The mechnism by which this occurs is unclear and may be myriad. Economic inequality may curtail opportunities for some, leading to feelings of hopelessness, inferiority and fear which then lead to violence. Inequality may encourage social competition, and low levels of trust and community cohesion within a society.

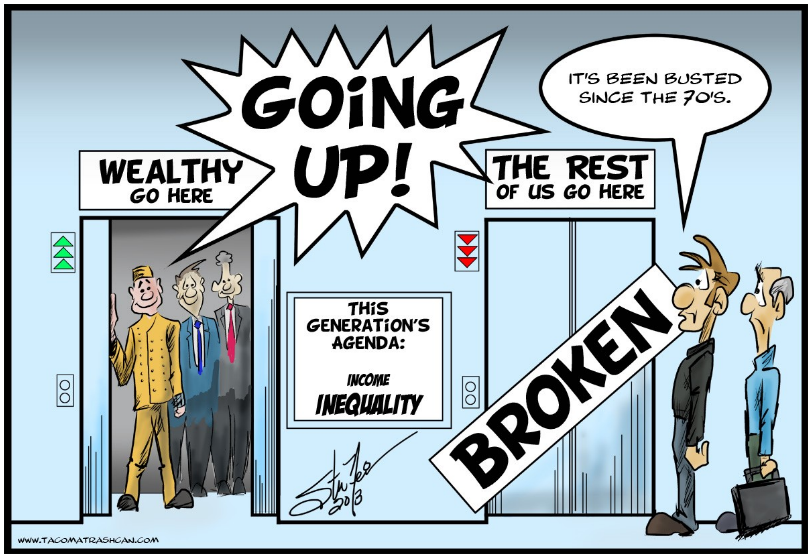


Figure 6.7: Cartoon showing the relationship between income inequality and social mobility

There is also a strong correlation between high income inequality and low social mobility. Social mobility is the upward or downward movement of people -between social strata in a society. Mobility may be intra-generational (i.e within a generation, such as 'rags to riches' stories, or it may be inter-generational, i.e a change in social status from parents to children.

In an intergenerational study of the American context by researcher Corak, it was observed that high earnings inequality is likely to be associated with a stagnation in intergenerational mobility. This means that earnings inequality makes societies more 'sticky', such that children are more likely to stay in the same social strata as their parents.

Corak cautions that this outcome is particularly likely if labour market inequalities translate into political power, which then influences whether progressive policy reforms are made. He warns,

> *"Without changes in these underlying factors the transmission of inequality from the current generation to the next will remain a movie that is played to the same script as that viewed by past generations."* (Miles Corak 2011)

Figure 6.8 shows the strong correlation between inequality and a measure called 'intergenerational earnings elasticity' (IEE), which is used by social scientists when considering intergenerational social mobility. IEE is the percentage difference in earnings in the child's generation associated with the percentage difference in the parental generation (Miles Corak 2011). An intergenerational elasticity in earnings of 0.9, for example, means that if father A makes 100% more money than father B, then the son of father A will, as an adult, earn 90% more than the son of father B. An elasticity of 0.2 says this 100% difference between the two fathers would only lead to a 20% difference between the sons.

The lower the elasticity, the more mobility in the society. Figure 2.5 shows that increased inequality at any point in time is correlated with lower generational earnings mobility. Note that mobility can be in either direction, up or down. The IEE is simply considering the earnings difference between generations.

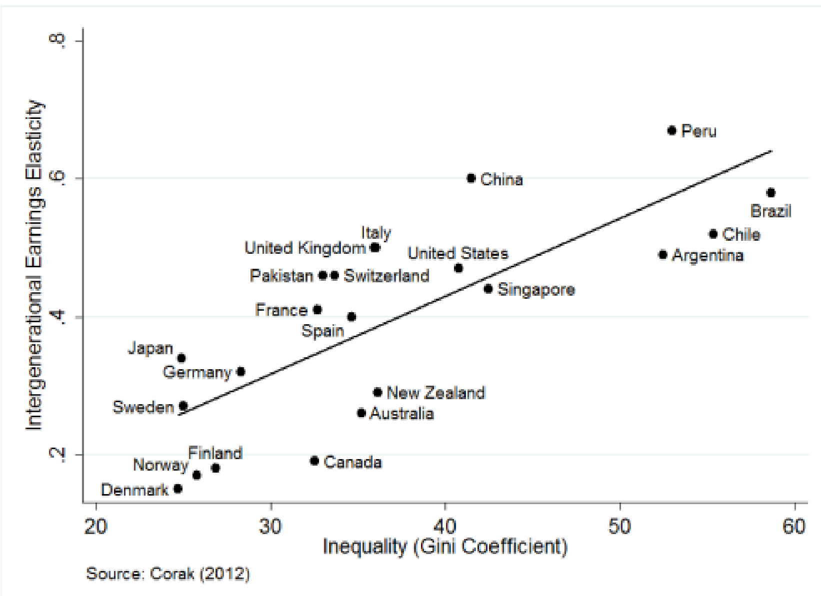


Figure 6.7: Intergenerational earnings elasticity

This chart is widely known as the 'Gatsby Curve'. It is so named after the character of Jay Gatsby in the famous novel by F. Scott Fitzgerald. In the novel, Jay Gatsby tries in vain to raise his social standing by becoming very The novel is set in the 1920s, when there was high inequality of wealth, and very low social mobility.

One suggested reason for the correlation between inequality and intergenerational earnings mobility is unequal access to educational opportunities. This is exacerbated by poor social and family relationships, which then inhibit learning. The below image is from a 1916 advertisement for a vocational school, and suggests that education is a pathway to upward social mobility.

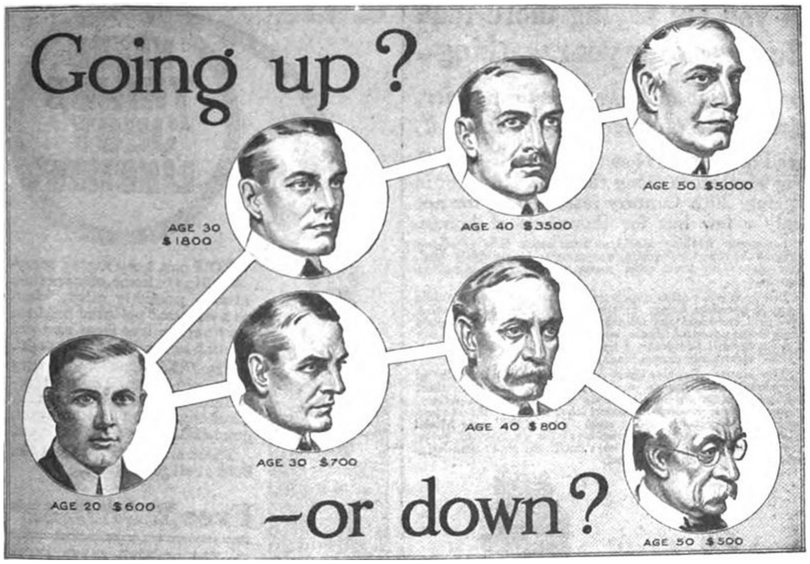


Figure 6.9: Advertisement promoting education as a route to upward mobility

These findings offer insights into how intergenerational poverty and welfare dependency have a real structural basis and are not entirely within the control of an individual's willingness, effort or merit.

Inequality and Liberty

If we accept the evidence that economic inequality lead to negative social outcomes, might we nevertheless also argue that inequality is a necessary and inevitable outcome of a free society and equality before the law? In his book 'The Constitution of Liberty', political philosopher Fredrich Hayek argued,

> *"From the fact that people are very different it follows that, if we treat them equally, the result must be inequality in their actual position, and that the only way to place them in an equal position would be to treat them differently. Equality before the law and material equality are therefore not only different but are in conflict with each other; and we can achieve either one or the other, but not both at the same time."*

Hayek also argues that an attempt to achieve complete material equality between people, can only come at the expense of freedom,

> *"While an equality of rights under a limited government is possible and an essential condition of individual freedom, a claim for equality of material position can be met only by a government with totalitarian powers."* (Hayek 1944)

One response would be to say that in objecting to extremes of inequality, one is not advocating strict equality of outcome for all.

The obvious problem with Hayek's argument is that distribution according to merit is just one conception of social justice. Consider the principles of fair equality of opportunity, and raising the lowest social position as much as possible." The point being that extreme inequality needs to be eliminated to create a level playing field where individuals are given the opportunity to demonstrate their merit (Lister 2011).

Wealth Inequality and the Democratic Process

Figure 6.10: Cartoon showing wealth inequality in the democratic process

Despite Hayek's famous theory on the constitution of liberty, a very real danger of wealth inequality is the threat to the democratic process. Extremes of wealth mean that those at the top, whether they be corporations (as per the above cartoon) or individuals,have disproportionate access to power, and an ability to influence politicians for their own interests. A famous quotation, attributed to noted American Supreme Court Judge Louis D. Brandeis, puts it simply,

> "*We can have democracy in this country or we can have great wealth concentrated in the hands of a few, but we cannot have both.*" (Dillard 1904)

There is strong evidence that extremes of wealth inequality lead to so-called 'representational inequality'. Work by Professor Martin Gilens of Princeton University found that in the US, when the policy preferences of the affluent differ from those of the middle-class or poor, there is virtually no relationship between policy outcomes and the desires of less advantaged groups (Gilens et al. 2004). Policies favored by 20 percent of affluent Americans, have about a one-in-five chance of being adopted, while those favored by 80 percent of affluent Americans are adopted about half the time. In contrast, the support or opposition of the poor or the middle class has no impact on a policy's prospects of being adopted (Gilens 2012).

Economist Dabla-Norris notes in a 2015 IMF report (Dabla-Norris et al. 2015), that income inequality can have serious consequences for political stability, saying,

> "*Widening inequality also has significant implications for growth and macroeconomic stability, it can concentrate political and decision making power in the hands of a few, lead to a suboptimal use of human resources, cause investment-reducing political and economic instability, and raise crisis risk.*"

Inequality and Growth

Some would argue that inequality is nevertheless necessary for economic growth. Inequality is thought by some to encourage entrepreneurialism (Matthews 2016) and the wealthy are thought to invest in the economy. It is also claimed that when the state redistributes wealth through taxation and benefits, resources are lost through administration and bureaucracy. However, recent research by the Organization for Economic Cooperation and Development (OECD) suggests that even this purely economic argument is on shaky ground. Its 2014 analysis found that income inequality has a negative and statistically significant impact on growth.

The study found that,

> "*Rising inequality is estimated to have knocked more than 4 percentage points off growth in half of the (OECD) countries over two decades. On the other hand, greater equality prior to the crisis helped GDP per capita in a few countries, notably Spain.*" (OECD 2014)

Furthermore, while there is evidence that the promise of wealth is a strong motivator for entrepreneurs, the majority of the top 1% in the US, are not entrepreneurs but are executives, managers, supervisors, and financial professionals (Bakija, Cole, and Heim 2012).

These findings reinforce the work of Piketty previously examined on inequality and 'low growth capitalism'.

In this section, we have considered the effects of inequality in terms of its impact on empathy, social problems, crime rates, and social mobility. Contrary to claims that income and wealth inequality are necessary for liberty and growth, we see evidence that inequality threatens a functional democracy and growing economy.

7.6 *How much inequality do people want in society?*

We've seen above that income inequality and wealth inequality are associated with very undesirable social consequences. However, most would not welcome an economic system in which everyone received exactly the same amount. There has been some research from the US, as to what distribution of wealth people believe there should be in society.

In a 2011 study by Dan Ariely and Michael Norton (Ariely and Norton 2011), a nationally representative online panel of Americans were asked to estimate the current distribution of wealth in the USA, and to describe a distribution they deemed 'just'. The results were striking. All demographic groups (including Republicans and the wealthy) desired a more equal distribution than the actual US wealth distribution. Secondly, all groups vastly underestimated wealth inequality in the US, estimating that the top quintile held about 59% rather than the actual amount of about 84%.

The below chart shows the distribution which the participants estimated was the case, the participants' ideal distribution and the actual US wealth distribution. We can see that the participants' estimated distribution is as far from the actual distribution as their ideal distribution is from their estimated distribution of wealth inequality in the US.

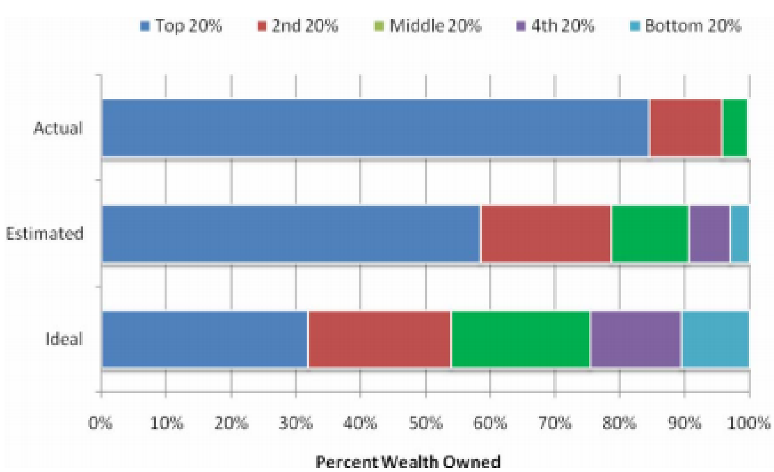


Fig. 2. The actual United States wealth distribution plotted against the estimated and ideal distributions across all respondents. Because of their small percentage share of total wealth, both the "4th 20%" value (0.2%) and the "Bottom 20%" value (0.1%) are not visible in the "Actual" distribution.

Figure 6.11: United States wealth distribution - Actual, Estimated and Ideal as surveyed

The researchers concluded two main points.

First that a large, nationally representative sample of Americans seems to prefer to live in a country more like Sweden than like the United States. Americans also construct ideal distributions that are far more equal than they estimated the United States to be; estimates which themselves were far more equal than the actual level of inequality.

Second, there was much more consensus than disagreement across groups from different sides of the political spectrum about this desire for a more equal distribution of wealth, suggesting that Americans may possess a commonly held "normative" standard for the distribution of wealth despite the many disagreements about policies that affect that distribution, such as taxation and welfare.

In short:

- Americans think the US is more equal than it is, and
- Americans would like the US to be even more equal than they think it is (more like Sweden)
- This preference held across the political spectrum.

7.7 Is Income Inequality Merited?

We have now seen,that inequality is associated with significant social ills, such as increased crime rates and poor health and longevity outcomes. We have also seen that it may pose real threat to representative democracy and to economic growth. So, there is clear evidence of harm or potential harm arising from wealth inequality in Britain.

What about fairness? Has the wealth of the very rich been accumulated through fair means? Remember again the ways of accumulating wealth which we discussed in th beginning of this chapter. There was primary wealth acquisition, occurring through income from economic activity or inheritance. There was also secondary wealth acquisition which involved putting wealth to use in the form of investment, to create more wealth. We said that if the rich arerich because they work hard and 'work smart' and the poor are poor because they do not, then that might be one reason for viewing wealth inequality as fair.

Inequality due to Income or Inheritance

When it comes to those primary forms of wealth acquisition, we know that unfairness exists. It would be wonderful if everyone had an elderly aunt who could leave them a sizeable inheritance, but that is clearly not the case. Some people have friends who help them get a high-paying job, some do not. Some people go to excellent schools, some do not. Some work, no matter how important to society, pays less than other work. These kinds of unfairness are difficult to tackle, raise many ethical issues and are outside the scope of this book. However, it is worth mentioning that the world is not a level playing field and while attempts can be made, (through for example, inheritance tax and affirmative action policy) to redress unfairness of opportunity to gain primary wealth, attempts to totally eradicate it would probably be futile. They would also probably have serious unintended consequences. As your parent may have told you when you were a child, 'Sometimes life just isn't fair'.

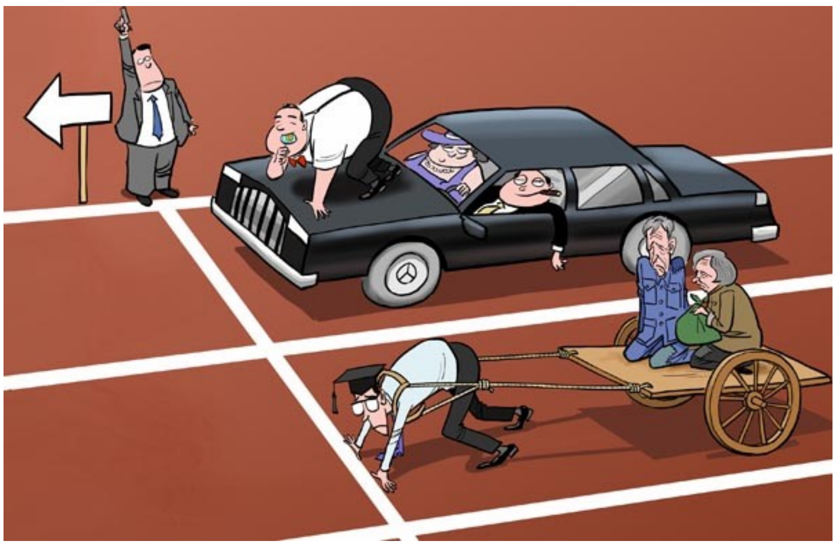


Figure 6.12: Cartoon showing Inheritance as a wider social problem

To what extent is someone's monetary success due to their own work, and to what extent is it their luck or privilege (in terms of genes, or parental support), or a product of the wider society? And to what extent should we reward those who seek money over other objectives?

Income taxation is one of the main ways in which the government affects the income distribution across society. From a purely philosophical point of view it's not easy to determine what the rate of income tax should be. We'll come back to this in the next chapter, when we look at this through the prism of income inequality and the recent historical experience. We'll also consider the equity of processes of wealth growing.

7.8 Direct Taxes and their Redistributive Role

Income Tax in the UK

Most people, when they think of tax, immediately think of income tax. It is possibly the most noticeably intrusive tax in every individual's life, requiring, as it does, the keeping of records,the filling in of forms and the possible sanctions from the 'tax man'. Unlike VAT, which is added to goods and services we purchase, income tax comes out of our earnings. There is often an added feeling of grievance associated with the sense that the government is taking money for which we have worked very hard.

Income tax is progressive, with different rates of tax payable, according to income. These rates are called 'Bands'. As of 2016, each individual is entitled to a'personal allowance' of £11,000 of non-taxable income. Above this, their income is taxable. Taxable income (i.e. income above the personal allowance) is subject to different tax rates depending upon the band within which it falls. The below table summarises the income tax bands and rates.

Band	Rate	Income after allowances 2016/17	Income after allowances 2015/16
Starting rate for savings	10% (0% for 2015/16)	Up to £5,000	Up to £5,000
Basic rate	20%	Up to £32,000	Up to £31,785
Higher rate	40%	£32,001 to £150,000	£31,786 to £150,000
Additional rate	45%	Over £150000	Over £150000

The current top marginal tax rate is 45%. The below chart shows how top marginal tax rates have changed over time for different countries. We can see that the top tax rate for the UK was very high during the Second World War and in the late 1970s. The rate dropped sharply during the prime ministership of Margaret Thatcher in the 1980s.

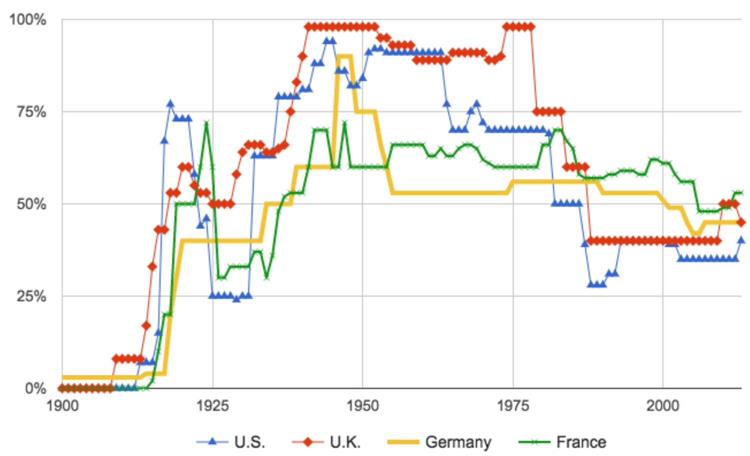


Figure 6.13: Top Income Marginal Tax Rate

The Effect of UK Taxes on Income Inequality

Direct taxes (e.g. Income tax, National Insurance Contributions) act to reduce inequality of income. Wealthier households pay higher amounts of direct tax and a higher proportion of their income in direct taxes. They are *progressive* taxes.

The below chart shows the effect which the combination of tax and benefits have on income inequality (Wells and Thomas, n.d.). The y-axis is the degree of inequality as measured by the 'Gini coefficient'.[4] The blue line is the level of income inequality before taxation and benefit distribution.

[4] A higher Gini value represents a less equal society, with 100% meaning one person has all the income, and 0 meaning everyone has the same

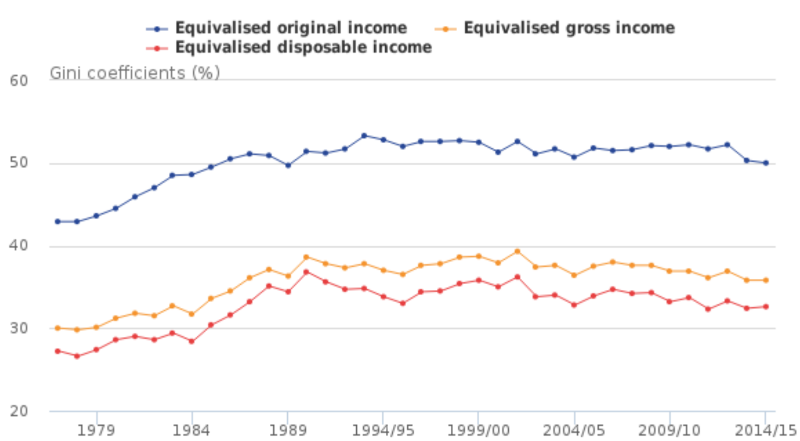


Figure 6.14: Impact of tax and benefits on income inequality

According to these ONS figures in 2014/15, the richest fifth of the population paid 22.8% of their gross income on direct taxes. The majority of this was income tax. The average tax bill for the poorest fifth was 11% of their gross income. The majority of this was from Council tax.

In 2014/15, after direct taxes, the average incomes of the richest fifth of households was five and a half times that of the poorest fifth (£67,000 and £12,300 per year respectively).

Income Tax made up the largest proportion of direct tax paid by the richest fifth of the population. Income tax is the most progressive of the direct taxes and thus has the biggest effect on reducing income inequality. The below chart compares the progressivity of income tax, National Insurance Contributions and Council Tax. A positive value indicates progressivity.

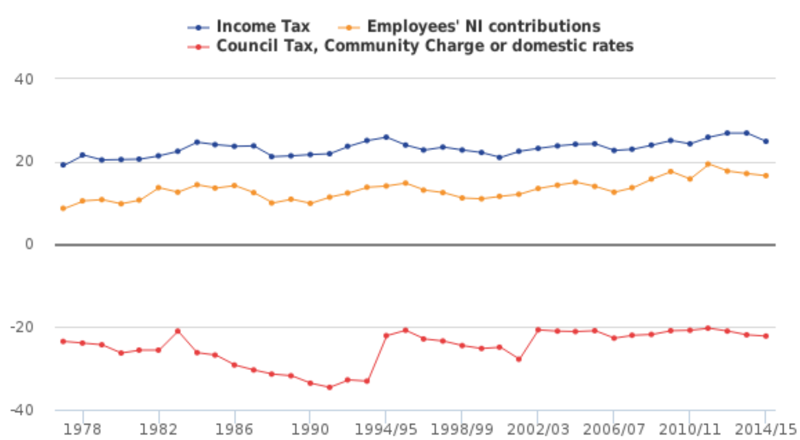


Figure 6.15: Income progressivity for various tax types

Despite fluctuation, there is a clear overall trend towards increased progressivity.

Using Income Tax To Reduce Income Inequality

Earlier, we discussed the top 1%, and evidence that their share of total income is racing away from the share of the other 99%. The below chart shows how the income share of the top 1% correlates with top marginal tax rates in the USA.

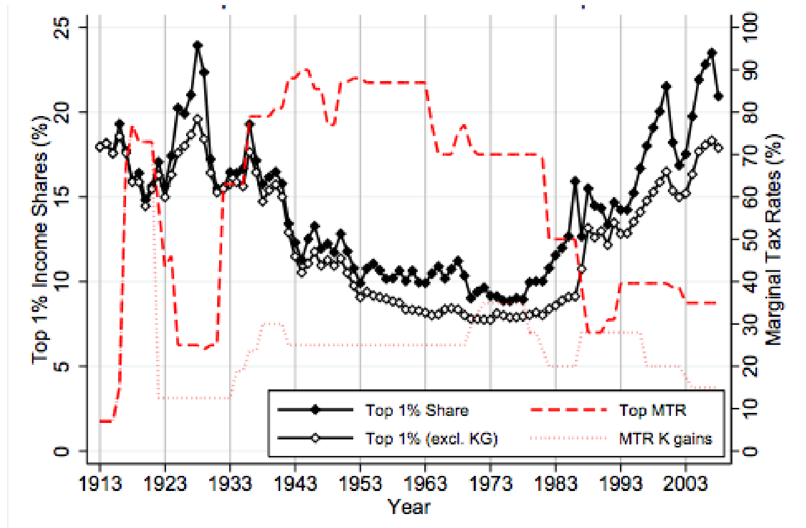


Figure 6.16: Correlation between top 1% income shares and top MTR

Immediately we can see a strong oppositional relationship, whereby a high marginal tax rate is generally correlated with a lower income share. So again, in the roaring 20s, we have a lower top marginal tax rate of about 25%, and the income share of the top 1% reaching a height of around 23%. During the depression of the 1930s and the Second World War, there in an increase in the top marginal tax rate and a severe reduction in the top 1% income share. During the 1980s, another drop in the top marginal tax rate and and an increase in the top 1% income share once more. So, this suggests a strong direct relationship between an increase in top marginal tax rates and a decrease in the top 1% income share.

The pattern is also evident if we compare different countries. The below chart shows the top tax rate and 1% share for a variety of countries in 2004-2008.

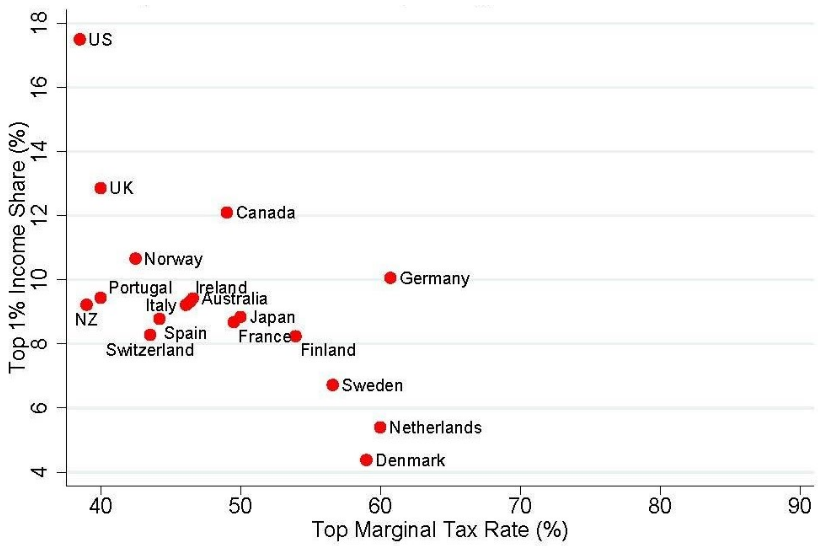


Figure 6.17: Top 1% share and top MTR for various countries in 2004-8

Again the top marginal tax rate appears to have an inverse relationship with top 1% income share. Those with the lowest 1% income share are the Nordic countries, with top marginal tax rates of between 55 and 60%. The UK and US, with lower top marginal tax rates of 40% and under, are also among the highest in 1% income share. There are anomalies, however,which indicate that top marginal tax rate is not the only factor contributing to the 1% income share. Germany is a bit of an outlier, perhaps due to tax deductions.

So, we conclude by arguing that firstly, the progressivity of income tax is welcome; and that atop marginal rate of around 60% is probably necessary to keep a moderate and stable income and wealth share of the top 1%. Reforming deductions and other complexities that the rich can exploit is another possible area of focus.

7.9 Income Tax: The details

Income tax is the tax which most people think of first when they think about tax. As the name implies, it is a tax which people pay on their income, which can include money earned from employment and or self-employment, state benefits, some pensions, rental income, investment income, income from trusts and work benefits. Some income is exempt from tax, for example; interest on savings and tax-exempt accounts.

How is it paid?

There are several ways in which income tax is paid, which vary in general according to whether the taxpayer is an employee, self-employed and/or in receipt of benefits. There is generally no minimum age for paying most income taxes, therefore even children who earn have income over the tax-free threshold will be required to pay tax.

Employees

Employees in Britain have income tax taken out of their pay packet before they are paid their wages. This is called Pay As You Earn (PAYE). Employers determine the tax payable by using the employee's tax code. This is a code which HMRC gives each taxpayer for tax assessment purposes, and which delineates their income tax bracket

State benefits

Those whose only income is state benefits may not have to pay any tax. In some cases, HMRC will require those on state benefits to submit a self-assessment tax return. This is a form (available online or in paper form) which stipulates an individual's income and is used by HMRC to calculate tax owed. The below table shows which benefits are taxable and which are not.

Self-employed

Those who are self-employed, such those those operating as a sole trader, will be required to register as self-employed and submit self-assessment tax returns.

Foreign Income

In some cases, a person may be required to pay tax on foreign income. This is income from outside England,Scotland, Wales, Northern Ireland or other parts of the world. Whether a person is required to pay tax on foreign income will depend on whether they are considered 'resident in the UK'for tax purposes. Those who are not resident in the UK will not have to pay tax on foreign income. UK residents pay tax on such foreign income. Special rules exists for UK residents who are 'domiciled' abroad. Foreign income includes wages if a person has worked abroad, foreign investments and savings interest, rental income on overseas property and income from pensions held overseas.

Taxable State Benefits	Non-taxable state benefits
The State Pension Jobseeker's Allowance	- Housing Benefit Employment and Support Allowance (income related)

Taxable State Benefits	Non-taxable state benefits
Carer's Allowance	Income Support (though you may have to pay tax on Income Support if you're involved in a strike)
Employment and Support Allowance (contribution based)	Working Tax Credit
Incapacity Benefit (from the 29th week you get it)	Child Tax Credit
Bereavement Allowance	Disability Living Allowance
Pensions paid by the Industrial Death Benefit scheme	Child Benefit (income based)
Widowed Parent's Allowance	Personal Independence Payment (PIP)
Widow's pension	Guardian's Allowance
	Attendance Allowance
	Pension Credit
	Winter Fuel Payments and Christmas Bonus
	Free TV licence for over-75s
	lump-sum bereavement payments
	Maternity Allowance
	Industrial Injuries Benefit
	Severe Disablement Allowance
	Universal Credit
	War Widow's Pension

Personal Allowance

Most people will not pay tax on all of their income. Rather, there is aset amount of income which a person can keep tax free. This is known as the 'Personal Allowance'. Income above the personal allowance is taxable. As of 2017, the standard Personal Allowance is £11,500. Thus, for most people, income up to £11,500 will be tax free and income above this amount is taxable. Those whose income is greater than £100,000 will have a smaller tax free personal allowance.[5] Those in receipt of Marriage Allowance or Blind Person's Allowance have a greater Personal Allowance.

[5] The Personal Allowance goes down by £1 for every £2 that the 'adjusted net income' is above £100,000.

Tax Bands

Above the personal allowance,income is taxable. However it is not all taxable at the same flat rate. The tax rate progressively increases in 'bands' as the amount of income increases. That is why income tax is known as a'progressive' tax - the rate increases as income increases. These rates are known as 'marginal tax rates'. The below table shows the tax bands for the UK (with the exception of Scotland, which has different rates).

Tax Band	Taxable income	Tax rate
Personal Allowance	Up to £11,500	0%
Basic rate	£11,501 to £45,000	20%
Higher rate	£45,001 to £150,000	40%
Additional rate	over £150,000	45%

Income above £150,000, is taxed at the Additional Rate of 45%.

So, for example, a person who had an income of £50,000, would calculate their tax payable as As can be seen above, the personal allowance is effectively a 0% tax rate on the first £11,500. The basic rate of 20% applies on income above £11,501 and up to £45,000. Any income between £45,001 and £150,000 is taxed at the higher rate of 40%. follows; they are entitled to the personal allowance of £11,500, leaving £38,500 of taxable income. The next £33,499 (£45,000 - £11,501) is taxable at 20%. The income above and including £45,001 is taxable at 40%. So, a calculation of tax owed would be:

(£33499 x 0.2) + (£4999 x 0.4) = £6699.8 + £1999.6 = £8699.4.

Savings and Dividend Allowances and Tax Relief

There are some other specific circumstances in which one might pay less income tax.

Tax relief: Tax Relief allows taxpayers to reduce the tax they pay or to get some tax repaid back. Tax relief may be available to people who pay personal pension contributions, charity donations, maintenance payments and to those working in special circumstances.. Tax relief also applies to work or business expenses. Self-employed persons may be able to claim tax relief for certain business expenses, while employees may claim tax relief for some expenses incurred for the performance of the job.

Generally, tax is payable on interest earned from savings accounts and on any dividends earned from shares owned. However, for these two sources of income, tax relief may be applicable depending on how the investments are disposed or reinvested.

Savings interest allowance

In the case of savings interest, the size of the allowance depends on how much 'other' (i.e non savings interest) income the taxpayer has. If the total amount of 'other' income is less than £16,500, then they will be eligible for a maximum savings interest allowance of £5,000. This is called the 'starting rate'. The starting rate will be reduced by £1 for every £1 of other income above the Personal Allowance. Those whose 'other' income is greater than or equal to £16,500, will not be eligible for the 'starting rate' of savings allowance.

HMRC offer the following example of a savings allowance calculation on their website (we paraphrase for clarity) (HMRC, n.d.);

> *Mark earns £15,000 in wages and gets £200 interest on his savings. HIs 'other' income (his wages) is less than £16,500, so he is eligible for the maximum savings interest allowance of £5000. Therefore his starting rate is £5000*
>
> *This rate is reduced by £1 for every £1 of 'other' income above the personal allowance. His Personal Allowance is £11,500.*
>
> *Therefore £15000 - £11500 = £3500. He has £3500 of 'other' income above the Personal Allowance. Therefore his starting rate is reduced by £3,500. His remaining savings interest allowance is £1,500 (£5,000 minus £3,500).*
>
> *Therefore, as Mark's savings interest is £200, which is under his allowance, he doesn't pay tax on his savings interest"*

The starting rate is not the only way in which one can avoid paying tax on savings interest. Depending on which tax band a taxpayer's income falls in (Basic, Higher or Additional), the taxpayer may get up to £1000 savings interest tax free. The below table shows the different allowances for the respective tax bands.

Income Tax band	Tax-free savings income
Basic rate	£1000
Higher rate	£500
Additional rate	£0

The savings covered by the allowance include bank and building society allowances, savings and credit union accounts, unit trusts, investment trusts and investment companies and peer to peer lending. Also, government or company bonds, life annuity payments and some life insurance contracts. Savings which are already in tax-free accounts (eg ISAs), are not included in the allowance.

Dividends

No tax is payable on the first £5,000 of dividends received in the tax year. Above this allowance, the tax payable depends upon which income tax band the taxpayer is in. The below table shows the dividend tax rate for various tax bands.

This area of income tax is somewhat complex. For further information, HMRC offers a detailed factsheet

Tax band	Tax rate on dividends over £5000
Basic rate	7.5%
Higher rate	32.5%
Additional rate	38.1%

7.10 National Insurance Explainer

Originally, National Insurance(NI) did resemble an insurance program. It began in 1911, whereby employees would pay a portion of their wages into the scheme, and could claim from it if they fell ill or became unemployed. In this sense, it was very much a contribution-based system, whereby 'those who paid in, could takeout'. Now, workers pay National Insurance to build up an entitlement to claim several social benefits. One's entitlement to benefits, depends on the'Class' of National Insurance one pays.

NI Classes and Contributions:

Some form of NI is payable by anyone who is 16 or over and is either an employee earning over £157 per week,or is self-employed and making a profit of £6,025 per year.

There are separate 'classes' of National Insurance.These are numbered 1 to 4. The class into which an individual falls, depends on their type of employment, and income level.

Class 1 National Insurance

This is paid by employees earning more than £157 a week and under State Pension age. It is automatically deducted by the employer. Employers also pay Classes 1A and 1B NI once a year on any expenses and benefits they give to their employees. For the tax year 2017 to 2018, the rate is 13.8%.

The 2017-18 Class 1 National Insurance Contribution rates are as follows:

Your pay	Class 1 National Insurance rate
£157 to £866 a week (£680 to £3,750 a month)	12%
Over £866 a week (£3,750 a month)	2%

Class 2 National Insurance

Self-employed people who earn £6,025 per year or over pay Class 2 NI. Those who earn less may choose to pay voluntary contributions. For the tax year 2017-18, the rate is £2.85 a week.

Class 3 National Insurance

These are voluntary contributions which can be paid to fill or avoid gaps in a person's NI record.

Class 4 National Insurance

Class 4 contributions are paid by self-employed people earning profits over £8,164 a year. For 2017-18, the rate is 9% on profits between £8,164 and £45,000, and 2% on profits over £45,000.

People who are employed and self-employed will pay Class 1 contributions on their wages, and Class 2 or 4contributions on their self-employment income.

Employed people continue to pay NI until they reach State Pension age. Self-employed people who pay Class 2 contributions, will pay until they reach State Pension age while those who pay Class 4 contributions will pay until April 6 of the year they reach State Pension age.

National Insurance Benefits:

By paying (some types) of National Insurance, workers build up an entitlement to claim state benefits, such as retirement pension. The kind of benefits to which one is entitled depends on the Class of NI which one has paid.

The table at the bottom shows which benefits are available to which NI Class payers.

National Insurance Credits for those unable to pay

Those who are not paying National Insurance Contributions, for example the unemployed or ill, may receive National Insurance Credits. Those on Jobseeker's Allowance (JSA) or Employment and Support Allowance (ESA) will receive Class 1 credits automatically, while those who meet the conditions for JSA or ESA but are not receiving them, can apply for NI Credits. There are also credits available (after satisfying conditions) for those on other types of payments. This includes maternity, paternity or adoption pay, carers and foster carers, carers, those on working tax credit, those on universal credit, and some other groups.

Benefit	Class 1: employees	Class 2: self-employed	Class 3: voluntary contributions
Basic State Pension	Yes	Yes	Yes
Additional State Pension	Yes	No	No
New State Pension	Yes	Yes	Yes
Contribution-based Jobseeker's Allowance	Yes	No	No
Contribution-based Employment and Support Allowance	Yes	Yes	No
Maternity Allowance	Yes	Yes	No
Bereavement Payment	Yes	Yes	Yes
Bereavement Allowance	Yes	Yes	Yes
Widowed Parent's Allowance	Yes	Yes	Yes
Bereavement Support Payment	Yes	Yes	No

7.11 Core Arguments for Progressivity

As has been outlined above, growing inequality in a society can lead to negative consequences for social cohesion, and outcomes for the poor. We base our argument for progressive tax systems on the following key ideas.

- Macroeconomic - rich save more, thus economy prospers with redistribution OR you growing private debt
- Utilitarian / Darwinian- Money for rich is worth less in utility terms (or subject to consumption arms races)
- Political problems withgrowing inequality -> Oligarchy. Monopoly/Oligarchy can also lead to increased rents and inefficient production of goods

We do have to balance these arguments against the idea of incentives. How indeed does a government decide what should be taxed?

Should this be income or consumption according to the above arguments. Should it be companies or individual wealth? And is the Government's nudges towards 'better' choices removing the freedom of the individual to choose? Will there be fears of paternalistic government.

If it is the case that consumption taxes, like VAT, are regressive, then this highlights the need to evaluate the broader systemic progressivity of the entire tax system, and its net effects on different income groups. We prioritise this in our proposals section, whereby the inequality of the system is one of our key evaluatory metrics.

7.12 Wealth Begets Wealth: Explaining Piketty

The economist Thomas Piketty (Piketty 2014) found that in a capitalist economic system, returns on capital wealth will increase at a higher rate (faster) than wages.

Poorer people make most of their income through wages and hold little wealth in investments. Richer people make a greater proportion of their wealth from investments and much less in wages. The below cartoon illustrates the state of affairs in the US.

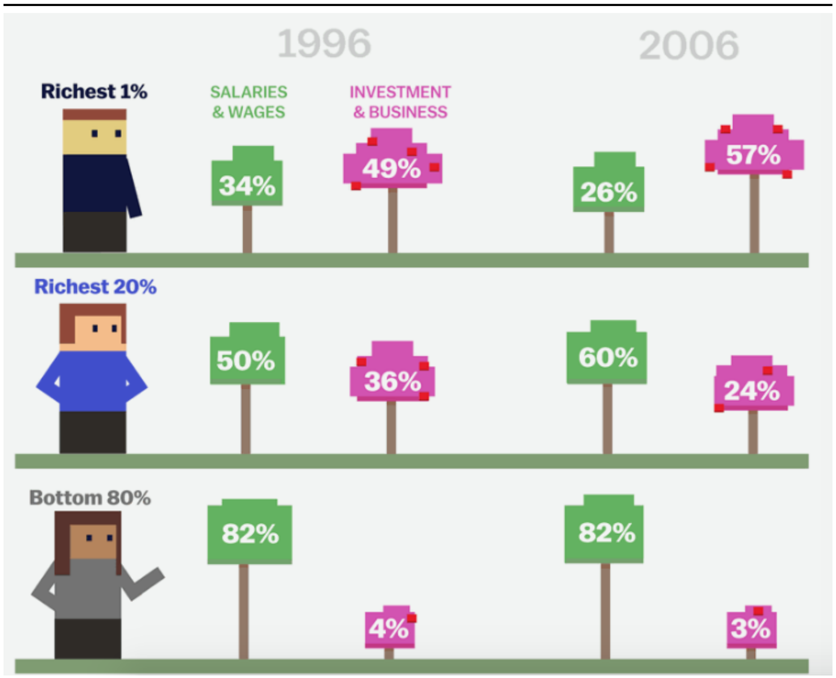


Figure 6.18 - The rich get richer through secondary wealth creation

So, as their wealth increases faster than poorer people's wages grow, the gap between rich and poor will tend to increase. There is a kind of unfairness built into the system, which operates in favour of those with wealth.

But why? Wouldn't we expect that financial capital available to invest would be diverted into high-yield 'low hanging fruit' investments first, and that over time competition over these promising investments pushed the returns down?

For sure, improving technology would create new investments, but even that should in the end lead to more competition and eventually reduced yields for investors? Why, then did Piketty find that the return on financial investment outstripped the growth in wages over the long term?[6]

[6] And then, if wealth is consequently better distributed, the option of more leisure time and less toil, as Keynes once hoped for

To answer this question we have to distinguish between the two meanings of the word 'investment'. The first and primary meaning of 'investment' is the creation, or building, of a new physical asset. So we can talk of a manufacturing company investing in new equipment. This is investment in the *economic* sense.

The second meaning of the word is in the *financial sense*. I invest if I buy a financial asset which I hope to give me a financial return. This is 'investment' in the financial sense.[7] There are some financial investments that are also economic investments. Classical economists talk about factories as 'capital' goods.[8] Such investments are *expandable*. As new funds become available, more factories are built. An investor who builds a new factory competes with another factory down the road. The competition reduces prices and the rate of profit falls overall. Even purchasing pre-existing assets can sometimes be part of this process, if the underlying asset is expandable, and that purchase leads to some physical investment elsewhere in the system.

[7] We can also talk of 'placing our money' somewhere, and French has a separate word for a purely financial, not real, investment - a '*placement*'

[8] The related distinction between capital and land (in classical economic terms) is considered in more detail at the end of part 3

But there are some financial investments that are not economic investments. We talk of these as 'pseudo-investments'. The critical thing about these pseudo-investments is that they are not expandable: they are fixed. *Their return is not competed away* when funds are plentiful. Rather the price of the assets goes up. A typical example is land. The amount of land in central London is fixed. It cannot expand.Another example would be shares in monopolies, or even other companies existing outside the perfect competition beloved of economists.

So what does this mean for the inequality of wealth? Well if wealth is primarily composed of 'expandable' forms like factories, then greater availability of investible funds will lead to better growth. That growth will compete away the returns of investors as the profit rate falls. If however, wealth is composed primarily of non-expandable forms like land and companies in monopoly positions, then as individuals save and demand assets, these assets will just go up in price, making the richer even richer.

These methods of the rich getting richer are not only unfair, as the monopolist or landowner need not work for the increases in wealth, but are also economically inefficient as the monopolist overcharges and also pulls scarce investment funds away from productive investments.

The MIT PhD student Matthew Rognlie noted that Piketty's conclusion depends on housing being included in what Piketty calls 'capital' (wealth) (Matthews 2015). Without housing, the return on wealth ownership no longer outstrips the growth in the economy. The share of GDP going to capital when housing is excluded is even falling slightly.

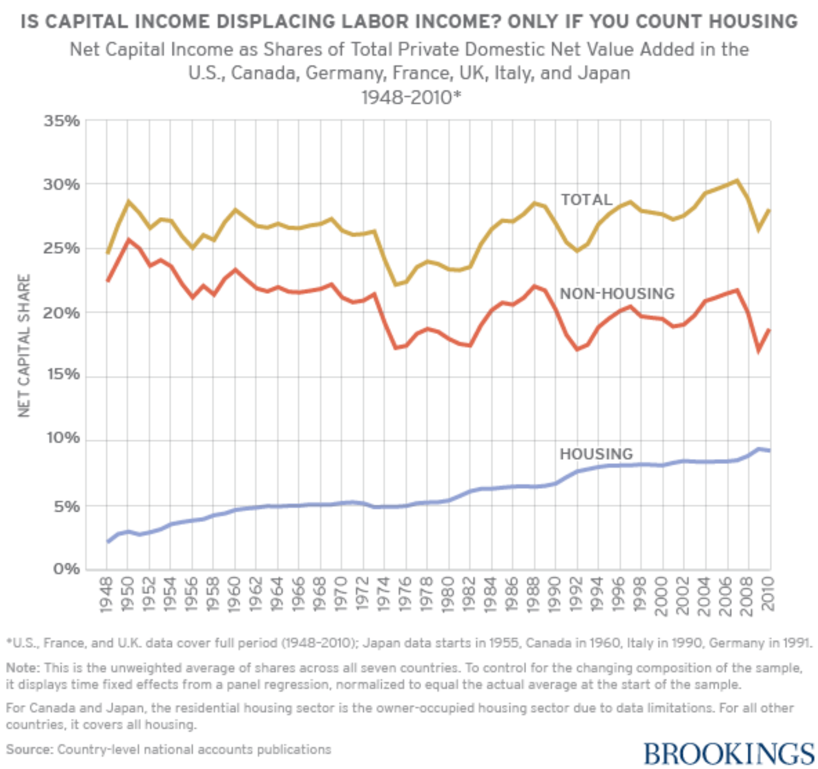


Figure 6.19 - Capital income displacing labour income

This is consistent with our argument, if housing is closer in nature to land (i.e. non-expandable, local monopoly) than capital. To properly test the hypothesis, we'd need to disaggregate the land element from housing (relatively straightforward) and the monopoly element from companies (much less straightforward). However, the data is at least broadly supportive of the case suggested by Piketty's economic theory.

7.13 Conclusions

To summarise, economic theory tells us that there are some particular ways in which the wealthy are able to accumulate wealth which we propose to be unfair and unproductive to the economy.: Land, Monopoly, and the interplay between interest rates and asset values.

Land

Wealthy people make a large proportion of their wealth through increases in the value of land which they own. When we talk about land, we are primarily concerned with the land on which urban buildings stand. This is the part of its value associated with *location*. Land is fixed in supply, and when certain locations become more desirable (such as London), supply cannot increase to meet demand.

The result is a localised price increase and the increase in wealth of people who own land in the area in the form of land value. It is important to remember that this value was not created by the landowner, but rather by the people who made the location more desirable. These external value drivers include the government for creating transport links, schools and parks; business owners for creating jobs, cafes, shops and services; and the community, by building community-links and atmosphere. All of these creations increase the desirability of the land in a particular location. This in turn increases its value. Under the UKs current system, the landowner is able to keep this value increase.

We believe that this is unfair, as the community as a whole produces the wealth and we propose a Land Value Tax to address this unfairness. We go into detail about this topic in Chapter eight.

Monopoly

> *'The head of one of the largest manufacturing firms in the United States said to me recently, "It is not on our ordinary business that we make our money; it is where we can get a monopoly." And this, I think, is generally true.'*
> (George 1883)

A 'monopoly' is a stranglehold on a particular desired product, asset or service. As in the case of landowners, who are themselves a sort of monopolist, the monopolists get rich because of a lack of competitors in the market, which allows them to set any price. This means that their profits are far above the efficent level that would be set in a freely competitive market. Natural monopolies can exist when the economies of scale in running a particular business mean that it is more efficient to be large and carpet market share. The figure below summarises these concepts of competition and monopoly.

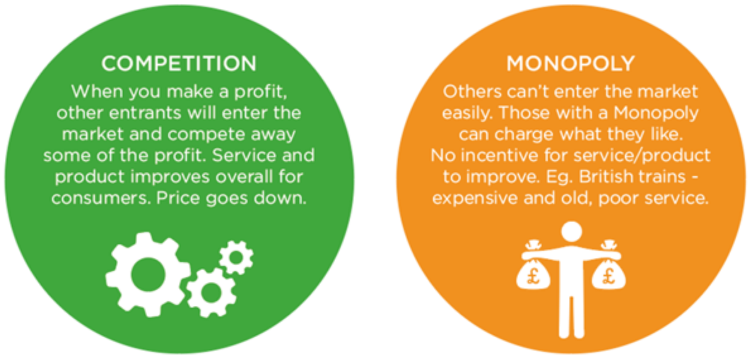


Figure 6.20 Competition and Monopoly

As Interest Rates Fall, the value of Assets appreciates

Another effect is closely related and acts to accentuate the monopoly effects. As real investments get exhausted, rates of return on real investments may fall. In addition, the central bank can cut its interest rates to stimulate the economy. This encourages people to take on loans and through high indebtedness we can get accustomed to a low interest rate situation. This relationship has important price effects on land and other monopolies.

Wealthy people can see increases in their wealth when interest rates go down. The interest rate determines the ratio of the return on an asset to the capitalised value. For example, as interest rates fall people can afford to borrow more to buy a house. There will therefore be an increase in the ratio of the purchase price of the house to the rent that such a house will command. This is also true of other forms of wealth, like company shares. Of course if the interest rate goes up, then the opposite happens. Since the early 1980s, there has been a fall in interest rates to the current day historically low levels. Asset values have ticked up.

The figure below summarises how these factors can contribute to increased income inequality.

Figure 6.21 Factors of Income Inequality

Summary

We've seen that wealth and income inequality can have deleterious social effects. We've noted the importance of income tax as a progressive tax reducing income inequality. We've also noted three methods of wealth acquisition that are both economically inefficient and unjust: land ownership, monopolies, and related unearned capital gains due to falling interest rates. In the next two chapters we will look at corporate structures; after that we will consider land; and finally environment and resource rents.

PART 8: WELFARE AND WORK

Summary

- Work plays a major role in modern life, yet it can be difficult to define precisely. Work can be purposeful and fulfilling (work as leisure) or it can be unsatisfying drudgery (work as toil).
- Work can be of benefit to society (e.g. Nursing), or it can be harmful (e.g. Advertisement for junk-food). Benefit and harm are often not reflected in salaries.
- In the UK, there is has been a decrease in unemployment but growth in low income, low-skilled and insecure work. There has been an increase in people relying on tax credits to top up their wages.
- Many people feel overqualified and dissatisfied with their work. There has been an increase in the numbers of people working excessively long hours (NB: I don't know if this is true, workhouses?). This is associated with increased rates of heart disease, mental illness, diabetes and stroke.
- There is a relationship between the labour market and welfare. When work is precarious, there is a need for unemployment benefit to plug the gaps. Illness from overwork may lead to a need for Employment and Support Allowance or disability payment.
- The current British welfare system is unsuitable for the needs of today's workforce.
- The current system discourages people from transitioning into work. There is also a stigma associated with receiving benefits, contributing to a non-take up of benefit by people who are entitled to it. Administrative delays and assessment mistakes are also rife.
- Any new welfare system should be flexible, avoid disruptions in income, be empowering, promote work-life balance, be non-stigmatising, simple, avoid benefit trap, be modern and sufficient to live on.
- Citizens Income would meet many though not all of the above requirements. It is an income, unconditionally granted to all, on an individual basis, without means test or work requirement.
- Guaranteed Jobs and Skills training could be used to improve the skill level of people in deprived communities. A successful program would help people discover what work people would like to do and would be targeted towards skills needed by employers.

> '*I think there's a lot of pressure in this country to work when you have kids and I don't think that's true of everywhere.You think of somewhere like Germany, when you are at home with your kids that's OK ' but here there's pressure all the time to be out working*'.' 'Laurie',single parent

> '*I also just feel that bringing up a child is working! Why is that not given the status?*' 'Ray', single parent.

> *'I have a job with a really flexible employer, but I do get called up at short notice and it's incredibly stressful*.' ''Martina'

> '*If you are on a zero-hour contract, you are already not going to be earning much, so how do you pay for childcare to cover those times? It's not unreasonable for people to have some kind of predictability in the workplace*."'Keira'

8.1 What is Work?

'*We shall honour those who can teach us how to pluck the lilies of the field who toil not, neither do they spin*' (Keynes 1930)

THOSE WORDS WERE WRITTENin 1930 by John Maynard Keynes, the eminent economist, in an essay entitled Economic Possibilities for our Grandchildren'. In the essay, Keynes predicted that in 100 years time, people in the developed world would be working for about 15 hours per week on average. He claimed that this would be because of rapid technological advancement and productivity growth, meaning people could work less and still meet their needs. He thought that we would have more leisure time, and worried about how people might use it. This prediction was made for the year 2030, and we are far still from that point.

As explained by Keynes biographer, Lord Edward Skidelsky, in 'How Much is Enough' (Skidelsky 2013), Keynes was largely correct in his predictions on technological advancement. However, we have not seen a commensurate decrease in working hours or the wage growth that would allow society to meet its needs with reduced working hours for its citizens. From the latest ONS figures, full-time workers in the UK put in an average of 37.5 hours per week. Those working part-time work on average 16.1 hours per week (ONS 2016c). So, even what we consider nowadays to be a 'part-time' working schedule is greater than Keynes' predictions.

Work, in the form of paid employment, plays a huge role in our conception and experience of modern life. Many of us spend more of our waking hours in work environments than at home or in social situations. Even these basic categories are not fully descriptive, as our work colleagues can often become our friends and spouses, and our homes may also be our offices. Moreover, the concept of a career (as opposed to merely a 'job') plays a central role in our sense of identity and personal purpose. One of the most common questions asked when meeting someone is, 'What do you do'? Those without an impressive answer may feel a sense of personal shame at being unable to join in on this modern introduction ritual (YouGov and Will Dahlgreen 2015). This is no surprise - for most of us, the importance of our role in the workforce and the centrality of a career to our personhood has been drummed into us through the questions asked in our childhoods such as 'What will you be when you grow up?'

Defining work as Leisure or Toil

For such a widely used term, the specific meaning of 'work' seems strangely hard to pin down. A standard definition might be 'the exertion of effort in exchange for remuneration', although that would not account for unpaid domestic labour or the efforts of entrepreneurs and artists who are yet to see income from their activities. Even within this definition, the breadth of experiences covered is striking. For example, handsomely-paid actors who live out their dreams by appearing in films call this activity 'work'. This is the case even if they would do the same exertions for much less remuneration. Similarly, an exhausted cleaner, vacuuming office buildings at 2 AM on a very low wage because they need money to pay for rent and food, is also performing' work'.

Work is often talked about by politicians as though it is an absolute good. To some, to be 'in work' is always better than to be 'out of work', no matter what the job is, or what other worthwhile activities the 'out-of-work' person might be performing (Wintour, Patrick Wintour, and Mulholland 2010). Slogans about getting people into work are regularly parroted, and often precede restrictions on access to benefits. Yet, as the above example demonstrates, work can be both a purposeful and fulfilling activity which a person engages in for its own sake and a drudgery which a person does purely for the purpose of remuneration. This difference is clarified by Skidelsky, who makes a useful distinction between work as 'leisure' and work as 'toil'. *Leisure* is described as activity done for its own sake, because it is intrinsically purposeful to the person performing the activity, rather than for an extrinsic reward. Notably, this definition of leisure does not equate to idleness. As Skidelsky writes,

> *'The sculptor engrossed in cutting marble, the teacher intent on imparting a difficult idea, the musician struggling with a scene, the scientist exploring [. . .] space and time. Such people have no other aim other than to do well at what they are doing. They may receive an income for their efforts,but that income is not what motivates them.'* (Skidelsky 2013)

Toil, on the other hand, is activity with no intrinsic value to the person performing it. It is done solely for an extrinsic end, usually a paycheck. Of course, this division is not clear cut; a lawyer might be engaging in leisure when fighting a cause they believe in, and toiling when they are not. An artist who sells a few paintings may be engaging in leisure, but also has to toil as a taxi driver to make ends meet. An activity which is fun and enjoyable once per week, may become toil when it is performed on a punishing 40 hour-a-week schedule. So, these concepts are limited, but useful, because they help us to direct ourselves towards what we want more of in society (purposeful activity) and what we want less of (drudgery). We therefore apply these terms in our discussion of welfare and work, as they help better flesh out the issues that can arise with policies geared at 'getting people back into work'.

Work as Benefit or Harm

The concept of work is also broad when taken to signify benefit or harm. In its common usage, it is taken to describe both activities which are beneficial to society and activities which are socially destructive. The activity performed by a teacher, for example, is thought to be socially useful. A good teacher helps children to develop into thoughtful, mature adults. A teacher imparts valuable knowledge and skills which prepare students for further study, future employment and life in the outside world. This way, educated students can then go on to make their own valuable contributions. Teachers' activities are essential for all kinds of social progress and social cohesion.

Consider then the work of an advertising executive who designs campaigns that promote tobacco, alcohol or online gambling. Their exertions at work are designed to encourage impulsive purchases, which then may lead to addiction and illness. The social costs of such outcomes can then have downstream effects on social provision like health services, on welfare and on the prison system. Much (though not all) advertising work is an effort to create a sense of need or desire in people which is not already present, or to create a sense of inadequacy which (it is promised) will be relieved by purchase of the advertised product. The result is often status anxiety, with social comparisons between those who 'have' the desired goods and those who do not, and wastage as 'obsolete', but still functional, items become undesirable. This also leads to increased consumption of the earth's raw materials. The New Economics Foundation has attempted to quantify the social value contributed by some work, and the social costs caused by other work. In their report, 'A Bit

Rich', they found that 'for every'£1 of value created by an advertising executive, '£11.50 is destroyed.' By contrast, they found that for every '£1 paid to a hospital cleaner,'£10 is created in social value (New Economic Foundation 2009).

Consider also the work of tax accountants who specialize in tax minimization for the super rich. Such individuals are often well paid and spend their time finding loopholes in the tax system to enable companies and wealthy individuals to avoid paying tax. It is estimated that '£12 billion is lost to the government from companies and'£13 billion from individuals each year due to tax avoidance. These activities are harmful to society as a whole, yet they are also considered to be 'work'. According to the New Economics Foundation, tax accountants destroy '£47 of value for every pound in value they generate.

There are, of course, forms of work which neither greatly benefit nor greatly harm society. There may also be work which appears not to make any contribution, but which may lead to a socially beneficial outcome after a long time. Few people could have imagined, for example, that Charles Darwin's curious hobby of cataloguing plants and animals would lead to a theory which would underpin major scientific and medical developments. So we cannot always tell when work is socially beneficial, but at a basic level we should try to incentivize that which we know to be beneficial, and reduce that which we know to be harmful.

Work, value and pay

There is no necessary correlation between pay and the kinds of work which are socially beneficial. If anything, the opposite is often true. Using the examples mentioned, the tax accountants and advertising executives are vastly better paid than the teachers, despite the perhaps dubious outcomes from the former options. We could take this point further and observe that it is possible to perform activities which are extremely socially useful, but receive no remuneration at all. As they lack remuneration, there has been debate as to whether to term these activities as 'work', but activities such as child-rearing, caring for elders, volunteer work and other forms of unpaid activity are often of great value to society. We should keep this point in mind as we consider the role of welfare and welfare recipients in society. Although people may be in receipt of benefits because they have no or little income from paid work, they may in fact be performing unpaid work which is socially beneficial (Webber and Chris 2016).

8.2 Work in the UK

Wages and the growth of low-skilled work

With those broader considerations picture in mind, we can consider the status quo for work here in the UK. In the three months leading up to May 2016, the UK unemployment rate fell to its lowest figure since October 2005. The below graph shows the unemployment rate from March 2011 to March 2016 (Richard Clegg 2016).

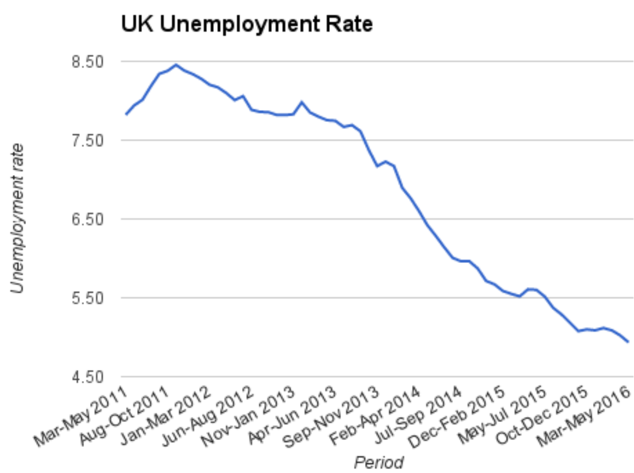


Figure 11.1 - UK Unemployment Rate

The number of employed people reached a record high of 74.4%. On the surface, this seems to be great news, but much the same as the concept of 'work', the employment rate hides a myriad of experiences.

Firstly, employment often does not provide sufficient income to cover an individuals essential outgoings. According to research by the CIPD Institute in 2014, in-work poverty in the UK has grown by 20% in the past decade (CIPD 2014). According to the New Policy Institute, in 2012, 4.3 million working families were receiving some form of welfare benefit, with the vast majority receiving support in the form of tax credits. While the level of employment is at a high not seen since the early 1970s, the annual rate of growth in wage earnings is slowing.

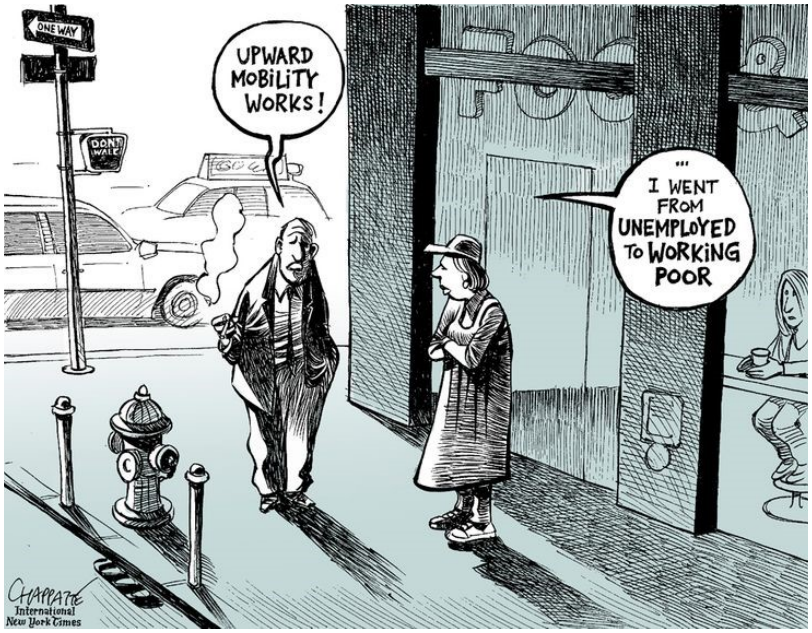


Figure 11.2 - Cartoon showing the folies of upward mobility and the working poor

Economics editor Larry Elliot (Larry Elliott 2016) suggests three reasons why this might be occurring. Firstly, he suggests that the UK is attracting people from other EU countries, so employers can comfortably find workers without increasing wages (Brexit may well put a dent in the number of EU citizens wanting to come to the UK). He believes that restrictions on public sector pay have been a factor. Finally, the jobs being created tend to be those which are low paid, such as those in hospitality. The CIPD Institute suggests that the government has taken a 'low road' approach to industrial policy, whereby the workforce are relatively disposable, providing relatively standardized goods and services at a low price and firms come to the UK because of the country's low corporate tax rates. They argue;

'Not only does a drift towards a low-road labour market and economy make for unfulfilling working lives for many (with associated stress and health costs attached), it supports the increase of low-skilled, low-paid work, helps fuel the growth in 'in-work' poverty, and at least some of the costs of employers adopting such practices are being passed on to the taxpayer and government via in-working tax credits that top up low wages." (CIPD 2014)

Underemployment and dissatisfaction at work

A related phenomenon is underemployment and the under-utilization of skills. The Spring 2016 Employee Outlook report from CIPD found that a third of employees believe that they are overqualified for their jobs (CIPD 2016). As well as contributing to low wages, this is likely to lead to dissatisfaction at work. The ONS compared the educational distribution in the UK labour market against average educational attainment per occupation. Their findings, shown below, were that the percentage of employees who were overqualified for their jobs had steadily increased since 2010 (Fred Foxton 2016).

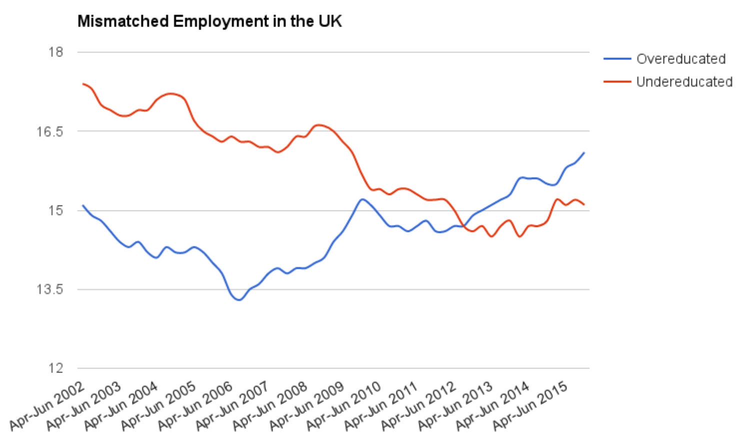


Figure 11.3 - Mismatched Employment

The CIPD report found that a third of employees thought that their organization did not provide them with the opportunity to learn and grow. Over a quarter felt dissatisfied with opportunities to grow their skills. Our earlier discussion introduced the concepts of work as inherently meaningful and work as toil. It seems probable that when people feel as though their abilities are being underutilized, they are more likely to experience their work as toil.

Work will also seem toilsome if it feels meaningless or pointless. A YouGov survey from 2015 investigated meaninglessness and work. 37% said that their job is not making a meaningful contribution to the world. 33% said that their work was not very fulfilling or not at all fulfilling. Another 45% said their work was 'fairly fulfilling' (YouGov and Will Dahlgreen 2015). Clearly this is a far cry from the ideal of people undertaking deeply satisfying and meaningful work which one would perform for its own sake. Further research reveals widespread employee dissatisfaction. The2016 employee sentiment poll from Investors in People reported that 1 in 3employees in the UK are unhappy with their current job and 49% are looking for a new job in 2016 (Investors In People 2016).

Illness and Wellness

Another cause of workplace dissatisfaction that appears again and again in employee surveys is an insufficient work-life balance (Antonia Molloy 2015). A punishing work schedule can transform work into toil. It can also contribute to workplace stress, mental illness, physical illness and family discord. Worryingly, the number of people working excessively long hours is increasing in the UK. A total of 3.417 million people are working longer than 48 hours per week, an increase of 15% since 2010 (Middleton 2015). The associated health risks are well documented. There is a direct correlation between the length of a working week and stroke risk. A comprehensive study by University College London (Sarah Boseley 2015) found that those working between 41 and 48 hours had a 10% higher risk of stroke and those working 49 to 55 hours per week had a 27% increased risk of stroke. The over 55 hour group also had a 13% increased risk of coronary heart disease. Other studies have shown increased risk of diabetes and obesity. These findings are unsurprising when we consider that long working hours often entail more time being sedentary, less time for physical exercise, less time to prepare healthy meals and less time for relaxing or sleeping. These basic lifestyle factors which underpin good health are all undermined by long working hours.

Overwork doesn't only show itself in physical illness. The Mental Health Foundation warns,

> *'The pressure of an increasingly demanding work culture in the UK is perhaps the biggest and most pressing challenge to the mental health of the general population.'*(Mental Health Foundation 2018)

In 2014/15, there were 440,000 reported cases of work-related stress, depression and anxiety. This translated to 9.9 million working days lost annually, with an average of 23 days per case. Stress accounted for 35% of all work-related ill-health cases (Health and Safety Executive 2018). However, long working hours aren't the only causes of mental illness. Other work factors reported included tight deadlines, excessive responsibility, a lack of managerial support and workload pressures.

Clearly, the current status of work in the UK today is far from the future which Keynes envisioned. Rather, overwork and underemployment are both prevalent factors, with some workers suffering from lack of work life balance and others from low pay (and some from both). Many experience their work as toil, feeling little satisfaction or meaning, whilst those making meaningful contributions to society may be unpaid or poorly paid. Importantly, the labour market does not distinguish between work which is beneficial or harmful to society in the way those jobs are remunerated. There is a need to apply new approaches and perspectives in addressing issues related to labour markets and state provision of safety nets. It is to this that we now turn.

8.3 Welfare

> '*I have reduced hours and taken time off from work and will have to do so again in order to continue caring. I am torn between caring, working and being there for my own family. I don't want to care anymore but I have no choice. I will jeopardise my job, health and persona llife in the process ' I don't know what will happen to me in the future'*.''Jane', carer (Carers UK 2014)

> '*The statements flying around about the 'work shy' and 'people who don't work for their money' are actually pretty offensive to me. This is not a life that we chose and my own experiences have shown me that it really could happen to anyone - we have gone from living in a privately rented home and earning a good wage to the very real struggles of living in social accommodation while struggling to get b*y' . ' Christina, living with illness (Fishwick and Carmen Fishwick and Guardian readers 2013)

> '*Trying to work full time (which is necessary!) and look after my father caused me to almost get to breaking point.This is when I was advised to contact social services about direct payments. I have since found out that I could have received direct payments for the past three years due to my father's condition, but nobody advised our family of this*'.' 'Sara', carer

> '*Even though I had been actively looking for work, and proved I was, when I spoke to my local centre about my difficulties in leaving my house, I was spoken to like a "benefit bum" and was sanctioned with absolutely no benefits for FIVE WEEKS. I was finished. I got more into debt, and had to rely on family to help me out. I really think a lot of the problems in people not finding work is down to the advisors in Job Centres who make claimants feel dumb, worthless and who obviously need extra help. I truly think this is where the government need to start, rather than just slashing people's payments.'* 'Martin, age 25. After becoming unemployed, he started receiving JSA. He became depressed while unemployed and missed an appointment, leading to benefit sanction.

> '*I'm sick of the government only describing the working as 'the strivers'. I AM a striver too, I worked incredibly hard to get into the best university in the country, but I can't work. That isn't MY fault. But I am STRIVING to get better and make a decent contribution to society. I wish I could give those ministers in the multimillion pound homes a piece of my mind*'. ' Bernadette, aged 18, has clinical depression.

What is Welfare?

People who are unable to find work, are too ill to work, are retired from work, are too young to work or whose work doesn't generate a livable income, still need the means to live. They still have to pay for food, shelter, heating, medical care, transport and family costs.

This is where government assistance, known alternatively as 'social security', 'social insurance', 'welfare' and 'benefits', comes in. Welfare exists to prevent people from becoming destitute. It aims, at the bare minimum, to provide a minimum standard of living.

The origin of the welfare state may be traced back to late Victorian Britain, during which liberal policymakers responded to the widespread squalor, poverty and criminality prevalent during industrial revolution. The modern welfare state was formed amidst the idealism of the post-WWII period, and it was set up to tackle the 'Five Giant Evils'; Want (Poverty), Disease, Ignorance, Squalor (Homelessness) and Idleness(Unemployment) as described by William Beveridge (Beveridge 1942). The Labour Party sought to eliminate these evils in their pledge to provide for the people of the United Kingdom 'from the cradle to the grave' through their victory in the 1945 general election. The plan for the welfare state was visionary, in the sense that it was motivated by a vision of the future which could be much better than the present and the past.

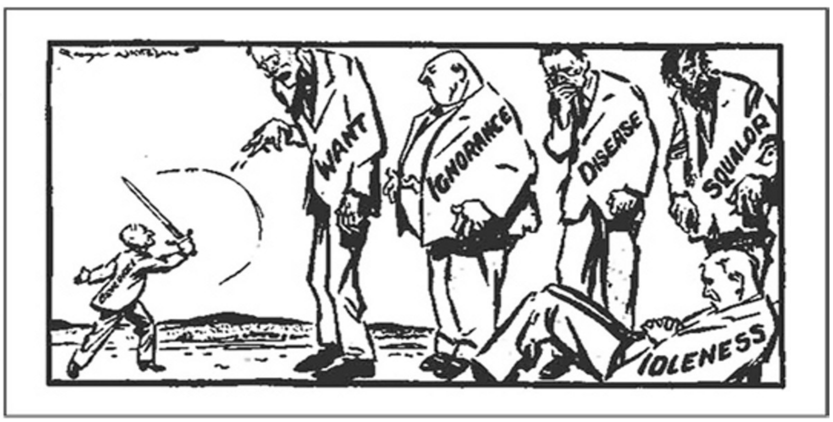


Figure 11.4 - Beveridge and society's five evils

Philosophically, it had two moral underpinnings. Firstly, it was based on reciprocity. This is the idea that if you've paid in, you're entitled to take out. Secondly, it had an absolute moral position, which said that whether a person had contributed or not it would be wrong to allow them to become destitute. Thus, a multifaceted welfare system emerged in the United Kingdom, built from a raft of different policies to protect the citizens from destitution. These include social insurance for the unemployed and sick and those injured at work, a national health service, free education, council housing and increased employment through public spending.

The welfare state has grown rapidly since its inception. In 2015/16, the total benefit pay out, (including the state pension) by the Department for Work and Pensions is expected to amount to about '£171 billion (23% of public spending) (fact 2015). This does not include the costs of administering the benefits.'£116 billion is projected to be spent on benefits for pensioners (including state pension) and '£53 billion on working age people. Benefits and tax credits together are projected to amount to'£210 billion in 2015 (fact 2015).

There is, of course, a sympathetic relationship between the issues with work outlined above, and demand for the welfare system. With increasing numbers of people in low wage jobs, there is a parallel increase in the need for supplementary income from the state insurance mechanisms.

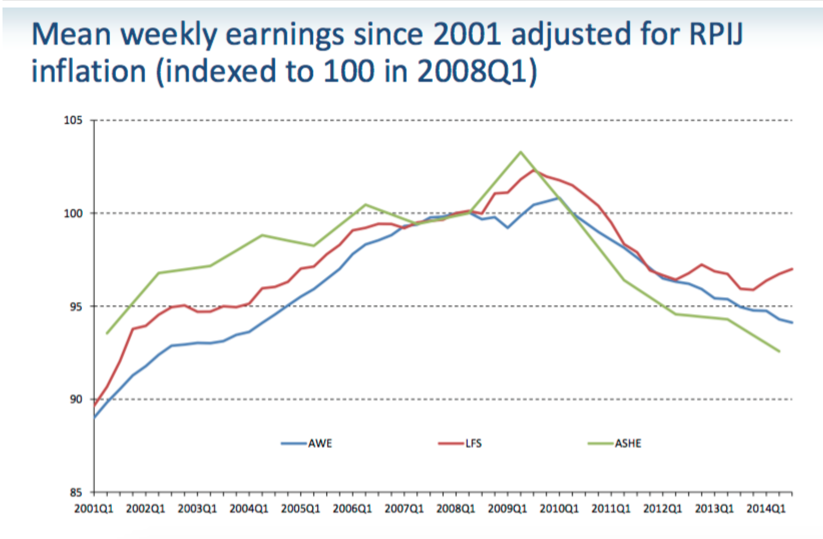


Figure 11.5 - Drop in real wages growth since 2009

With an increase in precarious, short-term jobs comes an increased need for unemployment benefit to fill in the gaps in employment. Overwork and unhealthy work habits can lead to illness which then require the payment of Employment and Support Allowance. Built around the model of long-term employment with a single employer, the current welfare state is unsuited to the demands of today's working environments.

Today's welfare state covers five main groups of welfare spending:

1. Incapacity, Disability and Injury benefits
2. Pension Spending
3. Unemployment Benefits
4. Housing (including Housing Benefit and Rent rebate)
5. Family Benefits, Income Support and Tax Credit

8.5 Issues with the benefit system

The 'benefit trap'

One of the problems with means-tested benefits is that they can create a disincentive to seeking paid employment. A person receiving benefits may find that their benefits cease when they take a job, and they also pay tax on their earnings, which often leaves them scarcely better off than they were on benefits. The current system is engaged in a shift from a sharp cut off point to a gradual phase out. With the former, when the costs of commuting to work and/or childcare are taken into account, this creates a strong disincentive for the unemployed to take up a low wage job.

The below diagram shows how benefits taper off as take home pay increases, for a lone parent with two children. We can see that the parent could hold a job which makes '£175 per week, and along with benefits, will receive a net income of around'£570 per week. If the lone parent decides to increase her income from paid work (usually by increasing working hours), to '£400 per week, she will be barely making any more in net income than she was before - around'£590 per week.

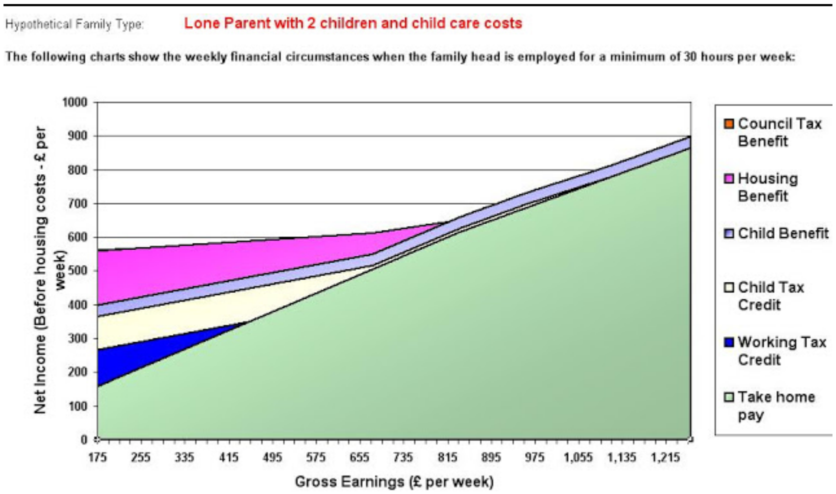


Figure 11.6 - Lone Parent with 2 children and childcare costs

Similarly the below chart shows how increases in household incomes can provide 'disincentives' for some when income reaches beyond certain thresholds, creating a jagged transition for income progressivity (Dyson 2015).

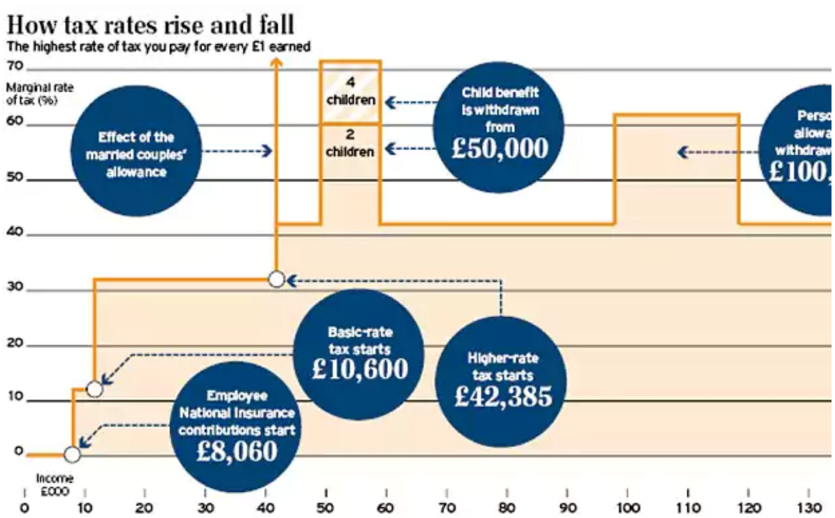


Figure 11.7 - How tax rates rise and fall

When we add the means-testing of benefits, the situation is even worse. For every '£1 earned, 70p or more of benefits are withdrawn. This is clearly a disincentive to work, a 'welfare trap'.

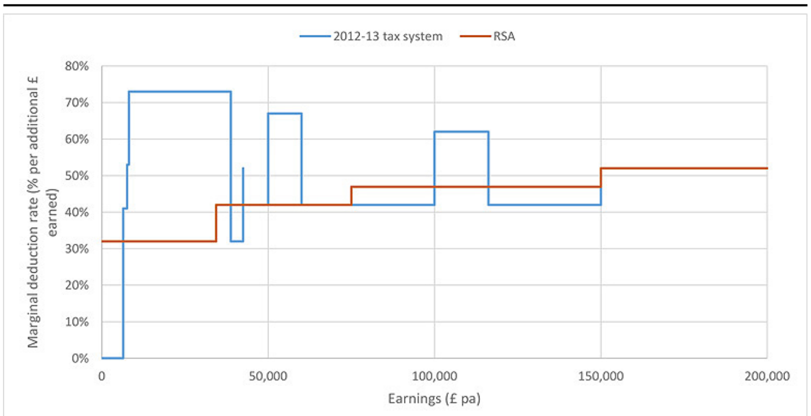


Figure 11.8 - Benefit Withdrawal and Marginal Tax Rates, with RSA Proposals

Administration

Many benefits require claimants to inform the Department of Work and Pensions of any changes of circumstances which may affect their benefits. Such changes may include, for example, a decline or improvement in an illness which may affect one's capacity to work, or affect one's living support needs. A gift of some money may affect someone's Job Seeker's Allowance. In many cases, the claimant is obliged to volunteer the information to the DWP. In some cases, (as for ESA and PIP), capability assessments are made by the department.

When a change in circumstances affecting entitlement occurs, this can often mean a sudden withdrawal of benefits and a long wait while decisions are appealed. There are also significant waiting times for people once they have submitted applications but before payments materialise, particularly in the case of JSA and Housing Benefit. When these gaps in support occur, individuals often experience serious economic hardship and mental stress.

The following real life case studies demonstrate ways in which hardship can occur;

Liam:

Liam received Employment and Support Allowance for mental health and mobility issues. After undergoing a work capability assessment, his ESA was withdrawn. Liam appealed the decision and after four months, his ESA was reinstated. However, he was without income for several weeks between the termination of his ESA and applying for JSA. He attempted to make savings and was compelled to go to a local food bank. His anxiety issues increased and the process exacerbated his young son's anxiety issues. After having ESA reinstated, it was again withdrawn after another work capacity assessment and he was forced to go through the same process again. He says,

> '*It's hard when you have to make choices. Do you cut down on the electricity you're using or do you cut down on the food? And when you're cutting right down to the bare minimum it's hard to cut back any more*' (Child Poverty Action Group 2018b)

This example demonstrates the hardship which can occur from an incorrect work capability assessment and from any form of sudden disruption to income. The frequency of errors in work capability assessments is concerning. Figures recently released by the DWP show that tribunals overturned 52% of Employment and Support Allowance appeals in the period Oct 2014-Dec 2014.

Sarah:

Sarah is a single parent and is at university. During the student summer, she has to go on job seeker's allowance and is subject to the conditionality criteria even though she would be unable to take up work because of her studies. She receives housing benefit during the summer months and this is reduced during term time. She says that whenever she has to reapply for Housing Benefit, she always has problems or delays;

> *'It causes me nothing but trouble. Last scholastic year I had to restart my housing benefit because they stopped it... it's just stress, stress, stress, stress,*

> *stress, all the time. Are they going to do it properly? Every time, twice a year I have to change my circumstances with them. And it's never once gone right, not once.* (Child Poverty Action Group 2018c)

These issues have exacerbated her anxiety and this has had an effect on her studies. She also feels that she has taken out some of the stress on her young son as there are only two of them in the family.

Emma:

Emma and her husband have very variable monthly incomes. They also receive tax credits. Despite contacting the DWP on a monthly basis to inform them of their fluctuating incomes, they were overpaid. As a result, they are now not receiving any tax credits at all. They now feel that even if they are entitled to tax credits, they are more trouble than they are worth.

> *'Currently we're not receiving any tax credits. We've not had anything for a wee bit and anything we do receive now would be offset against the over payment received. But we've come to the conclusion now that it's been so much more hassle than it's worth that, I think if I'm entitled to something then I should get it, but I'm scared to spend it.* (Child Poverty Action Group 2018a)

Stigma

There is a significant social stigma in receiving government assistance. Television shows like 'Benefits Street' and salacious tabloid headlines have contributed to the idea that those receiving benefits are lazy or a drain on society. Political and media rhetoric arguing for 'crackdowns on benefit cheats' have also fostered a culture in which people claiming benefits are viewed as untrustworthy and lazy. In such an environment, it can be seen as shameful to receive benefits.

In 2012, the charity, Turn2us UK, commissioned a study (Baumberg et al. 2012) to assess the impact of stigma in applying for benefits. Their findings were concerning. They found that the wider public sees benefit claimants as less deserving now than they did twenty years ago, with particular increases around the early 1990s and 2000s. They observed that these increases correlated strongly with non take-up of benefits, suggesting that many people do not take up the benefits to which they are entitled out of a desire to avoid the associated stigma. Worryingly, given the prevalence of mental illness in Britain, the study found that social stigma contributed to feelings of low self-esteem and worthlessness in claimants. As one contributor to the study, who was claiming Job-seeker's allowance stated,

> 'I *know I'm not a scrounging bit of scum but when it's told you over and over again and that's all you hear I can understand some people get really affected by it.*' (Baumberg et al. 2012)

The study also found that countries with benefit systems based on citizenship or contribution, see lower levels of benefit stigma than those with benefits based on means testing.

Benefits exist to prevent extreme poverty, to ensure a minimum standard of living for people, to enable people to take part in the economy and social life of the nation and to help individuals better themselves. It is beneficial for the nation as a whole that those who are entitled to benefit receive them.

There is, however, a serious problem of people not taking up their benefit entitlements. In the period 2014-15, only 6 out of every 10 people who were entitled to pension credit claimed this benefit. Only 5 out of 10 of those entitled to income-based jobseeker's allowance claimed it. 1.4 million families who were entitled to housing benefit did not submit a claim.

According to a 2014governmental report, 'Take-up may be affected by factors such as the attractiveness of the benefit, lack of awareness of the benefit or application procedure, lack of awareness of entitlement, the perceived stigma of receiving a benefit or other factors.' (ONS 2016b)

The below chart shows the proportion of unclaimed benefits, to overpaid benefits.

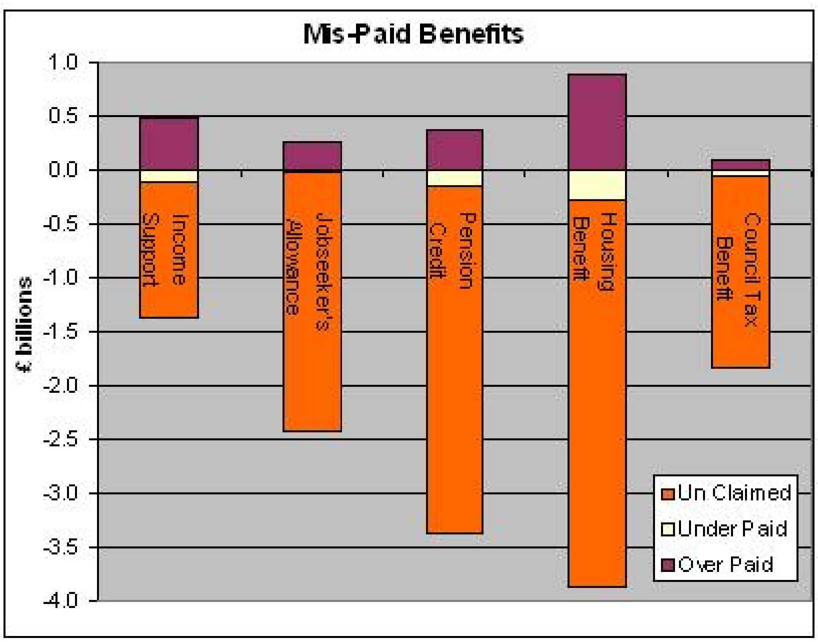


Figure 11.9 - Mis-paid Benefits

8.6 Criteria for a New Welfare Model

- **Flexibility** The welfare system needs to be adapted to a current work environment, in which people go in and out of short-term contracts and may be working part-time. The current system involves a time-consuming application process which is not responsive enough to changing conditions in people's work lives.
- **Stability** The system should, as far as possible, minimise or eliminate anxiety-inducing disruptions to income. Whether due to delays in processing applications, or because a claimant has changed their address or experienced some other life change, the current system imposes delays and cuts to benefits. This can cause extreme anxiety and repercussions on family members.
- **Enabling** In the area of support into work, the system should enable people to find their own way towards what they want to do. Ineffectual fortnightly appointments and compulsory work programmes often do not provide the tailored support needed. The goal should be to assist people to find work which is fulfilling and enjoyable for them (work as leisure), rather than taking any job for fear of benefit sanction (work as toil).
- **Balance** The welfare system and industrial policy generally should promote as far as possible a flexible workforce in which people are able to avoid illness-causing overwork. Improved work-life balance is likely to help carers, parents and older people who wish to continue working past retirement age. It is also likely to reduce unemployment, as people are able to share jobs.
- **Non-stigmatising** The current system is extremely stigmatising, particularly for the unemployed. Some of this stigma derives from compulsory and infantilising processes, such as requiring people to fill in a job diary,attend fortnightly meetings and take any job offered. Some also derives from the fact that the benefits are means-tested.
- **Simple** ' The welfare system should be as simple as possible and avoid excessive and unnecessary bureaucracy. Complexity creates confusion about entitlements, which can then lead to costly sanctioning.
- **Incentivising** The welfare model should avoid creating a benefit trap in which people experience a high effective marginal tax rate when they move from benefits to working.
- **Modernise** The welfare system should make use of technological advances as much as possible. Allowing people to submit information online rather than fill in pages of paper forms, can save both time and money.
- **Sufficient** Many people are struggling to make ends meet on the

benefits they receive. Many carers, for example, are sacrificing basic essentials as they try to survive on Carer's Allowance. Jobseeker's allowance is too low for most to live on, so for those who cannot rely on savings or family and friends, it can be extremely difficult to survive whilst looking for work.

Current Changes to the Welfare System

Much has been said already of the issues in the current welfare system. Bureaucracy and expense, over-complexity and poor built-in incentives have plagued the system since Beveridge's proposal for a 'Social Insurance' system (Beveridge 1942) was published in 1942. Following the 'National Assistance Act' in 1948, the first of Beveridge's policies implemented by Atlee's Labour government, successive Governments have continued to build and shape the modern welfare system into what it is today.

Beyond the original report the reforms have generally lacked overarching strategy. There have been a number of jolting, ill thought-out changes were made to the administration of welfare in the United Kingdom, as each party sought to make their own mark on improving the system. It seems then that tackling the problems of the welfare system may have had cross-party support, but that there has been no cross-party agreement on a coherent plan to fix them.

Emphasised by Damien Green, the current DWP secretary, it is 'compulsory to quote William Beveridge in any review of welfare policy'. Beveridge laid the foundations for the modern welfare system and is remembered for stating that 'the object of government in peace and war is not the glory of rulers or of races, but the happiness of the common man'. This is, of course, what the welfare system aims to achieve - if you understand 'happiness' as the ability to live a dignified existence with sufficient access to nutrition, shelter and healthcare. The entire endeavour is founded on the idea that any civilised society needs an economic 'safety net' for its poorest, and most at need. In any reforms this principle must be held above all others. The system may be efficient, it may be beautifully designed, but above all it must ensure that enough support is given to those who need it to survive.

A welfare system must also be sustainable. Firstly, it must ensure that sufficient revenues are collected from those in employment to fund this 'collective insurance', and secondly it must encourage those who are able to seek employment from other sources than the government. This should be a welfare system, rather than a welfare state. The current welfare system arguably doesn't do a good enough job at encouraging people back into work. This is, in part, due to built-in bugs that mean an individual faces a 'cliff-edge' when they work above a certain, arbitrary threshold. [3]There is also a lack of effective retraining opportunities and support that would enable an individual to upskill themselves and seek more fulfilling employment. These are important considerations when planning any kind of reform to the current welfare system.

The most recent overhaul of Welfare fell to Iain Duncan-Smith, then the Secretary for the Department of Work and Pensions (DWP). This overhaul was spearheaded by 'Universal Credit'. First proposed as a concept in a 2009 report by Duncan Smith's think tank, the Centre for Social Justice (Centre for Social Justice 2009), the government legislated for UC in their Welfare Reform Act 2012.

It was announced that the 'best performing' DWP and Tax-Credit processing centres would be chosen to run the pilot scheme from 2013. This was subject to a great deal of critique as to the 'overly ambitious' (Norris 2016) timetable chosen for the UC roll out. Such criticisms have also been echoed in the National Audit Office's report on 'Rolling out Universal Credit' (National Audit Office 2018). In this, they allege that the rapid implementation of the Universal Credit scheme has had detrimental impacts on the aims of the project - which include saving money on administration, running costs and promoting people to re-enter the workforce. The National Audit Office, which oversees government spending, said that the universal credit programme was "driven by an ambitious timescale" and that it had suffered from "weak management, ineffective control and poor governance".[4] They recommended that the roll-out be much slower, with a great deal more monitoring to ensure that any potential impacts on claimants are accurately assessed and accounted for.

At inception, Universal Credit had cross-party support. The policy involved combining six different means-tested benefits, and their associated IT systems, into one coordinated benefit. The benefits which were consolidated were Income Support, Income-based Jobseeker's allowance (JSA), Income-based Employment and Support Allowance (ESA), Housing benefit, Child tax-credit and Working Tax-credits. The purpose was to streamline these benefits and make it easier to claim

Unlike with the old system, there is no limit to the number of hours that an individual claimant can work. Rather, the system operates on a universal entitlement principle, whereby a base threshold of income is set which is thereafter reduced on a flat rate as an individual's earnings increase.

This adjustment to the system means that people on a low income no longer face the 'cliff-edge' of the 100% benefits withdrawal rate once they start working more than 16 hours. It is thought that a more gradual withdrawal rate, like that built into the new system, encourages such an individual back into full-time employment as it ensures that no one is better off claiming benefits than they would be working. Universal Credit currently sets this at a 63% withdrawal rate. This means that for every £1 earned above the income threshold, £0.63 is removed from their Universal credit entitlement.

The title is perhaps a misnomer. Universal credit is still subject to eligibility criteria. An individual must be between age 18 and state-pension credit age, not in full-time education or training and with savings under £16,000. They are also still subject to a maximum income threshold, above which they are no longer able to claim Universal Credit.

The Institute for Fiscal Studies has warned of a possibility that 'over three million households will see lower entitlements from universal credit with an average loss of £1,800 a year (and around two million households will see bigger entitlements with an average gain of £1,400 a year)' if they are not eligible for transitional protection (Hood and Waters 2017). Claimants for Child Tax credit and Working Tax credit will be the hardest hit by these changes.[5] For those who fear a sharp reduction in their benefits entitlements, there is a transitional smoothing mechanism built in to the system. This is part of the Government's commitment that 'no-one will be worse off under Universal Credit'. Provided an individual has claimed correctly for their benefits entitlements in time for the universal credit roll out, any loss in income when transferring to the new system will be accounted for by a transitional top-up payment. This, of course, omits those who have not, or cannot, fully engage with the current UK welfare system (e.g. the homeless, those with mental-illnesses and those who have fallen through the cracks in the social security system).

With over 1 million claimants now within the Universal Credit scheme, it has become apparent that there are some major flaws within the administration of the scheme. Designed to replicate the payment schedules of traditional employers, Universal Credit payments are made in arrears. This means that a claimant must submit their projected income for the month at least four weeks in advance. This obviously ignores the fact that most people who live on small incomes often receive payment on a weekly basis. Under the old system, the goal was to pay benefits within two weeks of a claim. Under Universal Credit, there is a formal waiting period of one week with no money when someone is onboarded to the scheme. With an average initial processing time of two weeks for every applicant, this means that there is at least a six week wait built into system before any benefits are paid out. However, around 25% of all Universal claimants must wait more than 6 weeks to receive their first payment in full because of errors and problems in evidencing their claims. This has caused problems for individual budgeting, especially for those on exceptionally low incomes, as well as for landlords.

According to the Trussell Trust, food bank usage has continued to climb in areas where Universal Credit has been rolled out. They claim that this is because delayed payments have seen people struggle to afford the basics as they wait for their entitlement to be paid. More pressingly, because of a shift in the payment of housing benefit to being paid directly to tenants rather than their landlords. This has caused significant increases in the number of people falling behind with their rent. Moreover, because the new system is fully digitized, those claimants who lack access to the internet or a mobile phone will find it difficult to follow up on, edit or even make new claims. This may cause further issues in administering the payments.

Moreover, the updated welfare system still does not incorporate the necessary retraining opportunities to effectively encourage individuals back to work. Perhaps lessons should be learned from alternative welfare systems like that in Switzerland, where language lessons and retraining classes are covered by the state if an individual becomes unemployed. Although the system makes headway by removing the 'cliff-edge' and improving the incentive mechanisms to return to work, the conditional element of UC still penalises an individual - both in income and time - for choosing to look for gainful employment rather than taking poorly paid and unfulfilling roles. It is understandable that for any welfare system to be sustainable, individuals with the capacity to work must do so. However, without effective retraining and educational opportunities, the bulk of the low-income workforce may remain under-skilled and underemployed.

Universal Credit is not in itself a bad proposal. As with most political agendas, the key lies in its administration. Streamlining the welfare system has been well overdue. With over 25 different benefits, it can often be an overwhelming process for claimants to ensure that they are receiving everything which they are eligible for. However, the rapid roll-out of the Universal Credit scheme has resulted in several administrative issues, delayed payments and increased confusion on behalf of the claimants. This can hardly be said to be fulfilling Beveridge's requirements for ensuring successful welfare reform.

Universal Credit should be considered as the first step towards a new system. It has done the 'hard work' of reconciling a few different benefits to give reformers a tractable baseline for income related benefits. It has also gone some way to reducing the bureaucracy by consolidating six different, separate IT systems into one, though it must be said that the UC administrative system is still far from perfect in terms of both operative efficiency and expense. We need now to work on addressing the remaining conditionality in the system, which still 'penalises' individuals for working. We also must expand the focus of these reforms to include better training opportunities and cooperation between the state and private sector to better support people into gainful employment. A shift in this direction would also help tackle stigma by transforming the 'welfare state' into its intended form, as a form of social-insurance that builds an individual's capacity/capabilities and guarantees them a sufficient and decent standard of existence.

We therefore argue that a Citizens Dividend could be the next step forward in combating these issues, which we will explore in the next section in more detail.

8.7 The Citizens Dividend

Brief History and Principles

In June 2016, a landmark referendum was held in Switzerland. The Swiss went to the polls to vote on whether the Swiss government should pay each citizen a monthly sum sufficient to allow them to live in a dignified manner and participate in public life. In Switzerland, referendums are commonplace - but what made this one remarkable is that it was the first time that the citizen's dividend idea was put to a referendum for serious consideration by the populace. Even more significantly though, the referendum launched the idea into the mainstream media, bringing it widespread attention, both within Switzerland and internationally.

So what is a citizens dividend? There are many different models of a citizens dividend, but the core principle is the same. The Basic Income Earth Network describes it as follows:

'A basic income (citizens dividend) is an income unconditionally granted to all on an individual basis, without means test or work requirement.

It is a form of minimum income guarantee that differs from those that now exist in various European countries in three important ways:

- It is being paid to individuals rather than households;
- It is paid irrespective of any income from other sources;
- It is paid without requiring the performance of any work or the willingness to accept a job if offered.' (Basic Income Earth Network (BIEN), n.d.)

This idea sounds shockingly radical to many of us, who are used to the mainstream stigmatizing of benefit claimants as lazy and work shy. For that reason, many assume that the idea of a citizens dividend is a new innovation. However, there has been a long history of advocation for a citizens dividend and it has been advocated at different times and in different countries by both progressive and conservative economists.

One of the earliest modern scholars to advocate the idea was British. Towards the end of the First World War, philosopher Bertrand Russell advocated a universal income sufficient for necessities, writing;

> *'A certain small income should be open to all, whether they work or not and that a larger income - as much larger as might be warranted by the total amount of commodities produced should be given to those who are willing to engage in some work which the community recognise as useful. When education is finished, no one should be compelled to work and those who choose not to work should receive a base livelihood and be left completely free.'*(Russell 1918)

Case Studies

Alaska

The Alaska Permanent fund is a constitutionally established fund, owned by the State of Alaska. It began in 1976 with the goal to ensure that every Alaskan could benefit from the state's exploitation of oil resources and that future generations could benefit even after resources ran out. Since 1982, Alaskans have received a yearly dividend from the fund, the amount of which varies according to returns on investments in the fund. In 2015, the dividend payout was '£2072.

The fund has been credited with contributing income equality, with Alaska having the second-lowest inequality of any state in the USA. In the period from the early 1980s to 2000s,Alaska was the only state in which the income of the bottom 20% of the population grew faster than the top 20% (Merchant 2015).

Madhya Pradesh, India

In villages in Madhya Pradesh, every adult was given a monthly payment of 200 rupees and every child, 100 rupees (paid to the mother or guardian). These amounts were later increased to 300 and150 respectively. These figures mean that an average family received the equivalent of USD$24 or GBP'£15 a month . These amounts were initially paid in cash, and later into bank accounts. The effect of the grants on the communities was studied over period of eighteen months, with the villages receiving grants compared with other 'control' villages which didn't receive the grants.

The findings were very positive. Many in receipt of the benefit used the money to improve their housing, latrines and to protect themselves against Malaria. There was a significant improvement in the average weight-for-age among children, particularly with young girls. People had better diets, partly because they could afford to eat more vegetables and fruits. School attendance also improved.

Those receiving the payments were more likely to reduce debts. Also there was an increase in production from small-scale investments, such as planting improved grain, repairs to equipment and the creation of shops. The scheme had a particularly positive effect for disadvantaged groups, such as women, the disabled and lower caste families.

According to Professor of Development Studies Guy Standing, allowing people to gain control over their lives was crucial to the scheme's positive outcomes. He states,

> *'The policy has transformative potential for both families and village communities. The whole is greater than the sum of the parts. Unlike food subsidy schemes that lock economic and power structures in place, entrenching corrupt dispensers of BPL (Below Poverty Line) cards,rations, and the numerous government schemes that supposedly exist, basic income grants gave villagers more control of their lives, and had beneficial equity and growth effects.'*
> (Standing 2017)

Manitoba, Canada

Between 1974 and 1978, the Canadian government ran a field experiment in the town of Dauphin,Canada. As part of the experiment, any family without income from other sources would receive a dividend amounting to 60% of the 'Statistics Canada Low Income Cut-Off' - (called LICO (Statistics Canada 2018)). Every dollar of income from other sources would reduce the payments by 50cents. Payments were indexed to cost of living. This meant a particularly significant increase for people who did not qualify for welfare under traditional schemes, such as the elderly, single, employable males and the working poor. Those who already received social assistance would see little change in their income.

The experiment ended without an analysis or report of findings, but in 2010 a Canadian social scientist, Dr. Evelyn Forget, uncovered the raw data. She found that compared with a control group,for those receiving the income there was a significant reduction in hospitalisation, especially for accident, injury and mental illness. Contact with physicians regarding mental illness also reduced during the period. They found no increase in fertility or family dissolution. A greater proportion of students also stayed in school to Grade 12. Dr Forget concluded: 'These results would seem to suggest that a Guaranteed Annual Income, implemented broadly in society, may improve health and social outcomes at the community level.' (Forget 2011)

Arguments in favour of a Citizens Dividend

It avoids the 'benefit trap'

The basic income concept avoids this trap because it is not means tested. It provides a minimum income floor. Therefore, any income from work which a person receives, will be added to this income floor. This will make it much easier for people to take on part-time or low wage jobs.

Citizen's Dividend is simple and cheap to administer

Means-testing adds to the cost of administering benefits. The finances of each claimant is individually assessed, which is time consuming and labour intensive. For example, the cost of administering claims for housing benefit and council tax benefit is almost 16 times higher than the cost of administering child benefit,which is non means-tested.

Also, the Department of Work and Pensions makes individualised disability assessments to determine claimants' eligibility for the Employment and Support allowance and the Personal Independence Payment. These assessments are performed by private contractors and are costly and time-consuming. A report by the National Audit Office in January 2016 found that the over the period 2015 to 2018, the Department of Work and Pensions expected to spend '£1.6 billion on contracted out health and disability assessments. The cost of ESA assessments was found to have increased from'£115 per assessment to '£190 per assessment after a change in contractors in 2015. The process of assessment for Employment as Support Allowance can be painful for claimants. The report found that ESA claims take on average 23 weeks to administer,during which period, the claimants are not entitled to full payments (Department for Work & Pensions 2015).

A citizen's dividend model would require no individualised means-testing of benefits. Most models of citizens dividend still require some benefit for those with particular disabilities or long-term illness, who have higher living costs as a result. Therefore, even with a citizen's dividend, some individualised assessment would be necessary. However, it is feasible that many people who currently receive Employment and Support Allowance, do not have extra costs due to their illness, but are merely unable to work. That is, many are on ESA because JSA would require them to look for work, not because they have extra health costs. With a Citizen's Income of a sufficient amount, it is reasonable to believe that many of those people would be satisfied with the basic amount, and will not require assessment for additional benefits.

As Simon Duffy of the Centre for Welfare Reform notes, 'Even on its own such a system (citizens dividend) would replace a large part of the need for the ESA, which currently costs'£14 billion and is received by 2.5 million people (an average of '£108 per week). This would kill in one stroke the crazy and expensive world of conditionality, sanctions, privatised assessments and ineffective training programmes into which disabled and sick people are currently forced.'

It reduces the stigma of receiving benefits

The study also found that countries with benefit systems based on citizenship or contribution ,see lower levels of benefit stigma than those with benefits based on mean-testing (Duffy 2016). The basic income would be universal and therefore is less likely to induce social stigma. It may not completely remove stigma of course, as there may be some stigma towards those who receive the benefit and do not attempt to find work.

It promotes freedom & independence, without compulsion

Rather than force people to apply for jobs which they have no interest in or for which they are unsuitable, the Citizens Dividend allows them to make decisions about what is best for them. As Sam Bowman of the Adam Smith Institute argues,

> *'A basic income (citizens dividend) is the least paternalistic welfare scheme possible. Instead of pushing would-be computer programmers into work as Poundland assistants, a scheme like this would leave decisions entirely up to the individuals involved. The discovery process that each of us is engaged in would continue, and now without mass decision-making by a central state authority.'* (Bowman 2013)

Assessing how much would be paid

Our citizen's dividend is not intended to meet all living costs. It is intended to exist in conjunction with a workfare scheme and together these would provide sufficient income on which to live.

To get some idea of what people might receive, we can look at the Minimum Income Standard calculator provided by the Centre for Social Policy and Research . They suggest that a single adult with no children will need '£286.54 per week. This can give us an upper bound for the amount needed. The Royal Society for the encouragement of Arts, Manufactures and Commerce (RSA) has proposed a basic income of'£3692 annually, rising to '£7420 for pensioners (RSA 2015). The current state pension is'£115 per week. The below chart shows that the RSA model would provide a more gradual marginal deduction rate as earnings increase, compared with the status quo.

For those who are ill long-term, or disabled, we would provide a greater amount based on their particular needs. This would be a non means-tested, non-taxable amount. Like the Personal Independence Payment today, an assessment of needs could be made,and supplementary amount provided. Depending on the base level of our Citizens Dividend, a supplementary amount may also be needed for full time carers. Simon Duffy of the Centre for Welfare Reform proposed a system in which abled people receive a taxable top-up to their citizen's income, as well as a supplement based on additional needs.

In assessing disability needs, we should avoid the harsh bureaucratic and alienating system which in operation today. Duffy (Duffy 2016) suggests a model in which people can claim the correct disability assessment for their circumstances and then have it validated by a GP, social worker or NHS expert (we suggest a new department at the NHS that would do these assessments). Reassessment should occur on a more personalised basis.

> *'In the end this system would help us take a big step forward towards human rights for all, including disabled people. Nobody would be subject to demeaning systems of control and punishment managed by the DWP(whether they had a disability or not). Everybody would get a basic income.Sick or disabled people would get an appropriate supplement to that income. In addition we would organise any further support and assistance in a way which was empowering and under the control of disabled people themselves.'*

8.8 Guaranteed Job and Skills Training

We would also propose a guaranteed job and skills training program, operating in conjunction with the Citizen's Income. For example we propose taking around 250,000 people into full technical apprenticeships each year.

There are severalreasons why we propose these two in tandem:

Geographical

Citizens Dividend is a flat payment to every individual. The difficulty with setting an amount is that it is hard to make it high enough for London and low enough to be affordable

One option would be to have a variable Citizens Dividend based on location. However this could encourage more pressure on housing in London, thereby worsening housing problems.

If you base the income level on original residency, then you introduce a sort of apartheid, in which neighbours may receive different Citizens Dividend levels.

Unlike the Citizens Dividend, a guaranteed job and skills training program can be applied geographically. It is more targeted.

Cost

Citizen's Dividend is intended as a low level payment, available to everyone apart from temporary residents and tourists. Along with the guaranteed job, everyone can be kept above the poverty line. Individually, they will not be sufficient.

The guaranteed job is not likely to be taken up by everyone. The purpose of the guaranteed job is to improve the skill level of people so that they can get an economically viable job in a globalized marketplace. We want to take people from being deskilled to highly skilled. The approach is to combine skill training in something that the person enjoys with real work experience in that area.

Tailoring

The system can be tailored to different types of people. For example, prisoners, homeless people, young people and older people whose work no longer exists have different requirements from a social welfare system. Implementation would involve trialled schemes and schemes operating in parallel. Local authorities can also be encouraged to set up their own schemes. Best practice could be developed to ensure individual needs are met. We would need a specific scheme for homeless people and disabled or chronically ill people.

We propose that prisoners get the full amount. Whilst in prison they would have access to the money to spend on provisions, then when they leave they will have a lump sum to restart their lives and not be a burden upon society. (If they die in prison the money cannot be passed on to relatives). Young people up to16 years get half the adult amount and those over 65 get 50% more than the adult amount.

Compulsion

If you just had a workfare scheme, then poor people would be compelled to take a job they didn't want. This kind of compulsion, as well as being difficult to impose, can lead to wasted time and opportunity, with people showing up for work but doing nothing. Rather than compelling people to take any job, a work scheme should help people to discover what they would like to do and assist them in that regard. To achieve this, flexibility is required. In contrast to a monolithic single scheme, we propose options for guaranteed jobs of different types which would be optional.

Tailoring jobs to skill gaps

Companies can give an idea of what skills are missing. If there is a situation in which skills are missing, people can be provided with combined training courses and work experience. In the beginning, there will be more training than working and then more working than training as individuals progress. Training will be targeted to particularly deprived areas. The idea is to upskill people within a 2 month time period, for lower skilled work. There would be conditionality attached to payment, with possible bonuses for high performance.

Organisations providing jobs

Three sectors will be active in providing jobs: government, companies and charities. Charities could run schemes and charities that could be unrelated to the problem of de-skilled unemployment could take on jobs. The benefit of allowing charities to run schemes is that charities often have a caring culture and attitude. This often provides an appropriate work environment for those who have physical or mental illness or who have been long-term unemployed.

There would be both providers of guaranteed job schemes and providers of the jobs themselves. Most jobs should be combined work and skills and may be affiliated with education providers. There would be no limit on the number of times people can go through the scheme. People can pursue more than one skills set if they so choose.

Entrepreneurship and networking

The scheme should not discriminate against people who want to start their own business. Entrepreneurship should be part of the core training. Currently, whilst there is a lot of support for innovation, there isn't much support for 'non-innovative' businesses. For example, China is good at supporting businesses which are not innovative, such as corner shops and copy shops. Skill sharing and networking will also be a part of the scheme. Once a database of skills is developed, people can call on others in the network. This could be in the form of a voucher or time banking system. Supplementary to this would be a system of CVs of people who have been through or are currently in the program, which could be useful for employers.

Creating a more caring society and building local communities

Local authorities can use the scheme to get more funding. This will contribute to a more caring society and promote the creation of more 'cathedrals' - projects which bring the community together.

Potential issues or limitations of the scheme

Guaranteed jobs could displace existing workers. Some employers that have people already could take the free labour and fire the people they already have. This occurrence may be difficult to prevent. In the worst case scenario, people will be rotated through the skills program.

A high skilled economy is inevitably more inflexible as it takes longer to get particular skillsets. Computer Technicians cannot easily retrain as brain surgeons. Also, certain work is only suitable for those with very high academic ability. This scheme would not be of great assistance as regards those kinds of skills.

PART 9: CORPORATIONS

Summary

This chapter is about the taxes on company profits. We consider what corporation tax is, whether it should be high or low, how it can be avoided, and some options for its reform.

9.1 Introduction

What Is Corporation Tax?

Personal Income Tax is paid by people who work. VAT is paid when people buy goods or services. Surely it follows that a tax should be paid when people are organised into a company?

Corporations, however, are legal constructs. They have no *real* presence in the world. They are legal forms which are ultimately owned and controlled by a person or people. A limited company is a legal form where the financial liability of the owners is limited to the net assets of the company. In other words, a company can go bankrupt and the owners of the company have some protection from the company's creditors. Corporations are the legal forms which are dominant in modern society and, much like religious organisations and educational institutions, wield enormous power.

Corporation tax is not the only tax on companies. Companies also pay business rates, which is a tax on the rateable value of land and buildings. This is covered in the part on section on land and property.

Corporation tax is a tax on company profits. In simple terms, profit is the difference between sales revenue and company costs. In this, there is an analogy with a general principle of taxation, which says that those who have more should pay more. With respect to corporations, those companies who make more profit, should pay more Corporation tax.

Who Pays Corporation Tax?

Corporation tax is also indirectly a tax levied on those who are owners of capital. These owners may be individuals or shareholders of corporations, and they gain value through changes in the value of their shares, or through the receipt of dividends after a company gains profits through their operations. Notably, the corporation tax burden falls mostly on capital owners, rather than employees because stock ownership is most concentrated amongst the wealthiest individuals and family trusts (Shaxson 2011).

Because corporations are not natural, but are legal constructions, it has been argued that Corporation Tax is not paid by corporations but by people, and that sometimes these people are not the ones we might prefer to target.

Economist Helen Miller makes this argument:

- "an important feature of Corporation tax is that the ultimate burden is not necessarily entirely borne by company shareholders. It can be borne by workers. In short, if firms decide to respond to higher corporation tax rates by doing less investment in the UK, that leaves UK employees with fewer job opportunities and lower average wages. Evidence suggests that, because capital tends to be much more mobile than workers, a significant share of the burden of corporation tax tends to get shifted to labour. Corporation tax can also be borne by consumers if firms respond by increasing the prices they charge." *(Miller 2017)

However, others have argued that it is unclear whether corporation tax falls largely on employees, and have made the wry point that if Corporation tax doesn't fall on the owners of capital, then why do so many companies try to avoid the tax?

We will consider later the possibility of a form of corporation tax that encourages companies to locate to the UK.

Companies Rely on Public Services Too

Corporate profits are not totally independent of public investment. Corporations require a number of public goods to run their companies successfully - from educated and healthy employees, smooth roads and public transport systems, and power grids and telecommunications systems for their companies to operate. They therefore rely on tax-financed public goods, including social investment in the education and health of employees, public infrastructure, legal contracts and property rights. Without these structures, which are upheld and funded by government, corporations would not be able to conduct business profitably.

Persistent High Profit or 'Rent'

Another reason for corporation tax concerns economic rents. Economic rents are basically the analogue to land rents: whereas it is assumed that high profits would be competed away by other companies, in some cases this is not possible because the company has some advantage that cannot be replicated by others.

The OECD describes these as 'profits above the normal level of return required for a business to be successful. Economic rents mainly arise as the result of monopoly profits or market power and entrepreneurial skill or ideas.' There are many kinds of economic rent. For example, this includes control over intellectual property, which prevents competitors from entering a market (and thereby lowering prices through competition) can lead to such profits.

Nicholas Shaxton offers further examples, >*'[rents] like oil money that flows effortlessly into Saudi or Kuwaiti coffers - are earnings that arise not from hard work and real innovation but from accidents of nature or good fortune. Adair Turner recently explained how banks in the City of London are particularly adept at earning rents, such as from exploiting insider knowledge and expertise; from natural oligopolies in market-making and other activities; and from "valueless" trading activity'(Shaxson 2011).*

It would be ideal to design corporation tax so as to tax economic rents only, which should result in no market efficiency losses.Therefore, companies who hold a monopoly over certain goods and services collect economic rent due to market imperfections such as lack of competitive pressures. In such cases, the consumers or the public pays an economic rent over and above an acceptable price. Corporation tax is able to recoup such rents and redistribute those funds to the public.

Corporation Tax and Income Tax

Individuals can have income from employment and from owning assets. The tax on this income is levyed the UK's 'income tax' and 'National Insurance' systems. We call the tax on profits of companies 'corporation tax'[9]

Income tax is not only a tax on employment income, it is also a tax on distributed profits (dividends). Profits distributed as dividends are taxed twice; once under the corporation tax and once under the income tax system. The rate of income tax paid is lower to account for the corporation tax already deducted.

[9] Sometimes different terminology is used: the income tax is called the 'personal income tax' and the corporation tax 'corporate income tax', but we avoid this terminology here

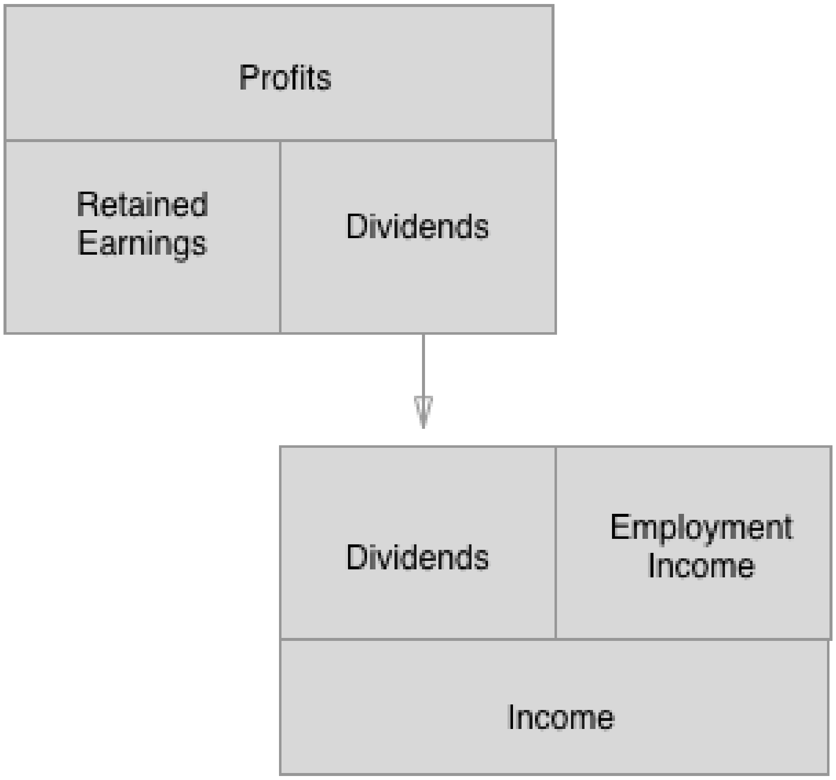


Figure 7.1 - Corporation Tax and Income Tax

Since the country of the activities of the company and the country of residence of the owner could be different. This means that profits made in one country and then distributed to an owner resident in another country

Corporation Tax as Backstop

Corporation tax is paid on profits. Profits can, in turn, be retained within the company (retained earnings), or paid out as dividends to the owners of the company. Dividends would be subject to income tax, but since they have already paid corporation tax, a deduction is made for that purpose. The tax paid on dividends will depend on the residence of the person receiving the dividends.

Thus corporation tax acts as a sort of backstop to the income tax system. Foreign owners of UK companies are not caught by UK income tax, but Corporation tax requires them to pay some percentage of the profit they received.

As discussed earlier, it might be difficult to tax residents' wealth for two main reasons. First, that rich people are geographically movile and can move to the lowest tax jurisdictions; second, residents can hide offshore wealth in foreign and secret locations. It is therefore difficult to tax individuals on their global wealth. It is not impossible though, as the US does attempt to tax US passport holders on their global income.

Corporation tax prevents at least some of the avoidance associated with companies as a legal form. Without a corporation tax, wealthy individuals could *shelter* their income in a company. Companies are a legal form, and a company does not necessarily represent a business nor is a business necessarily incorporated. For example, an individual can be paid through a fully-owned company, and then offset some costs and smooth wage and dividend payments so as to minimize higher rate income tax on their earnings. In this sense then, corporation taxes is an essential companion to the personal income tax system.

9.2 Competing Narratives

There are two competing narratives at play regarding corporation tax.

The (right-leaning) microeconomic story posits corporations as wealth creators and suggests that they should be taxed lightly. According to this narrative, corporation tax creates 'distortions'. Reducing corporation tax encourages business to invest and to make profits, and, in so doing, employ more people and provide more useful goods and services.

The (left-leaning) macroeconomic story is focussed on the returns for each part of the economy. If an economy is 'wage-led' (as most economies are), then boosting the wage share will lead to increased aggregate demand. The profits and capital gains of companies in the end simply make the rich richer, and the rich spend a smaller proportion of the income than the poor. So a higher corporation tax could promote economic growth.

Economic 'Distortions'

When taxes cause corporations or individuals to behave differently than they otherwise would, for example by moving their headquarters to another country, the taxes are said to cause *distortions*. Taxes on corporate profits are thought to be particularly distorting, in that they create and negate a variety of incentives which result in significant behaviour change by corporations, and those who invest in them. Researchers Johannson et al, in their 2008 OECD Working Paper, observed that corporation tax is likely to have many kinds of effects;

> *'The corporate income tax is likely to distort the total amount of investment and the type of investment projects that are undertaken, the corporate sources*

of finance (debt, newly issued equity or retained earnings), the location of the corporate tax base, the choice of a business legal form and the tax might have an impact on corporate mergers and acquisitions.' (Johansson et al. 2008)

The researchers suggested that, when different taxes are ranked from least distortive to most distortive , recurrent taxes on immovable property are the least distortive tax instrument, followed by consumption taxes (and other property taxes), personal income taxes and finally corporate income taxes being the most distortive.[10]

[10] This is in terms of reducing long-run GDP per capita

In particular, these distortions are likely to negatively affect economic growth. There is evidence that corporate income taxes negatively affect economic growth. Research by Lee and Gordon examined data from 70 countries which covered the period 1970 -1997. They found that, after correcting for other variables, that the corporation tax rate was 'significantly negatively correlated' with economic growth. They suggest that that cutting the corporate tax rate by 10 percentage points can increase the annual growth rate by around 1.1%. The authors explained these findings by suggesting that lower corporate tax rates may encourage more entrepreneurial activity, with more people choosing to leave employment and start businesses.[11] The authors stressed that

[11] The authors noted that lower corporation tax rates seem to be correlated with lower personal tax (income tax) revenue, which would be consistent with such a theory.

the growth effects of tax reforms, as well as the more standard efficiency and equity effects in a static context, merit serious consideration. (Lee and Gordon 2005).

The is a particular kind of distortion which is particular to corporation tax. This is the 'debt-equity' distortion. This results from an asymmetry at the heart of corporation tax, whereby the return on equity is taxed, but interest payments on corporate debt are tax deductible. This can increase the risk of bankruptcy and encourage tax-minimisation strategies through taking on more debt. Writers of an IMF blog argues for 2 ways to mitigate debt bias - to limit the tax deductibility of interest or provide a deduction for equity costs (Mooij, Tieman, and Keen 2016).

9.3 Corporation Tax in practice

Corporation Tax is Volatile

Corporation tax makes up approximately 8% of HMRC total receipts. It is the fourth biggest tax in terms of receipts: after Income tax, VAT and National Insurance Contributions, although the financial crisis saw income from the tax fall significantly, from £46.3 billion in 2007/08 to £39.3bn in 2013/14 (UK Parliament 2015). A small number of firms pay the vast majority of income tax. According to the Oxford Centre for Business Taxation, 1% of all companies account for 81% of receipts. As it is a tax on profits, income from the tax is strongly correlated with the business cycle and thus can be very volatile. The below chart shows the relationship between the state of the economy and receipts from corporation tax (UK Parliament 2015). The vertical axis is the annual change in corporation tax receipts and the horizontal axis is the annual change in economic output (1979/80-2013/14).

At the time of writing, receipts from Corporation Tax are surprisingly high, with the UK government raising £56 billion in the 2016-17 financial year, which is an increase of 21% from the previous year (Miller 2017). This is forecasted to decrease to £53.2bn in 2017-18. However, onshore receipts are projected to fall to 2010 levels, as the below chart from the Institute of Fiscal Studies shows.

The current level of receipts from Corporation Tax have been attributed to several factors, including a general growth in the UK economy, increases in the profitability of UK corporations, a fall in investment spending (because companies can offset some investment against profits) and increased focus on tax avoidance (Jackson and Houlder, n.d.).

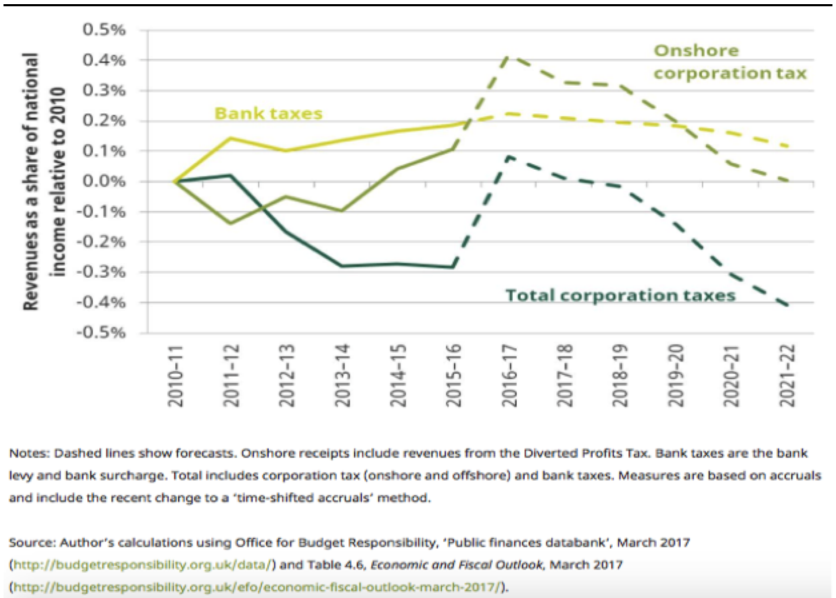


Figure 7.2 - Corporation Tax Avoidance

Corporate Tax Avoidance

Because Corporation tax is based on profits, it is vulnerable to clever accountants who are able to exploit differing tax rules in different companies. We outline a case study below about Apple's corporate tax avoidance.

Case Study: Apple

In 2016, the technology company Apple, accustomed to great praise, received a taste of bad press, but not for its new iPhone model. Rather, its tax arrangements attracted scrutiny from the European Commission, which demanded that Apple pay up to £13 billion (& interest) for unpaid taxes in Ireland. Both Ireland and Apple condemned the decision, claiming a right to create an agreement between a sovereign nation and a private company. Thus arose a farcical situation in which the Irish government brought legal proceedings in order that they not receive £13 billion in back taxes.

In fact, the agreement between Ireland and Apple allowed the tech company to pay a maximum effective tax rate of only 1% of their profits, a classic sweetheart deal. The standard corporation tax rate in Ireland is already quite low compared to other EU countries, at 12.5%. The arrangement between Ireland and Apple was complex. Apple created two subsidiary entities in Ireland, which effectively own most of the company's intellectual property. These organisations then licensed the intellectual property to Apple subsidiaries elsewhere in the world. Thus, profit earned in countries around the world is transferred to the Irish companies, ostensibly in the form of license fees. This income would normally be taxed at 12.5% in Ireland but the agreement between Apple and Ireland allowed the profits to be attributed to a 'head office', not located in any country (and thus not subject to tax in any jurisdiction). The result was that Apple paid only 1% tax on its European profits in 2003 and 0.005% in 2014.

According to the European Commission, this arrangement amounted to a form of state aid and was illegal for EU members. The European Competition Commissioner, Margrethe Vestager argued that the deal was unfair to other businesses, stating,

> *Our rules don't stop governments applying a law rate to every company...what they can't do is to select just a few favoured businesses and give them special treatment which their rivals can't get. So, when we ask national governments to reclaim unpaid taxes, all we're doing is ensuring that everyone has an equal opportunity.'* (Vestager 2016)

The Race to the Bottom

The above discussion illustrates the underlying tensions between governments and corporations, and the growing difficulty facing governments who attempt to tax corporate profits in a globalised world. Multinational companies wish to minimise their tax bill and are willing to move around and create complex tax structures to achieve this goal. Countries seek to attract investment and gain income from corporation tax. In the case of Ireland, the government has positioned itself as a low tax country in order to attract investment and create jobs. This dynamic between corporations and governments creates a *race to the bottom* in which governments compete to attract companies by lowering their corporation tax rates. The below chart compares the rates of Corporation Tax around the world (Miller 2017).

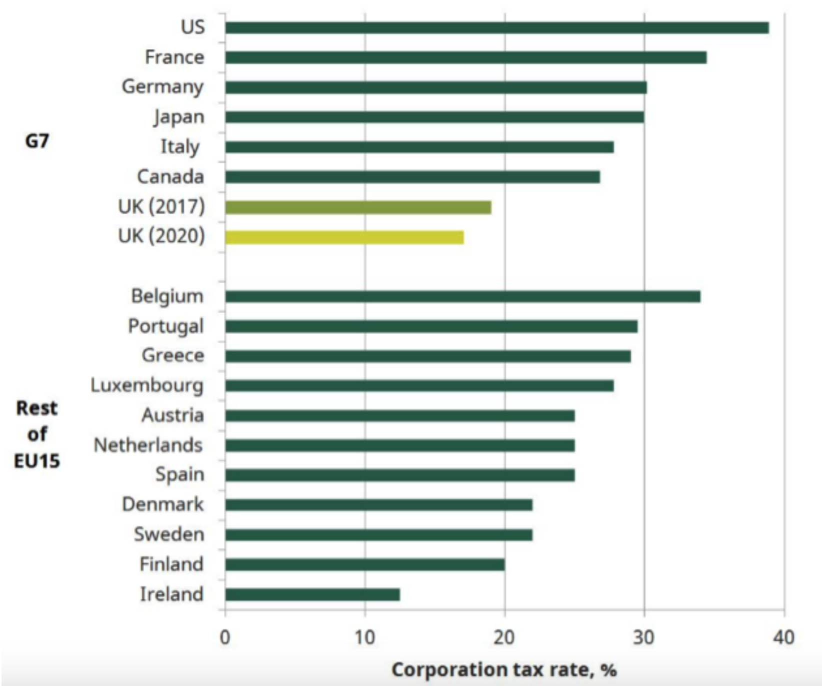


Figure 7.3 - Corporation Tax Rates Around the World

As can be seen in the chart, the UK's main rate of corporation tax will decrease to 17% in 2020. The stated objective of this reduction is to create a more competitive corporate tax system to provide the right conditions for business investment and growth. Government analysis suggests that the change will reduce income to the Exchequer of £120 million in 2019-20 and £945 million in 2020-21 (HMRC 2016). The below chart from the Institute of Fiscal Studies shows the revenue cost of past Corporate tax rate reductions, and the projected cost of future cuts (Miller 2017).

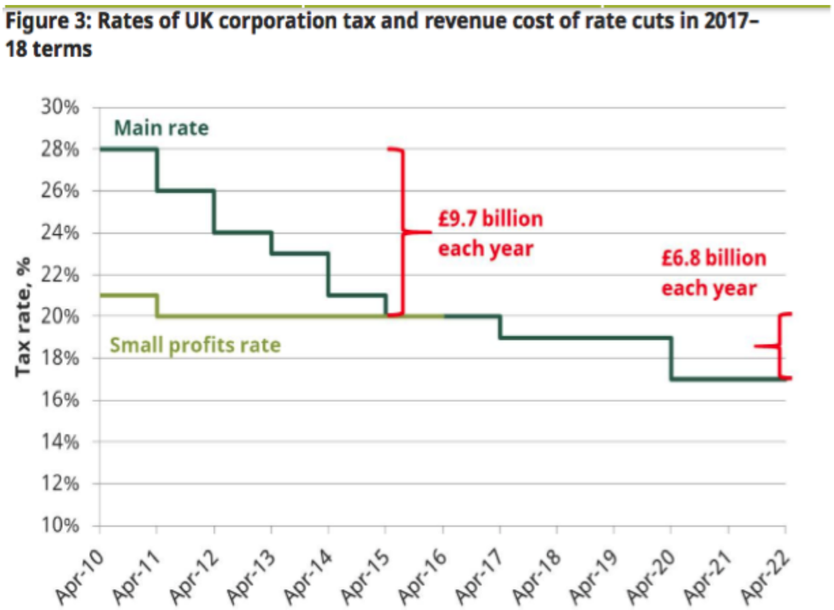


Figure 7.4 - UK Corporation Tax Rate Cuts

The picture is similar elsewhere. In 2015, Japan, Spain, Israel, Norway and Estonia decreased their corporation tax rates and Italy, France, Japan and the UK had announced plans to do so.

Corporation tax versus VAT: Inequality

These trends in corporate tax rate have a bearing on issues concerning wealth and income inequality. Tax Justice campaigners have warned that as governments reduce taxes on corporate profits, they have increased the rates of VAT, fuel and car taxes. The below chart shows the increase in the OECD average rate of VAT from 2000-2015. We can see a steady increase in the VAT average after 2009.

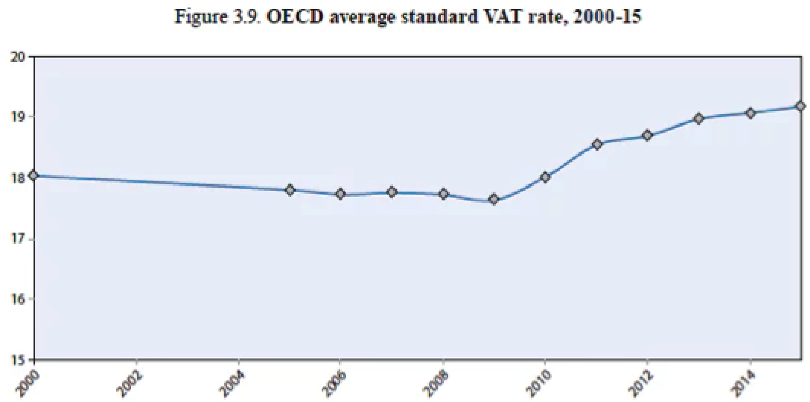


Figure 7.5 - OECD Average standard VAT rates

VAT and fuel taxes disproportionately affect lower income earners. According to the Tax Justice Network, "Governments make up the shortfall by levying higher taxes on other, less wealthy sections of society, or by cutting back on essential public services." Another concern is that if corporation tax reduces the return to company shareholders, this will not only affect people with directly held shares, but also older people with private pensions. This would suggest that tax competition boosts inequality and deprivation.

9.4 Corporation Tax in the UK

In the UK, Corporation Tax is a tax payable on the profits of doing business as a limited company, a foreign company with a UK branch or office or club, co-operative or other unincorporated association.[12]

[12] An unincorporated association is an organisation set up through an agreement between a group of people who come together for a reason other than to make a profit (for example, a voluntary group or a sports club).

Such organisations will pay corporation tax on the money they make from:

- doing business (referred to as 'trading profits')
- investments;
- selling assets for more than they cost (referred to as chargeable gains).

If the company is based in the UK, it must pay corporation tax on all its profits from both the UK and abroad. If a company isn't based in the UK but has an office or branch here, it only pays Corporation Tax on profits from its UK activities.

Rates and Reliefs

Companies pay corporation tax at the rate which applied during their accounting period. The current Corporation Tax rate on company profits is 19%.

More complex calculations are also required for associated companies[13], companies who have more than one applicable rate during their accounting period, and companies who have an accounting period of less than 12 months. There are also different corporate taxation rates for 'ring fence profits' of companies involved in oil extraction in the UK or UK continental shelf.

[13] One company is associated with another if either one company controls the other or both companies are controlled by the same companies or people

When preparing the company's accounts, the costs of running the company may be deducted from the profits. Anything which a company director or employee gets personal use from must be treated as a 'benefit'. It may be necessary to pay tax on these items. It may be possible to claim capital allowances on assets kept for use in the business, for example, machinery, equipment and business vehicles. Some other reliefs are also available for specific cases, such as where the business is involved in the creative industries or involved in research and development.

Organisations must calculate and report their own tax obligations. There is no bill from HMRC. Rather, they must register for corporation tax within three months of doing business. There may also be a penalty for late registration.

Registration

Registration can be done online, and companies require their Unique Taxpayer Reference number, which usually will have been posted to them by HMRC after the company was registered with Companies House.

While registering, companies also need to inform HMRC of:

- the company registration number
- the date they started to do business (the accounting period will start from this date)
- the date the annual accounts are made up to.

Unincorporated associations will need to call HMRC to register.

Accounting Records

In order to calculate how much to pay, companies must keep accounting records. HMRC has strict and detailed requirements for accounting records. If accounting records are not kept, companies can be fined £3,000 by HMRC or individuals may be disqualified from being company directors. It is necessary to keep records for six years from the end of the last company financial year they relate to.

Tax Returns

When companies or associations receive a 'Notice to Deliver a Company Tax Return' from HMRC, they must file a Company Tax return. They must still file a return, even if they have made a loss or have no Corporation Tax to pay. The tax payable should usually be paid 9 months and 1 day after the accounting period[14] it covers.

The tax return is due 12 months after the accounting period it covers. There are various penalties for late filing. If the return is six months late, then HMRC will send a 'tax determination' to say how much tax the organisation must pay. Organisations cannot appeal against a tax determination.

[14] The accounting period is normally the same 12 months as the financial year covered by a company's annual accounts

9.5 Reform of Corporation Tax

Objectives for Reform

What are the objectives of reform of Corporation tax?

1. We are looking for a way of taxing the wealth and income of the eventual owners of corporations. We would like to do this, so that this group pay their fair share of taxation.
2. We would like to apply these tax policies in a way that is not easily avoidable or evadeable, and that treats companies fairly.
3. We would like to prevent or reverse the 'race to the bottom' theory whereby it is seen to be in countries' self-interest to reduce corporate taxes
4. In the UK context, given our poor trade performance, we would like to help give an advantage exporters in the short term

There are a number of possibilities for reform of corporation tax. We deal here with two.

Unitary Taxation

Unitary taxation is a method for taxing large corporations which allocates their global profits according to different jurisdictions. So instead of there being a confusing plethora of different formulae for determining how much taxes should be paid in a certain jurisdiction, a standard formula is used. One such formula is the so-called 'Massachussets formula', which was proposed to be used in the United States for allocating the profits of corporations between various states in which they are based. The formula takes the total worldwide profits, to which are then applied a weighting in each country or other state in which they are based.

The weighting has three components: the proportion of sales, the proportion of assets, and the proportion of employees that are in each jurisdiction. We then take the average of these three weightings. This average weighting is multiplied by the global profits to determine the tax payable in the jurisdiction.

Thus the corporation tax paid in jurisdiction i is given by:

$$CorporationTax_{UK} = t_{CT} * Weighting_{UK} * GlobalProfits$$

where t_{CT} is the tax rate and

$$Weighting_{UK} = \left(\frac{1}{3}\right) * \left(\frac{Sales_{UK}}{GlobalSales} + \frac{Assets_{UK}}{GlobalAssets} + \frac{Employees_{UK}}{GlobalEmployees}\right)$$

The Cashflow Tax

Another possibility for reform is the so-called Cashflow Tax, sometimes referred to as the 'Dyson Tax' in this book.

A cashflow tax is a tax on the difference between domestic (uk) sales and domestic (uk) wages and supplier costs.

$$CashflowTax_{UK} = t_{CF} * (Sales_{UK} - Costs_{UK})$$

In the language of International tax, it has a 'destination basis' for sales and a 'source base' for costs. Something can be counted as a UK cost so long as tax has been paid on it. So, for example, UK employment income would be counted as a taxable deduction so long as it was subject to income tax.

Note that cashflow tax can be either positive or negative. If a company locates in the UK but sells abroad, it may have a negative cashflow tax. Thus the cashflow tax encourages companies to locate in the UK. Conversely, if a company sells to the UK but has no UK costs, then it will pay the cashflow tax on all of its sales. In effect, this would be a sales tax not a profits tax. Thus it encourages business to locate in the UK; with the higher the tax rate, the greater the incentive to move.

Thus the cashflow tax satisfies two of our requirements for reform: it reverses the race to the bottom and it gives a boost in the short term to UK manufacturing. Whilst unitary taxation is also a good option, the cashflow tax fulfills more of our objectives.

Integrating Cashflow Tax and VAT

Since the cashflow tax operates on the 'destination' basis for revenue, it is similar in some way to a Value Added Tax, but where UK wage costs are deductible.

Given that we also propose to introduce a comprehensive system of environmental taxation (see later chapter), it might make sense to integrate our corporation tax system with our system of VAT. Assuming a cashflow tax rate of 40% for domestic firms, how should imports be considered? Under the VAT system, there is a tax on imports and a subsidy on exports. But it is not as high as 40%.

We propose that cooperative tax nations would pay only a 20% rate on imports.[15] This means in effect that payments made to compliant countries would be half-deductible for the purpose of coherence and ease. This clause would not apply to tax havens, which would lack all deductibility so as to discourage use.

[15] Corresponding to a 25% VAT rate, as the definition is inverse

PART 10: LAND AND PROPERTY

Summary

- In the UK, buying a house is extremely and increasingly unaffordable for many. This is contributing to other problems, such as homelessness.
- High house prices are due to high land values. House prices go through boom and bust cycles due to land price speculation. This is when people buy land in the hope that it will go up in value. This is not a productive investment, one that leads to economic growth, but rather is a 'pseudo-investment' or placement.
- Landowners get free value from the work of the community, such as the building of public transit infrastructure or communities invest in local parks. Landowners receive an increase in land values from these external activities, which they themselves have done no work for.
- Land Value Tax is an effective solution to this unfairness and to the housing boom and bust cycle. It is a tax on land values.
- LVT is a well-established idea, with multiple benefits. It faces some obstacles, for which there are solutions. The biggest may be political feasibility.
- Land has been neglected in neoclassical economic theory, and generally is conflated with capital. However, land differs from capital in important ways. Many current problems have arisen from a failure to recognise this distinction.

10.1 How bad is the housing affordability problem in the UK?

THE AFFORDABILITY OF HOUSING is frequently the topic of national debate, but as housing charity Shelter UK warn, we risk becoming so accustomed to the high cost of housing, that we start seeing it as a fact of life (Shelter 2010).

The most recent review into this topic was conducted by Lloyds Bank, who found that home affordability (i.e. the ratio between average house prices and local earnings) across UK cities, "has hit its worst level in eight years" (Lloyds Bank 2016). The report found that the average UK city house price had risen in 2016 to its highest ever level of £211,880. Average affordability in the last twelve months had increased from 6.2 to 6.6 times annual average earnings. Most notably, the researchers found no cities in the South of England where house prices are less than 7.5 times the average local income.

The below chart shows how the UK house price to real earnings ratio has changed over time.

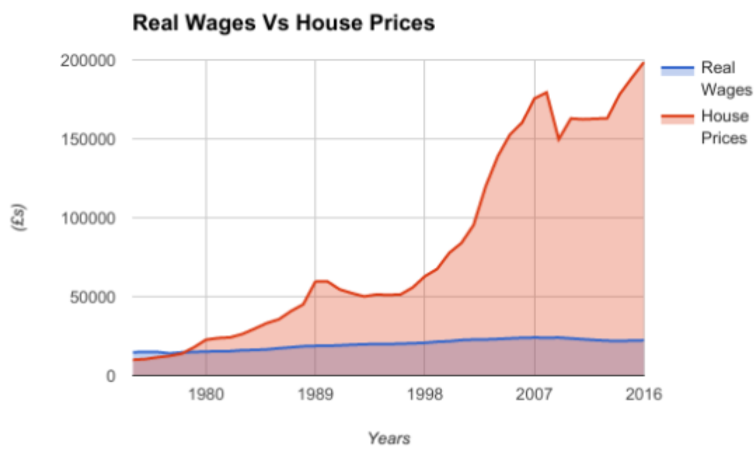


Figure 8.1 - Real Wages vs House Prices

The ratio is at its highest since April 2008, the beginning of the recession. We can see below that it is particularly hard for first-time buyers to afford a house in London.

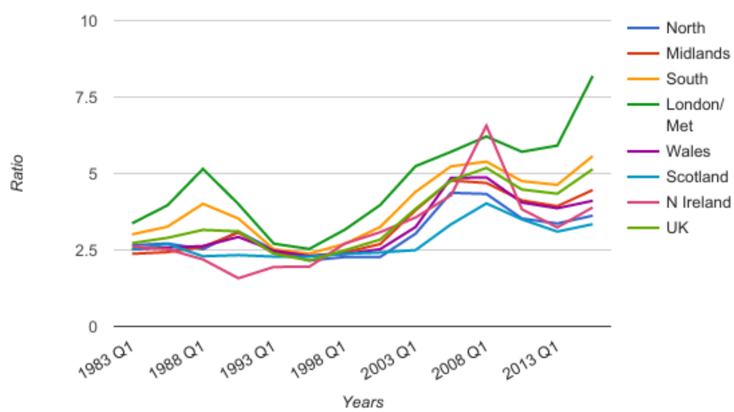


Figure 8.2 - First time buyer earnings to house price ratio across the UK

The below chart shows that the gap between the most and the least affordable local authorities has increased since 2002, and this is due to the least affordable areas moving further away from the overall affordability ratio (ONS 2016a).

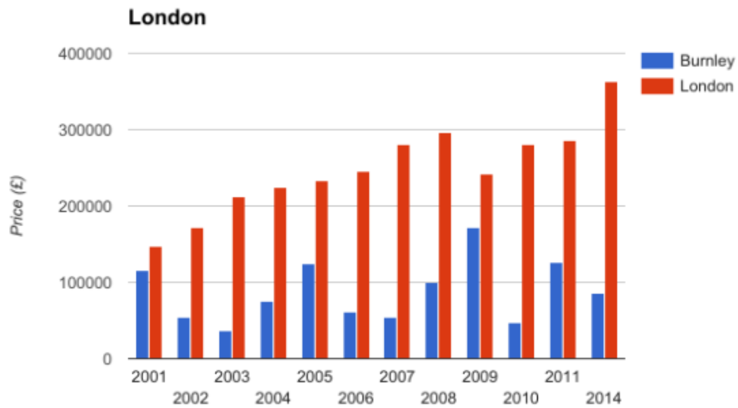


Figure 8.3 - House price affordability compared between Burnley and London

There have also been many demographic changes in housing ownership. The below chart shows the percentage of each age group that are home owners, from 1981 to 2014 (Ough 2016).

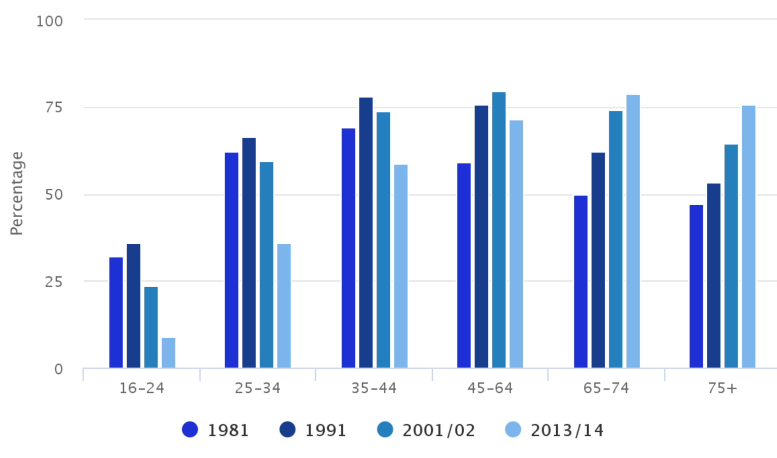


Figure 8.4 - Percentage of each age group that are home owners in England, 1981-2014

We can see a dramatic reduction in the percentage of people between the ages of 34-44 owning homes and an increase in the percentage of over 65s owning homes.

The Human Impact

The rising cost of housing is also contributing to growing inequality of wealth. The below chart shows the upper bounds of household net property wealth for each 1% of the net property wealth distribution in 2012.

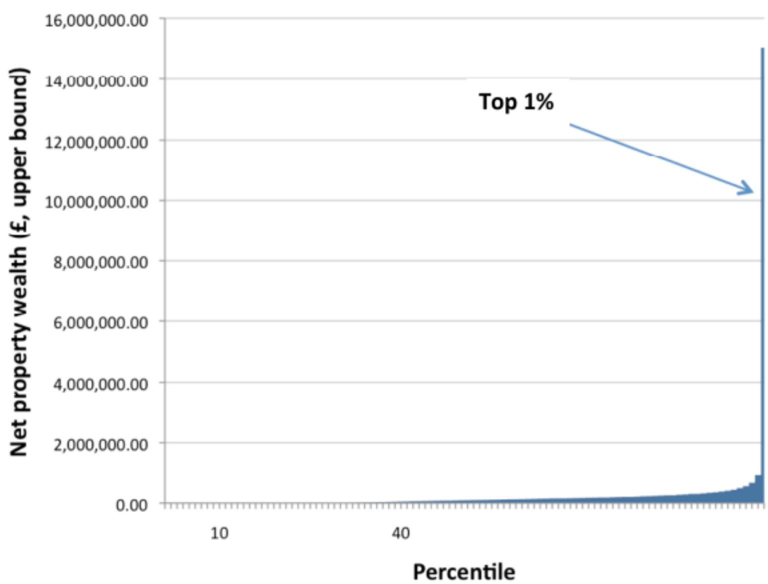


Figure 8.5 - Upper bounds of household net property wealth in 2012

The above graph shows the dramatic inequality in property wealth, but it still does not capture the devastating personal effect that unaffordable housing is having on British people. Shelter UK warns that,

> *"Unaffordable housing plays a vital role in changing the way people live and constraining their choices... the high cost of housing is having an impact on all aspects of life, and raises the prospect that, as a result of a collective failure to find solutions, we could be allowing ourselves to drift into a future where we will all ultimately be worse off."* (Shelter 2010)

A staggering 44% of working families in England (3.7 million families) cut back on essential food and clothing to help pay their rent or mortgage. A further 41% say that housing costs cause them stress and depression (Shelter England 2016). Many are also having to cut back on food and heating, in order to pay for housing costs.

Case Study: Michelle and Kevin

Michelle and Kevin rent a small home in Cambridge,where they live with their children. Kevin works full-time for a cleaning company, while Michelle studies for a career in criminal justice. Kevin had previously been self-employed and his income had dropped so low that they fell behind on rent. With Kevin now in full-time employment, they still struggle to get by.

> "*Even though my husband has a new job now and works as many hours as he can, it's constantly hand to mouth. We've cut back on everything to help pay the rent ' including food. When the children are at school the heating isn't on at all, and we only ever buy clothes when we absolutely have to because the little ones have grown out of something*"

Michelle and Kevin found that major life decisions, such as moving out of home and starting a family, were being affected by the lack of affordable housing. This is not an isolated problem. 21% of people aged between 18 and 44 said that they were delaying having children because of a lack of affordable housing. Worryingly, 36% of this group expected that housing costs would prevent them from starting a family for another four years. Shelter UK notes that this will create knock on effects for the NHS and other public services, as women are forced to delay pregnancy into their less-fertile years;

> "*If women continue to put off starting a family because of housing costs, this could drive up the numbers experiencing fertility problems, putting more people through the trauma of being unable to conceive. As well as the obvious human impacts, such an outcome could also result in additional financial costs to the NHS in the form of increased demand for fertility treatment*". (Shelter England 2016)

One of the most surprising findings was that 24% of adults have been forced into continuing to live with a partner because they cannot afford to move out, or know someone who has been in this situation. Housing costs are also causing many adults to move back in with their parents or delay ever moving out at all. At the other end of the age spectrum, housing costs are also making it difficult for adult children to live near to, and care for, their aging parents.

Case Study : Alan

Alan lives with his wife in Portsmouth and is an architect. Both of their parents live in Bournemouth and his wife's parents are becoming increasingly frail. Alan and his wife would like to move back to Bournemouth, but their house is in negative equity and house prices in Portsmouth are too high for them.

> *"We can't see any improvement in our situation in the short to medium term. What we really fear is that time is not on our side."*

10.2 The Cause of the Housing Crisis

If I was riding in a London cab, and I was to ask the driver why the cost of buying housing in London is so high, he might say to me, 'Well, its obvious! Its supply and demand! There is a huge demand for housing in London. Lots of people want to live here!" At face value this explanation sounds very reasonable, but if I thought a little harder, I might wonder why the cost of other things doesn't increase in the same way.

The best way to think of this is by picturing another product here, like mobile phones. There is very high demand for mobile phones. Almost everyone has one and like housing they are generally considered a necessity. However the cost of phones doesn't keep going up and up. Why not? Also we know that the housing market has boom and bust cycles, where the price in housing increases and increases and then suddenly starts dropping (a boom and bust cycle). Why doesn't the price of mobile phones do that?

Of course there is a key difference between housing and mobile phones. That is, we can increase the supply of phones, to meet human demand. Housing is different. Housing has to be built on land and the supply of land is fixed. The taxi driver was right, its is an issue of supply and demand. When demand for phones increases, we can increase supply. The price will stay the same, or even decrease, if there is an over-supply. When demand for housing increases, as it must when populations increase, we cannot increase the amount of land to build it on, so the price of housing (house and land) increases indefinitely.

Though we talk about 'house prices' increasing, it would make more sense to speak of 'land prices' increasing. It is the limit to the supply of land that is causing the cost of house + land prices to increase. If we look at valuations in UK regions with high 'house prices', we see that the land value is much higher than the value of the building sitting on it.

As campaigner Edward J. Dodson states,

> *"Actually,"house" prices are not increasing. A housing unit is a form of capital good, and all capital goods depreciate over time. The actual value of a house is best defined as its replacement cost, less any depreciation. Thus, the potential selling price of a house has everything to do with the owner's ongoing maintenance and periodic replacement of systems . . . . Ongoing efficiencies in the production of the materials that go into constructing a housing unit have resulted in a reduction in construction costs per square foot.*
>
> *"One need look no farther than land acquisition costs for an explanation of why a residential property is an impossible acquisition for a growing segment of the population."* (Shaxson 2016)

If you are not convinced, consider Figure 8.6 below (Wightman 2013). This graph compares four important costs relating to housing and shows how they have changed over time. The lowest line on the graph, 'Build Costs?, is the cost of actually constructing a house. 'House Price' is the value of the house only and 'Land Price' is the value of the underlying land only. 'Earnings' is the population's average earnings.

We see that while the cost of building houses has remained largely stable between 1986 and 2007, land prices have oscillated dramatically through a boom and bust cycle. The 'House Price' line is most revealing because, while the costs of building houses has stayed the same, the cost of buying them has oscillated - mirroring the 'Land Price' line (Lloyd 2009).

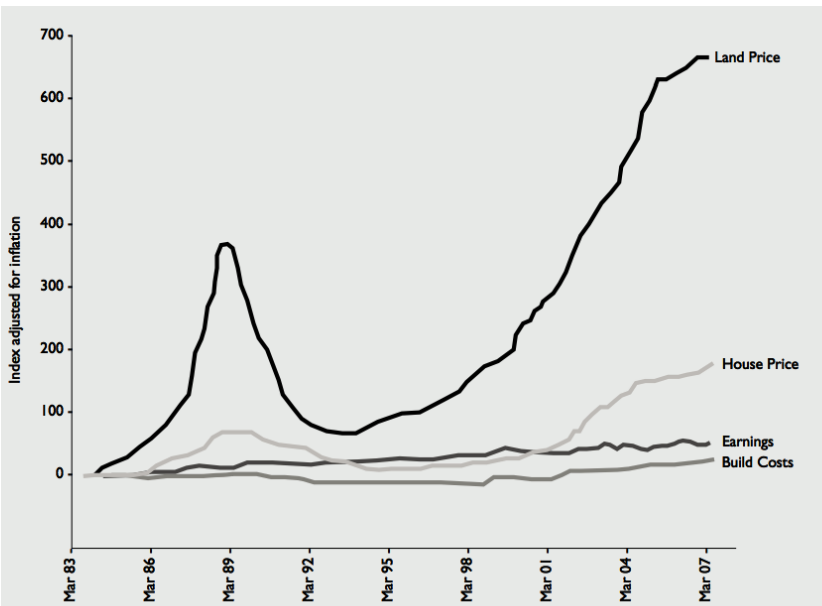


Figure 8.6 - Index of housing market costs 1983-2007

Why then the boom and bust cycle?

As the population increases, the demand for housing increases. Supply doesn't increase, so we would expect the price to steadily increase. Why do we see a boom and bust cycle?

This is because of 'land price speculation', whereby people buy land in the anticipation that its price will increase. This is a kind of bet (and a fairly safe one at that). When lots of people buy up land because they think the price will go up, it pushes the price up further. There is a fixed quantity of land, so supply cannot respond to demand. It is very difficult in this environment, for someone to buy a home to live in, because there are plenty of people in the market who simply want land as a way of making money. The price continues to rise until some form of shock occurs, and the value suddenly plummets as people exit the market. After some time, the price starts to climb again as speculators' confidence returns, and they again believe that the land price will increase. So speculation increases the demand for land and causes prices to increase faster and faster.

These land price speculators are treating land as a kind of 'investment'. However, land is not an investment in the economic sense, because no new product or service is produced. No improvement is made. They simply sit on the land, hoping it will increase in value so they can sell it later or borrow against it.

The effect of this sort of speculation for people who want to buy homes to live in, and for renters is obvious. The price of homes (on land) go up and up, and so does the cost of renting. This is also a loss for the economy generally, as the money is not put into productive investments which benefit the economy, such as new businesses.

10.3 Fairness and land values

We mentioned that one cause of increased house and land prices is population increases. However, that is not the full story. There are other reasons why some areas in particular may become more in demand and increase in value. In rural communities, it may be that a farmer has done some work to the improve the land itself, for example, by using new techniques to make the soil more fertile. In most cases though, and particularly in urban areas, the land value goes up without the owner making any improvements to the land itself.

One reason why the value of the land goes up in these cases, is because of the work of other members of the community in growing and developing the area around the particular piece of land. A bustling high street, cafes, public transport, well-kept parks - these are all examples of developments which may surround a piece of land and increase its value. In other words, because of government and community activity and investment, the general location becomes more desirable as a place to live and work. That is why we may sometimes exchange the term 'location value' for 'land value'. Unlike the farmer, the owner of the land in this case, has done no work to create the value increase.

Of course the opposite can sometimes occur. We have seen from the experience of the American Mid-west that land values can plummet when important local infrastructure or businesses close down, and the local area becomes a less desirable place to live.

The general trend, though, is for land values to increase. In many cases, a landowner captures significant value, due to the work of the wider community. It is appropriate for us to reflect on the fairness of this arrangement.

Let us consider some scenarios;

- If a noisy road is built close to a man's house, and the value of the land and property decrease as a result. Is that fair on him?
- If instead, the public as a whole, via the government, create beautiful parks and amenities close to someone's land, and this causes her land to increase in value, is it fair that she keeps the value? Consider that the rents which her tenants pay may also go up as a result. They have to pay more to live there, but their landlord's land goes up in value. She receives both increased rents and an increase in land value. Is that fair?

The Jubilee Line example

When the Jubilee Line on the London Underground was created it cost the public purse £3.5bn. The value of the land around its stations shot up by an estimated £13bn (Riley and Centre for Land Policy Studies. 2001) and it was private landowners who gained that extra value(Mitchell and Vickers 2003) . In particular, the land value around Canary Wharf station increased by £2.8bn, while the land value around Southwark station increased by £800 million (Transport for London 2004). This was an increase in land values that those landowners had done nothing to create. The public paid for the amenity, and those landowners received a windfall. Is that fair? Should all or at least some of that windfall benefit be shared with the public?

Great minds have already considered this matter. Winston Churchill made his viewpoint clear,

> *"Roads are made, streets are made, services are improved, electric light turns night into day, water is brought from reservoirs a hundred miles off in the mountains' and all the while the landlord sits still. Every one of those improvements is affected by the labour and cost of other people and the taxpayers. To not one of those improvements does the land monopolist, as a land monopolist,contribute, and yet by every one of them the value of his land is enhanced."*

> *"He renders no service to the community, he contributes nothing to the general welfare, he contributes nothing to the process from which his own enrichment is derived . . . the unearned increment on the land is reaped by the land monopolist in exact proportion, not to the service, but to the disservice done."*

John Stuart Mill similarly wrote in 1848,

> *"Landlords grow rich in their sleep without working, risking or economising. The increase in the value of land, arising as it does from the efforts of an entire*

community, should belong to the community and not to the individual who might hold title." (Mill 1848)

More recently, the writer George Monbiot wrote,

"(T)hose who own the land skim wealth from everyone else, without exertion or enterprise. They levy a toll upon all other forms of wealth and every form of industry"

As mentioned, this form of unearned land value increase is particularly prevalent in urban locations. It is less relevant to agricultural locations, where the work done by a farmer does little to affect the value of her neighbour's land.

Before we consider in detail, how to best address the unique situation of land, and the problems currently associated with it,let us lighten the mood and discuss board games.

10.4 The case of Monopoly

Monopoly is a fun game to play, but not necessarily one that leads to familial harmony, at least when playing the standard rules. We all know how Monopoly works - everyone has some starting cash and goes about buying up properties, building houses and charging rent. As players move around the board, they land on properties and pay rent to whoever owns it. In the end, one person owes everything and everyone else is left penniless. This is a parable for our present economy.

Rather less commonly known is the fact that Monopoly was preceded by and evolved from another game, called, 'The Landlord's Game', and invented and patented by Elizabeth Magie.

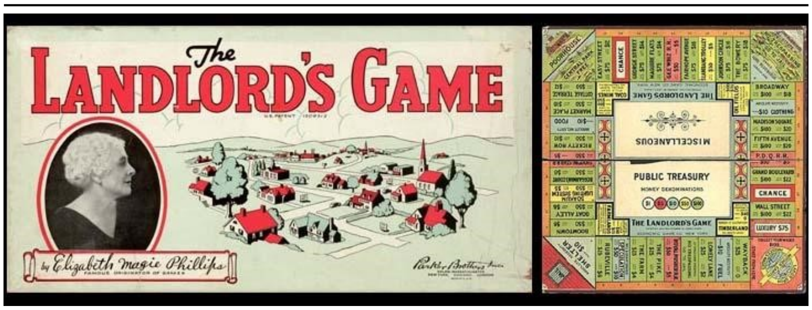


Figure 8.7 - The Original Monopoly was first called The Landlord's Game and invented by Elizabeth Magie

This state of affairs is also present when Oligopolies exist.[16]

This game had two sets of rules of play. The first set of rules is similar to the rules of Monopoly and similarly led to extreme in-

[16] A state of limited competition, in which a market is shared by a small number of producers or sellers.

stability, with the whole board monopolised by one player, and the other players forced into penury and bankruptcy.

The second set of rules in The Landlord's Game led to a very different outcome, however. The game when played by these rules led to a stable and admittedly boring game with no clear winner. Everyone ended up with something. Not quite world peace, or even family peace, but economic peace - at least within the confines of the game.

So what were the different rules that lead to a muchmore stable economic outcome?

The 'economically stable' rules involved a tax levied by the central authorities on the value of the land owned by each individual, and distributed back through public services or a per-capita dividend. This could be called, a site valuation tax, a location value tax, but is most often referred to as a 'land-value tax'.

10.5 Land Value Tax

History

Elizabeth Magie intended her game to demonstrate that a single tax on land values could lead to a sustainable economic system in which all benefited. This is the kind of tax which we are proposing.

Magie was not the originator of this idea. She was espousing the ideas of a 19th Century self-taught economist named Henry George, who argued that a single tax on land values would be both efficient and fair. It would be fair, because it taxed unearned increases in land values which occur, not due to individual effort or ingenuity, but because of development of infrastructure and the wider economy. It would be efficient, because the quantity of land does not change. He saw that when we tax labour (via income tax) or tax economic activity via sales tax and corporate taxes, we discourage these activities and make the economy less productive. Taxing land values might discourage people from speculating on land, and this would be a good thing as it would only free up funds for more productive investment and free up land for more beneficial purposes.

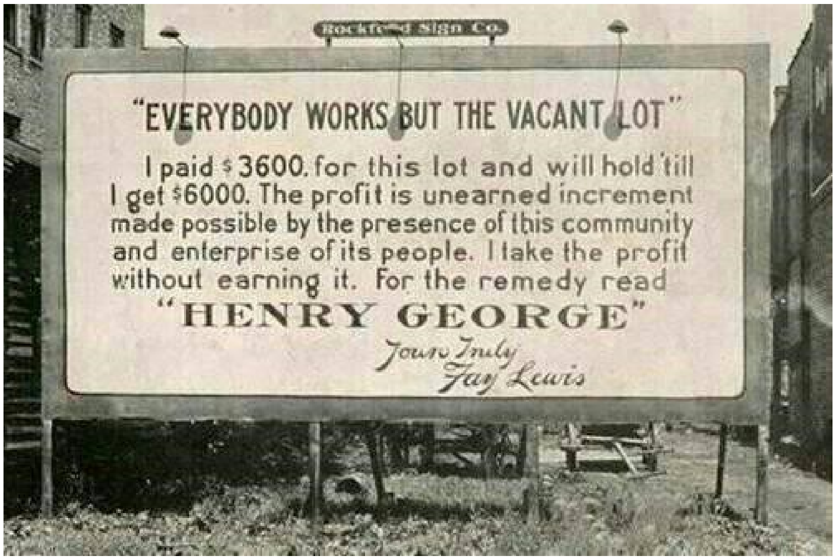


Figure 8.8 - Everybody works but the vacant lot

George presented his ideas in a bestselling book, 'Progress and Poverty', and the case for a land value tax was taken up by great thinkers and politicians including the Russian novelist Leo Tolstoy and British politicians, Winston Churchill and David Lloyd George. It was only the intervention of the first World War that prevented the tax being implemented in the UK. The "people's budget" was passed by the pre-war government but had not been yet implemented by the outbreak of World War I. After the war, the government had different priorities and the tax was never implemented.

Though he popularised the single land tax, Henry George could be seen as a follower of the great classical economists. Adam Smith, David Ricardo, John Stuart Mill and Karl Marx all supported land value tax or public ownership of land. David Ricardo developed both the theory and recommendations in 1817 in 'On the Principles of Political Economy and Taxation'. A land value tax was considered the first point of the political program of Marx. The importance and optimality of a land value tax was one of the few things the great classical economists agreed on.

In the 20th Century the idea of a single tax on land values was espoused by economist Frank Ramsey (Ramsey 1927) . He explained that if any one commodity is absolutely inelastic, either for supply or for demand, the whole of the revenue should be collected off it (Putland 2013). To clarify, when a commodity is inelastic for supply, this means that its supply is (not very) sensitive to changes in price. Likewise, a commodity which is inelastic for demand is one whose demand is not greatly sensitive to changes in price. There are no commodities which are demand inelastic. However there is one which is supply inelastic - land - that is, one cannot increase or decrease the amount of land in existence.

Thus many economists over many years have recommended a land value tax, often considering it an 'ideal' tax. The arguments in favour of the the tax include arguments based on justice and arguments based on economic pragmatism. Land Value Tax is rare in this respect.

10.6 Benefits of Land Value Tax

Land value tax is very much alive within taxation discussion today and is advocated across the political spectrum. Greens MP Caroline Lucas described Land Value Tax as, sensible, efficient, effective and progressive. In the final report of the Mirrlees review (J. Mirrlees and IFS 2010), the economic case for land value tax was described as 'simple, and almost undeniable'.

The Mirrlees review was a review of the tax system which was commissioned by the Institute for Fiscal Studies in 2010/11. It brought together internationally renowned experts and researchers to

> *"identify the characteristics of a good tax system for any open, developed economy in the 21st Century, assess the extent to which the UK tax system conforms to these ideals, and recommend how it might realistically be reformed in that direction."*

The review wrote extensively about the merits of land value tax. A section of their findings is below.

> *"The economic case for taxing land itself is very strong and there is a long history of arguments in favour of it. Taxing land ownership is equivalent to taxing an economic rent'to do so does not discourage any desirable activity. Land is not a produced input; its supply is fixed and cannot be affected by the introduction of a tax. With the same amount of land available, people would not be willing to pay any more for it than before, so (the present value of) a land value tax (LVT) would be reflected one-for-one in a lower price of land: the classic example of tax capitalization."*

> *"Owners of land on the day such a tax is announced would suffer a windfall loss as the value of their asset was reduced. But this windfall loss is the only effect of the tax: the incentive to buy, develop, or use land would not change. Economic activity that was previously worthwhile remains worthwhile. Moreover, a tax on land value would also capture the benefits accruing to landowners from external developments rather than their own efforts."*
> (IFS, n.d.)

Along with the economic efficiency argument, there are other arguments in favour of Land Value Tax. A summary is found below.

1. Funding Infrastructure: Increases in land tax can be used to fund better infrastructure.
2. Difficult to avoid/evade: The owners of land cannot re-declare it as being held in an offshore haven. The tax is based on the location of the land not on the location of the individual owning it.
3. Natural rights: Individual work (labour) is naturally owned by the person who did the work whereas land and natural resources are naturally unowned or shared by all.
4. Fairness: Societies that tax land prevent individuals making an economic return simply by sitting on the land as others create improvements around them.
5. Incentives to invest productively: If individuals and companies can make money simply by owning land, they will not need to invest in the real economy. The Land Value tax incentivises those with wealth to invest in productive investments.
6. Economic stability: Speculation on the value of land is associated with credit-based booms and busts. For example, the Japanese late 80's boom and 90's bust or the recent 'great recession', which started the property crash in the U.S.
7. House Price stability: A Land Value Tax could help to stabilise house prices, giving incentives against disproportionate amounts of capital being tied up in property and unsustainable accumulation of debt. That is, people who are just holding land because they expect the land value to increase, will have an incentive to either use the land productively or sell it. Holding it will become too expensive.
8. Benefit to Local Government: Taxing land values can enable some of the increase in value that results from a prosperous economy and public investments to be captured by local government. This can provide an incentive for local authorities to support economic growth and development, and potentially an efficient way of financing infrastructure projects (Wightman 2013).[17]
9. Removal of counterproductive taxes: many taxes discourage productive behaviors, which we should be incentivising. Land Value Tax would allow us to do away with some of these distorting taxes. Nicholas Boles puts it succinctly in a Financial Times article (Boles 2011).

> "*The holy grail for every Treasury economist is a tax that costs little to collect and does not reduce people's incentives to do the things that we want them to do.'..Land Value Tax does not discourage productive behaviour, but would enable us to do away with counterproductive taxes on labour, production, dwellings, other capital and commerce.* (Gaffney 2009)

[17] Alternatively, a national land tax would naturally redistribute from one region to another, but then you'd lose the local connection.

10.7 Does the experience bear out the theory?

As indicated above, proponents claim that land value taxation can reduce real estate speculation and volatility in house prices. There are two ways in which LVT might have such an effect.

The first has already been outlined. When house prices start rising, LVT bills will rise commensurately. If a plot of land is not generating an income sufficient to defray the tax, rising bills may become unaffordable. Cumulative LVT bills will also reduce any capital gain the landowner may hope to receive one day by selling the land. Those with under-developed land (that is, land which has a more profitable permitted use) such as land-bankers will therefore have a motive either to put the land to amore profitable use, such as housing (or higher density housing), or else to put it on the market, thereby making it available to those who wish to develop it.

Thus in theory LVT should discourage land-banking and may help to reduce upward price-volatility in the housing market by increasing the supply of new housing when prices start to rise.

It is difficult to demonstrate through comparison studies (i.e. studies comparing times or places with and without LVT) that adoption of land value taxation is associated with higher rates of construction. Differences in population growth, interest rates and other taxes are just some of many variables which confound such comparisons. Thus Dye & England (2010) in a sympathetic report on land value taxation noted:

> *"Some advocates of land value taxation rely on comparison studies to predict greater building activity in communities adopting a land value tax, but they are making hopeful assertions rather than offering convincing evidence".*

The second way LVT might help to stabilise house prices is by helping to offset the effect of buyer' expectations regarding future prices. Expectations of future rises or falls in price can become self-fulfilling as they increase or decrease respectively what buyers are willing to pay today.

According to economic theory, the 'fundamental' price of property reflects the present discounted value of future returns (Returns are rents or savings in rent (if one is using the land oneself). They are discounted to allow for 'time preference', uncertainty, mortgage costs, and so forth. Fundamental prices tend to rise over time owing to economic growth,but when actual prices exceed fundamental prices it denotes a speculative bubble caused by self-fulfilling expectations.

LVT costs (and other property taxation) affect the future returns from owning a house and so should be discounted in house prices. The tax should be 'capitalised' into house prices. Thus when house-prices escalate, expectations of higher future LVT costs should in theory abate buyers' willingness to pay current prices, reducing upward volatility. Conversely, when house-prices threaten to fall, expectations of lower future LVT costs should bolster buyers' willingness to pay current prices, reducing downward volatility.

It is complicated to demonstrate empirically that property taxes are indeed capitalised into house prices. Studies which try to correlate tax rates and property values must contend with numerous confounding variables. For example, a high tax rate may be a consequence and not a cause of low property values, if the municipality needs to raise a certain level of revenue to pay for local services. One must also allow that local property taxes may not be significantly capitalised into house prices if home-buyers feel that the tax burden is indemnified by a commensurate level of local services.

Still, some rigorous studies have found evidence that property taxes are indeed capitalised into long term or 'equilibrium' house prices (e.g. Yinger et al, 1988). The question at hand though is the effect of LVT not on long term prices, but on short term price movements.

In Taxes & Speculative Behaviour in Real Estate Markets (1992), K. E. Case addressed the question of whether land holding taxes, as well as those on real estate capital gains, had significantly reduced volatility during real estate booms. His conclusion was that they had not.

Besides demonstrating these findings on countries such as Taiwan and Japan, he analysed house-sales data from the one hundred largest suburban towns across Eastern Massachusetts. Local property-holding taxes varied significantly across jurisdictions (effective rates ranged from 0.8% to 2.0%) and the data covered the decade of the 1980s during part of which there had been a real estate bubble. Although regression analysis revealed a negative relationship between tax rate and property prices (i.e. evidence of capitalisation) there was no significant relationship between tax rate and the amount of house-price appreciation (i.e. upward volatility) which a town had experienced between 1982 and 1989.

Case suggests that when prices are rising, home-buyers may willingly pay current prices, notwithstanding the prospect of increased property taxes, lest they find themselves priced out of the market. He further suggests that the potential capital gains to be made from purchasing real estate during boom periods are so large, whilst the 'investment' is of such low risk that even high rates of taxation are not sufficient to discourage speculation.

While Case allowed that land taxes could be used to reduce volatility in house-prices, he doubted the existence of "the political will to raise land taxes to levels high enough to really retard boom cycles". The level of land taxation which would be 'high enough' to have a significantly effect is, he surmised,

> *"Probably closer to Henry George's 100% than to current laws around the world".*

One reason even countries with forms of land taxation are still vulnerable to real estate bubbles may be ineffective implementation of the taxes. The example of Estonia demonstrates this case.

The Case of Estonia

Estonia experienced a real estate boom and bust between 2003 and 2009, despite having a local land value tax which was introduced in 1993 shortly after Estonian independence and the establishment of a property market. Nominal rates vary between 0.1% and 2.5% of a plot's'highest' or 'best' market value. However, because LVT re-assessments have been only sporadic, occurring in 1996 and then for the last time in 2001, effective tax rates have generally fluctuated inversely with prices (some municipalities even used a regulation introduced in 2002 to lower tax rates on properties in high value areas).

Cocconcelli and Medda (2012) showed using econometric tests that the Estonian real estate boom represented a speculative bubble. They also showed that if an asset pricing model were implemented, in which tax bills followed annual assessments to track market changes, LVT would have significantly affected house-buyer' attitude to price. That is to say, the effects of the tax would have been significantly capitalised into prices,reducing volatility.

However,because in reality LVT assessments were sporadic, even large changes in market prices left LVT bills unchanged for a long and indefinite period. As a result, house-buyers, especially speculators, did not take the effects of the tax into great account. This curtailed any stabilising effect of LVT on house prices. Thus Cocconcelli and Medda conclude that the Estonian land tax failed to act as"a protective buffer" against a real estate bubble because it was not implemented "correctly".

Denmark

Denmark is another country which suffered from a speculative housing bubble in the mid-2000s despite taxing land value. Moreover, in a paper on "the advantages of stabilising housing taxation", Klein et al (2016) detect signs of a new bubble in certain Danish cities such as Copenhagen, where price rises for flats have recently exceeded 10% year on year.

As well as a municipal land tax with an average rate of 2.4%, Denmark has a 'property value tax,' which is levied at 1% of a property' entire market value up to a certain threshold and then 3% on the excess. However, the tax was frozen in 2001 and so ceased to track changes in market prices long before the start of the speculative bubble in the mid-2000s.The average effective rate is now 0.55% and effective rates are lowest in the cities which are showing signs of a new housing bubble.

Nor does the municipal land tax necessarily track changes in market prices: assessments may be three years out of date and year on year increases are capped. Thus, for example, when house prices were plummeting in the period 2008-10, land tax demands rose, as owing to the cap on increases, they were still catching up with the huge rise in property values of the preceding period. According to the calculations of Klein et al(2016), the failure of the two property taxes to track market changes has increased volatility in the Danish real estate market by twenty-two per cent.

10.8 Practical Implementation

Valuation Methodology

Implementation of a land value tax would require regular valuation of land parcels. This would have to occur in such a way that the valuation does not take into account any buildings or other 'improvements' made to the land. Critics of Land Value Tax have frequently suggested that the need to provide accurate land valuations is an insurmountable obstacle.

However, while conducting accurate valuations may be a challenge, it is by no means impossible. The Mirrlees review notes that one difficulty is that in most areas and sectors there are generally few transactions in land, separate from any buildings thereon. This makes it somewhat difficult to determine what the market price of the land by itself would be. However, they also note that for Land Value Tax to be efficient (and not discourage productive activity), it does not have to be accurate. Inaccurate valuations could cause unfairness between taxpayers, however. They explain,

> *"It is worth noting that since we are looking at taxing a rent, the figure for land value does not have to be exact'or even approximate'for the LVT to be efficient. The value of each plot of land falls by the present value of the tax imposed on it; in principle, each plot could be taxed at an arbitrarily different rate without compromising the efficiency of the tax. However, to the extent that valuations are not accurate, inequities will be created between taxpayers'just as they can be created by inaccurate valuations under the current property tax regime, but the inequities will be worse if the valuation is*

less accurate."(Mirrlees et al. 2011)

The Mirrlees review also found that despite the 'thinness of the market', there are recognized methods for determining land values where there are a low number of transactions. For example, one obvious way is to look at cases in which similar buildings, in different locations, are on the market at very different prices. This brings us back to our London versus Scunthorpe example, in which we can see that the same house on the same size plot of land, sells for a lot more in London than Scunthorpe. This tells us something about the difference between land values in the two locations.

A study by the Institute for Public Policy Research (IPPR) suggested that another issue to overcome pertains to recording land ownership. Approximately 30 percent of land in England and Wales is not currently valued by the land registry, which makes it difficult to ascertain its ownership and value. They note, however that countries such as Denmark have found ways to record ownership information and assess land value.

> *"These are not necessarily insurmountable problems but it would take a lot of detailed work to devise a robust and sustainable system of land value taxation for the UK. Countries with a functioning land value tax have dealt with some of these issues. For example, land in Denmark is valued using a 'hedonic' pricing model based on the compulsory registration of all land transactions. This model uses information about the characteristics of land (location, transport links and soon) that is sold to estimate the value of other land"* (Lawton et al. 2013)

The Asset Rich - Cash Poor (The'Devon Pensioners')

One oft repeated concern with Land Value Tax is that there may be people who are living in property which is of high value, but who have little income, for example a pensioner who owns a home in central London. If they had to pay a tax based on land values, critiques argue, they might be forced to sell their homes. It should be noted that this concern is vastly overblown when the likely number of 'Devon pensioners' is considered. Oxford University Professor Iain McLean, estimated that only about 2% of the population are in this position.

He writes,

> *"'But what about the Devon pensioners?' I hear. There are actually very few poor people living in rich houses ' about 2% of households. . . They should not distort the discussion of the best property tax for the other 98%."* (Mclean 2013)

Moreover, he argues that 'Devon pensioners' could easily be accommodated for, by raising the asset threshold for Council tax benefit eligibility and allowing the tax liability to be deferred and become a charge on the estate when the house is sold (Maxwell et al. 2005).

Political Feasibility Issues

'Sterns Law' of tax suggests that taxes which arebest economically, are the worst politically. Richard Brooks, research director at the Fabian Society has investigated whether Land Value Tax might be politically infeasible.

He states, in an IPPR report,

> *"The philosophical and economic case for a land value tax (LVT) seems strong, but the issue has all the hallmarks of a political minefield: large numbers of people would be affected by any change; the status quo is seen to be unsatisfactory but there is little consensus about the appropriate response;and public understanding is low*." (Maxwell et al. 2005)

We could add that those who would most be affected by LVT are also those who are wealthier and have the resources to lobby actively on their own behalf. Notably,many politicians and media moguls are landowners and would be affected by the introduction of LVT.

Brooks suggests some steps which could be taken to better 'prepare the ground' for an introduction of LVT:

- Increase public understanding of Land Value Tax. This could occur through discussion of LVT within debates which are related, for example debates around Council Tax
- Some of the impacts of LVT could be softened, even if this means losing some of the economic benefits. Brooks suggests that households might be protected from sharp increases in their tax liabilities.
- Introduce LVT such that it yielded less revenue than Council Tax in total, resulting in less domestic losers overall. This could be paid for by increasing the total revenue from non-domestic property.

He also offers an test for proponents of LVT to assess the policy's political feasibility;

> - What is needed is "a really clear understanding of what the household impacts might look like by income group, household type, and geographical area. This kind of work would allow the parameters of a politically plausible scheme to be determined. There is no clear formula for such a calculation, but very crudely, no scheme which appears to be financially detrimental to significant numbers of swing voters in marginal constituencies is politically plausible."* (Maxwell et al. 2005)

The Denmark Experience.

Land Value Tax has been applied in some form in several countries, including Denmark and Estonia, and some parts of Australia, New Zealand and the USA. (Conservative et al. 2016). The chart below illustrates the widespread nature of land tax policies (Dye and England 2009).

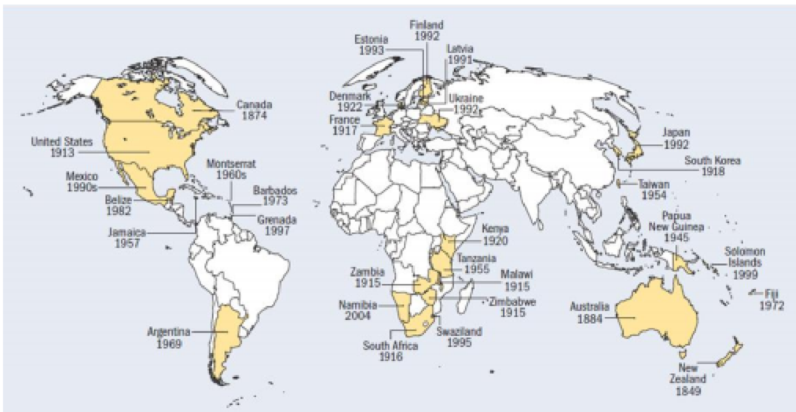


Figure 8.9 - Land Value Taxation: Theory Evidence and Practice - Countries with Land Value Taxation by Year of Adoption

Since 1922, Denmark has levied a land value tax based on the market price of land, revalued every two years. The tax is payable to the local authority and county based on a per-thousandth share of the value of the land. The share varies according to different types of land use, however each share is a minimum of six and a maximum of 24 thousandths of the value of the land, giving an effective tax rate between 0.6% and 2.4% of the land's estimated market value.

> *"Such a tax raises the cost of holding developable land when demand, as expressed through rising market prices, increases. This should, absent other factors, make holding valuable land more expensive as development pressure increases, encouraging land release for development."* (Barker and Ekins 2004)

This localised Land Value Tax is still in effect in Denmark today. Denmark initiated another, more centralised, land value tax in 1957, under what was known as the Ground Duty Government. It gained this name because at its inauguration, the government announced that it would collect as much rent or 'Ground Duty' as possible. From 1957 to 1960, under their governance, the Danish economy improved dramatically.

> "*During the Ground Duty Government (1957-1960) Industrial production went up - it more than doubled; private investments were three

> times bigger than public investment; employees and entrepreneurs earned higher real income than ever before; inflation disappeared almost; savings soared immensely; unemployment almost disappeared to around 1 percent; foreign debt was reduced considerably;domestic and foreign trade expanded, and at the end of the period (1960) all economic forecasters expected further economic progress and prosperity."*
>
> *"How much of the progress was due to the formation and activities of the Ground Duty Government is difficult to estimate exactly, as other countries experienced economic progress in the same period; but in Denmark the progress was eminent."* (Lefmann 2007)

The Ground Duty government were defeated in 1960. According to writer, Ole Lefmann,

> *"Economic analysts who examined the defeat of the Ground Duty Government have all emphasized that the reason for the defeat was political and succeeded because Danish proponents of Land Value Taxation had not enlightened people in general well enough about the advantages of their proposal."*

According to Danish MP, Knud Tholstrup, after the Ground Duty Government defeat, inflation climbed back up to 5% and by 1964 reached 8%. Land prices increased dramatically, from 1960 to 1981 increasing 19-fold while prices of goods and services increased fourfold (Bauwens 2011).

The Denmark Experience could be seen as a lesson to proponents of Land Value Tax, or in fact any tax; It's not enough that the tax makes economic sense, is of benefit to the majority, and is 'just'. Public perception matters too. The public need to understand why it is of good in all these ways, otherwise they will be susceptible to noisy fearmongering and lobbying from powerful vested interests.

In the final chapter of this part we investigate in more depth the unique nature of land, how it differs from other factors of production and the implications of this for the economy.

10.9: Positive Externalities in Land Use

Markets tend to allocate land to the highest bidder, which suggests that land will go 'to where its *private* use value is greatest'. This, in other terms, is who ever can generate the highest revenue from using the land. However, little to no attention is paid to the social use of such a space. Rypkema (Rypkema 1992) argues that for any commodity to have economic value, it must possess the following four characteristics: 'scarcity, purchasing power, desire, and utility.' Much in the same way that a property value can be increased by the positive externalities flowing from an external investment, like a new transport link or better amenities, so too can the value in a community be increased by a positive use of the land space. The positive value that arises from land stems from the amenities that it provides to the surrounding community, whether that be in beautification, economic and commercial terms, or in facility-provision (like a useful village shop or a open access bathroom in a busy high street).

One example of a positive externality could be the conservation of beautiful historical building. Tiesdell (Tiesdell 1996) says that:

> "*Historic buildings are often more interesting than the new, 'industrial' buildings, housing and shopping centers.*"

A sentiment which is echoed by Romero's argument that such preservation helps people maintain a sense of the past, providing an 'anchor to the past, as well as an incentive to the future' (Romero 2004). This argument hinges on the idea that historic buildings can provide functional diversity, resource value and economic and commerical value to the surrounding community. However, maintaining such buildings can often come to a great cost for a private owner, to such an extent that they may deem it more financially prudent to not maintain the characteristic of the land - be that, as per this example, the historic facade, or perhaps they close the public bathroom that their property had previously offered.

Governments can intervene to help promote this social value above the private value, either through command and control (e.g. mandating all buildings be the same height so as to control aesthetics) or Taxes and Subsidies (taxing disused land and subsidising home improvements through rebates). Issues exist with both policy methods. This may be that such direct orders may appear draconian and totalitarian, and may also not be administered properly so as to ensure the correct characteristics of the land are maintained. The taxes and subsidies may also not be set at an appropriate level to properly manage the resource, but they do give individuals flexibility in what they choose to do with their property.

10.10: In More Depth: The Unique Case of Land

> *Ask for what end the heav'nly bodies shine, Earth for whose use? Pride answers, Tis for mine.* Alexander Pope

> *"This land is your land, this land is my land From California to the New York island From the Redwood forest to the Gulf Stream waters This land was made for you and me."* Woody Guthrie

> "*When the Great Way prevailed, natural resources were fully used for the benefit of all and not appropriated for selfish ends... This was the Age of the Great Commonwealth of peace and prosperity.*" Confucius

We humans encounter land, we do not make it. It is part of the primordial form which precedes human existence. It has been formed over millennia, by forces we only partially understand. We observe it, we walk over it, we change it, but we cannot create or destroy it. No human is responsible for the existence of land (or air, or water, or life or ourselves), but we all benefit from it. More than benefit, we rely on land in the very strongest and most fundamental way - to exist and to survive.

Land is not mere surface upon which we walk. Land generates good things for us without asking anything (or much) in return. A seed in the ground can produce a tree without any human involvement. The tree may produce flowers or fruit, and seeds for more trees. Land holds the power to make things grow. We may harness these forces, optimise them with agricultural practices, but we do not create them. Anyone who controls land also holds this power, that which Christians called 'God's Bounty' and governments call 'natural resources'. Whatever the name, land in this sense belongs to no-one or to everyone.

American Economist Mason Gaffney describes land as our 'free gift';

> "*Land is not produced, it was created. It is the world, the planet from which man evolved,with the sun that energizes it and the orbit that tempers it. Land is a free gift, variously expressed in different philosophies as Spaceship Earth, the Big Blue Marble, God's Gift, Creation, Gaia, The Promised Land, or Nature. Mankind did not create The Earth with its space and resources, nor can we add to them.We can only acquire them, often by fighting, or rent-seeking, or in other counterproductive ways. Man at best improves and develops capacities inherent in the free gift.*" (Gaffney 2009)

The notion of land as a gift applies even when land is developed and urbanised. Any piece of land in a city will be affected by its surrounds, but primarily this will be positive, because of the development of the land surrounding it and the decision by other people to congregate in that place. We can see that if the value of the land was publically owned, as perhaps it should be, then this form of 'free lunch' would be available to all.

Gaffney has spent his career critiquing the inadequate treatment of land in economics. This chapter largely summarises his essay, "Land as a Distinctive Factor of Production", which is highly recommended reading.(Gaffney 2009)

The Classical Factors of Production

Classical economic thought treated land as one of three 'factors of production'. These are resources or 'inputs' which are used to produce products and services(output). They are mutually exclusive, comprehensive and necessary for all kinds of economic activity. The

three inputs of classical economics were Labour, Capital, and Land. Each factor has a price; the price of labour is wages; the price of capital is interest, and the price of land is rent. Labour is familiar enough: human time spent working. Capital is "that part of wealth devoted to production".
18

This definition includes all tools that are really capital. For what makes a tool capital is whether its uses or services are to be exchanged or not. Thus, the lathe used to make things for exchange is capital; one kept as a hobby is not. Wealth used in the construction of a railroad, a theater, or a hotel is wealth in the course of exchange. The exchange does not occur all at once, but little by little, with an indefinite number of people ' yet there is an exchange. The consumers are not the owners,but rather the patrons who use these facilities.

This definition is consistent with the idea that capital is that part of wealth devoted to production of more wealth. But to say production is merely "making things" is too narrow an understanding of the term. Production also includes bringing things to the consumer. Storekeepers are as much producers as farmers or manufacturers. The stock in a store is capital, and it is as much devoted to production as the capital of the others."

[18] George's precise definition was "**wealth in the course of exchange**" which requires a little more explanation. Here is the whole passage: "The key, it seems to me, is whether or not the item is in the possession of the consumer. Wealth yet to be exchanged is capital. Wealth in the hands of the consumer is not. Hence, we can define capital as **wealth in the course of exchange**. We must understand here that exchange does not mean merely passing from hand to hand ' it also includes the increase in wealth from the reproductive or transformative forces of nature.Using this definition, we can include all the things that capital properly includes, and eliminate all it does not.

Land in Economic Theory

Gaffney (Gaffney 2009) defines 'economic land' as "all natural resources and agents, with their sites (locations and extensions in space) and emphasises that economic land is not simply that which we would colloquially call 'land'. Economic land also includes air, falling water, water and beds under it, game, fish, vegetation and the radio spectrum.

For John Stuart Mill,

> "*The part which nature has in any work of man is indefinite and incommensurable*" (Mill 1848)

Thus land (or natural resources) was recognised as being distinct from and on equal footing with capital and labour.

However, according to Financial Times economic commentator, Martin Wolf, 'something strange' happened in the transition from Classical to Neoclassical economic thought.

> "*In moving from classical to neoclassical economics 'the dominant academic school today 'economists expunged land' or natural resources. Neoclassical value theory... still makes a great deal of sense. Expunging natural resources from the way economists think about the world does not.*"

Neo-classical orthodoxies tend to conflate land (including natural resources) with capital. They recognise two factors of production -

labour and capital. For Wolf and a growing number of economists, this change is based on erroneous assumptions which are now having disastrous effects;

"The idea that land and capital are the same thing is evidently ludicrous. It requires us to believe that the economic machine is self-sustaining 'a sort of perpetual motion machine. Capital is the product of savings and investment. It is the result of human frugality and the invention required to imagine and create new capital goods. Labour is also' and in today's circumstances, increasingly ' a form of capital. Parents, governments and individual people invest in their own skills, so making themselves more productive.

Yet there would be no economy 'indeed no humanity' without a constant inflow of natural resources into the system: what lies above our heads (the sun and the atmosphere), what lies close to us (the soil, the seas and location itself) and what lies beneath us (fossil fuels, metals and minerals and heat). Humanity does not make these things; it exploits them. Some of these resources are also appropriable and so a source of unearned personal wealth." (Wolf 2010)

The effects of treating land as a kind of capital

According to writer, Martin Adams, this failure to effectively distinguish between land and capital in economic models leads to"incorrect forecasts and faulty economic applications in addressing social issues such as wealth inequality or ecocide." (Adams 2016) This occurs partly because by seeing land as capital, we fail to recognise that the factors which influence the price (land rents) of land are not the same factors which influence the price (interest rates) of Capital.

This erroneous conflation of land with capital also leads to the treatment of land as an investable product, though it is not. Because land generally increases in value,people talk about buying land 'as an investment'. The buy-to-let landlords in the UK who see themselves as investors in property, are not truly investing in the economic sense. Rather, they are parking their money somewhere. This is the case because to be an investment, something new of value must be created. Land is not investable in the sense that anything new of value is created by the input of money (purchase)/transfer of ownership.

When money is put into a start-up business, for example, this is a productive investment - it may, in tandem with the efforts of people labouring in the business, create something new, which is of value. This an a productive investment. The purchase of land is nota productive investment as it adds no new goods and services of value to the economy. Neo-classical economic theory fails to recognise this important distinction. The result of this is policies which allow or encourage people to 'park'their money in property rather than invest it in truly productive areas, such as business and infrastructure. This is a loss to all of us as we all lose out on the creation of new products and services which would benefit us.

10.11 Ways in which Land differs from Capital

Land has unique characteristics which distinguish itfrom Capital as an economic input. Gaffney emphasises ten primary distinctions;

1. Land is not produced, nor is it reproducible.

This should be most obvious to everyone. When satellites show us pictures of the earth from space, they show us something which we did not create, yet it exists. "Man at best improves and develops capacitiesinherent in the free gift".

Capital has been produced by human hand. As Gaffney argues (Gaffney 1994), capital is produced by human investment, thrift and production. It coexists with land, and he argues, this is why microeconomics makesthe error of conflating land and capital. He argues that neoclassical economics deals mainly with relations ofcoexistence and largely ignores relations of sequence, which occur over time,such as the formation and destruction of capital.

"*The life ofcapital, like that of people, is marked by major sacraments of birth, growth,aging and death - all missing from micro theory. Micro deals mainly with howexisting resources are allocated at a moment in time, not how they originate,grow, flourish, reproduce, age, die, and decompose*"

2. Land as 'site' is permanent and recyclable

Essentially, this is to say that land does not get used up (with the exception of extractive natural resources), destroyed or depreciate. Capital does decay, however. As a matter of course, capital products wear out They must be kept going by constant maintenance and repair. We talk about consuming land, but land in fact does not get consumed or used up, in the way that Capital does. It is of course, possible to damage land, for instance, through toxic waste dumping.

3. Land supply is fixed

One of the most crucial consequence of this fact is that, unlike Capital, land acquisition is a zero sum game. That is, no one can acquire more land without others having less. The amount of land we have now is fixed. We cannot make more (even attempts to create new land masses are simply moving land around)

4. Land is immobile in space and uncontrollablein time

The fact that land is immobile in space means that its supply cannot be increased to meet increased demand in a localised area. So, when demand goes up, prices go up.

The fact that land is 'uncontrollable in time' means that the benefits which flow from land, such as raising seedlings, flow steadily at a certain pace. The benefits cannot be set aside and stored for future use.

> *"Nature's services per se... come in a flow like time itself, unbidden and uncontrollable.Mankind cannot advance nor retard its services at will."*(Gaffney 1994)

Another effect of the immobile or fixed location of land is that is suffers externalities - both positive and negative - from surrounding land. That is, the economic value of a piece of land is affected directly by what is going on by the land surrounding it. So for example, land's economic value can be affected by negative externalities such as pollution or the rate of crime in the surrounding area. The value of land can also be increased by 'positive externalities', such as improvements to local infrastructure and the creation of public amenities.

5. Land does not turn over. It is recycled and versatile

Land is versatile in that it is available for a multiplicity of uses. Land rarely becomes obsolete, with the result that there is almost always an opportunity cost in the use of land: i.e. it can always be used for something else. This is not the case for many forms of capital, which do become obsolete.

"The only source of land for new uses today, as for ages past, is to take it from its previous use"

6. Land is not interchangeable with capital

Interchange must be distinguished from 'exchange'. Land can be exchanged for capital but they are not interchangeable. Capital can be converted into other types of capital. The consequence of this is that it is a mistake to think that 'uniformity' within taxation should occur between land and capital. It need only occur within each class.

7. Land is subject to market forces that differ from those that determine the price of capital (interest rates).

We mentioned earlier the costs or prices of the different modes of production. The price of labour is wages, the price of capital is interest and the price of land island rent. But what affects these various prices and are the influencing factors the same? The short answer is that they are not the same. Interest rates around the world are subject to 'common, interconnecting forces' and they rise and fall in sympathy. Land rents are also influenced by common forces, but these are not the same forces as those which influence interest rates. In fact, one of the forces which influences land rents is the interest rate. The two prices vary inversely. As Gaffney states,

"*Capital andLand are rivals for the same pie, so usually their returns vary inversely. Ground rent equals operating cash flow lessinterest on the cost of building, and less building depreciation. A rise in interest rates lowers ground rents.*"

The meld of land and capital in neoclassical thoughtcauses us to lose this distinction and inter-relationship. This is an obstacle to attempts to model theoutcome of economic policies.

8. Land price guides investors and determines the character of capital, as capital substitutes for land.

There is a relationship between land prices (rents)and the kinds of capital which investors choose to invest in. We are familiar with the idea that when theprice of labour (wages) are high, then investors prefer 'labour-saving' capital(such as self-service checkouts at supermarkets). Similarly, when land rents are high,investors prefer 'land-saving' capital, such as high buildings.

They also favour:

- land enhancing capital (capital used to improve land for a new use)
- land-linking capital (rail lines, canals etc)
- land-capturing capital (e.g. dams to secure water rights)
- rent-leading capital

9. Land is limitational

This is a technical term which essentially means that all human activity requires some land (including nature, space, water, the ecology etc) and some capital. Labour and capital cannot exist without at least some land, while land can easily exist without labour or capital. Land can not only exist, but support timber and wildlife.

It has often fallen to environmentalists to remind us of the limitational value of land. The famous environmentalist catch-cry coined by activist Judy Bonds puts it most powerfully: 'No jobs on a dead planet!'

10. Land value (basic permanent location value)is not an economic fund.

The unique qualities of land certainly give it value, but this value cannot be effectively described by the usual categories which are used to describe economic values. These standard categories divide value into funds and flows. Gaffney clarifies that land value is the present value of anticipated future service flows from land which cannot be hastened. This is a mouthful, but it expresses an important quality of land. This kind of value is not like capital stores (a fund), which can be drawn from, such as grain from a granary.

Here we are speaking about the basic permanent location value of land. There are particular cases to be made for exhaustible resources such as oil reserves.

10.12 Economic Consequences

1. The origin of property in land is political and owning land imparts superior bargaining power.

Capital may result from the ingenuity and effort of people and involves the creation of something new. There is thus a sort of natural ownership which arises. There is also a natural ownership of one's labour. There is no such natural ownership of land. That is,no-one claims land by right of production. Whilst there are good reasons for private ownership of land, it should be remembered that historically, the origin and distribution of property inland in not economic, but political.

> *"The initial distribution of land -the origin of property in land -is military,legal, and political, not economic. The prime business of nations throughout history has been to gain and defend land. What was won by force has no higher sanction than lex fortiores, and must be kept and defended by force."* (Gaffney 1994)

The enlightenment era thinker and member of the Physiocrats, Richard Cantillon, similarly wrote,

> *"It does not appear that Providence has given the right of the possession of land to one man preferably to another: the most ancient titles are founded on violence and conquest."*

This original distribution of land ownership often persists long term, transmitted through inheritance and confers political power for generations. This is particularly relevant as regards fairness.

For the American context, Gaffney puts it thus,

> *"If one's grandfather was a slave when the Land Office was parcelling out Federal lands to the friends and cousins of corrupt Congressmen,

one may be excused from believing Utopia will ensue from limiting all future changes to"win-win" Pareto-optimal changes from the inherited status quo."*

Similar reservations might be held by the descendants of peasants in England, who after the Enclosure Acts, lost access to the common land. Writer Helen Salmon has explained the unfairness of the Enclosure Acts.

"Predictably, the commissioners, appointed by the rich landowners, gave them the best land, often leaving the poor with useless,infertile plots. Plots were also often allocated to the owners of cottages rather than their tenants, leaving the poor with nothing and their landlords with yet more land.

If this were not bad enough, the costs of enclosure, including the costs of presenting the bill to parliament and fencing all the plots of land (estimated by the authors at up to '?5 per acre of land enclosed) would be shared between all the villagers. These costs were ruinous for the poor, who were forced to sell their land to the rich at whatever price was offered. (Salmon 2005)

The benefits of ownership of land multiply further because land imparts superior bargaining power. Whilst we all have labour power in varying degrees, landowners also receive income from land above that, which gives them 'discretionary spending or waiting power'. Also, whilst land appreciates in value, capital depreciates. So, in contests between the land owner and the non-land owner, the landowner has a key bargaining advantage.

2. Land rent does not evoke thrift, production or investment.

We mentioned earlier that 'investing' in land is nota productive investment. Gaffney puts it thus;

"*Investing in land is macro-economically sterile. It creates neither income nor capital.Socially, it is a wash: one buys, one sells, nothing else happens*".

Another term for this type of non-productive investment, is a 'placement'. This means that it is a 'place to put your money' rather than a physical addition to overall wealth in the society. When people owning placements are able to preserve and increase the value of the placement, they gain an increase in their private worth without a corresponding increase in overall wealth. This will, in relative terms, decrease social wealth.

Furthermore, since property and land are concrete assets with a fairly stable and easily-assessed value, they are highly attractive to banks as collateral for financial investment. Treating land as an investment therefore diverts banks away from their important role of funding productive investment in society.

3. Land value lowers savings rates

Land values in investment portfolios lower the need to create real capital. This also reduces the tendency to save and the supply of capital. Gaffney compares this situation with the case of slave ownership in the past;

"The existenceof high land rents and values, like the ownership of slaves, tends to satisfythe need for accumulation of assets without any actual capital formation."

3. Land Destabilises the Financial System

Two of the most serious recent economic crisis have been associated with land and property speculation: the Japanese crisis of 1990 and the following last decade and the overall financial crisis of 2007 and the following (and in Europe ongoing) 'great recession'. Both of these economic problems are triggered by property lending bubbles which burst, causing losses on bank loans. These losses rippled through the financial system causing banks to lose money and go bust. Banks reduced their lending activity causing a reduction in economic activity. The government stepped in both to recapitalize banks and also to stimulate the economy through low interest rates and fiscal deficits. These prevented an economic catastrophe and also led to a ballooning of government debt.

What has been wrong with the system and the economic model? Well, the model has been based on debt primarily and house price speculation. Banks have been primarily lending on existing collateral, primarily property (real estate), rather than performing their traditional economic role which is to finance new business investment. High and volatile house prices create various macroeconomic imbalances. Whilst house prices are increasing, the' wealth effect', makes people feel richer and able to fund higher consumption, which then increases indebtedness and equity control. However, when the bubble bursts and house prices fall, individuals feel overburden in debt and cut back on expenditure leading to a demand deficiency. This is when the government needs to step in to make up for the lack in private sector demand.

Land and property speculation is not economically productive. It also contributes to increased inequality, which itself has economic consequences. Lending and capital which has been allocated to house price speculation could instead have been used to support productive investment.

4. The Price of Land Must Be Systemically Risky to Compensate For Supernormal Return

If, as we argue, urban land has a supernormal 'monopoly' return potentially greater than that of other assets, then this presents us with a problem. If rational agents can deduce this, then we'd expect them to pile into the asset class, leading to a rapid appreciation to high levels from which it would no longer be expected to achieve a super return. This is, in fact, exactly what we observe. Land observes semi-regular booms (or 'bubbles') and busts. This instability has very significant economic effects - the Japanese crash of 1990 and the US sub prime crisis of 2006 onwards both had their roots in real estate.

5. The Fall In Interest Rate Makes Property Owners Richer and Makes Home use Ownership Too Expensive for Many.

Owners of capital also get capital gains and losses associated with changes in the interest rate. Changes in interest rates change the capitalisation rate between a rental flow and the associated capitalised value of a piece of land. Another way to see the same effect is that changes in mortgage rates affect the cost of purchase since they change the total quantity of interest paid to the bank.

Generally, since the 1980s, interest rates have been falling, leading to very large capital gains on land and property assets. Marx argues that capitalism, in accumulating capital, would lead to long-term reductions in the rate of return on capital. If these are accommodated by the central bank, this would lead to long-term reductions in the interest rate leading to the capital appreciation.

So as we can see from this discussion, the ownership of land conflates a great deal of power to the owner. Limited land supply means that the owner is able to benefit from the need for housing (Rent), increases in demand for housing in that area (rent increases), and decreases in interest rate (asset value increases). These increases in property wealth contribute to the impact outlined by Piketty (Piketty 2014), whereby the rate of the increase in wealth outstrips that of income, which further compounds inequality between the have-nots and the have-lots.

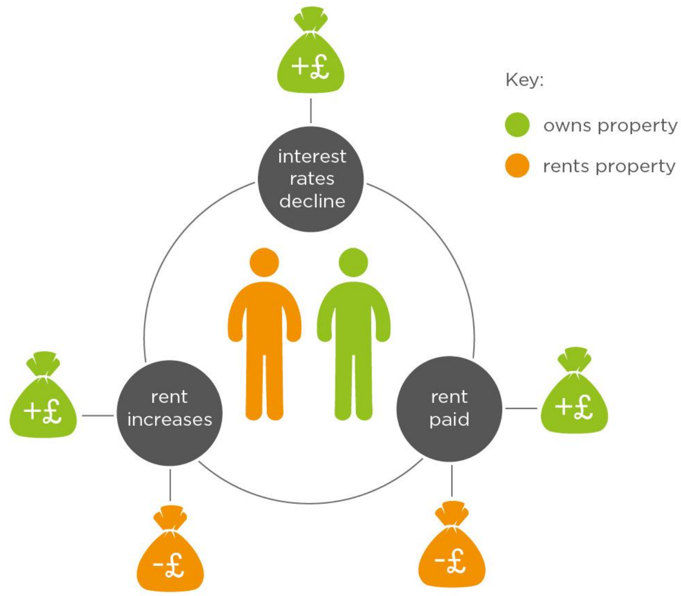


Figure 6.20 Land, Rent, and Income Inequality

10.13 The Treatment of Land in Economics Education

We have discussed the problems which the treatment of land in neoliberal economic theory has caused. To solve these problems, we need to bring land out of the shadows of economic theory.

According to Gaffney, the original conflation of land with capital may have occurred in part for political reasons, to deflect possible taxes on land. This unfortunate development in economic thought was then institutionalised; land was ignored in the main economic canon in universities and was marginalised into sub-disciplines of 'Land Economics' and 'Agricultural Economics'.

Gaffney is scathing;

> *"(T)he obvious is obscured, silenced, or denied. Hundreds of books on economic theory are published with"land" absent from the index. Denial is reinforced by dominant figures using sophistical, pedantic cant, which students learn to ape to distinguish themselves from the laity and advance their careers'.*

> *A number of economists don't buy it, but don't do anything about it - acquiescing in error by silence, indifference, passivity, or anxiety of the professional consequences. They handle the question by "going into denial," as it were, resolving a vexing issue by pretending it isn't there. Truth will not be made manifest by hedging, especially against

> such motivated forces as have an interest in hiding unearned wealth behind the skirts of capital... The discipline has not totally eliminated land, but marginalized it. [...] The sub-disciplines are kept away from the "core" and "mainstream" of economic thinking by compartmentalization and colonization. Patronizing "land economics" as a colonial discipline keeps potentially contagious movements within the empire, where they can absorb critical tendencies under watchful control, while yet remaining safely remote, in the outskirts of the system. Orthodoxy flows out from the core, communicated via mandatory "core courses." Land economics is banished from the "commanding heights" of economics."* (Gaffney 1994)

There may be some other reasons why land has been so neglected in mainstream economics. One reason may be that land is often thought of in agricultural terms and is therefore assumed to play a small role in modern industrial economies. However, though we may think of land as rolling green hills and farmland, it must be stressed that 'land' in economics includes urban land. In fact, urban land is possibly more significant to the economies of modern industrial societies, than is agricultural land. Another possibility for the neglect of land in economics is that economics in general is focused on production, not the cost of existing assets. The classical economists perhaps would not have considered the provision of housing services to be part of 'production'.

A further possibility is that land economics and by extension, any prospect of taxing land is politically unpalatable to many. Moreover, land owning interests are politically highly influential. Even universities, who are seen as places where ideas flourish, may feel threatened by land economics, as they often hold much of their wealth in the form of land.

Clearly, land itself must be brought out of the economic theory wilderness and given a central role.

Appendix: Singapore as a 'Property State'

Singapore is often described as a neoliberal paradise: low taxes, open trade, a large financial sector. It has been phenomenally successful, with average growth rates in the range of 5-10% and has transformed itself into a city state with amongst the highest GDP in the world.

Scratch the surface and a rather different story arises, one that has public ownership of land and provision of public housing at its heart, as described by Anne Haila's 'Urban Land Rent, Singapore as a Property State'. So what exactly is the 'Singapore model' in relation to property?

Ownership of land has really two components: it allows the landlord to collect rent on whoever is occupying the property, and it gives control over the development of that land, including usually the effects of that development on the physical environment, on other people and landowners and on the supply of housing. Singapore has both components: public capture of rent, and public development of housing.

The first component, capturing land rent for public purposes, is shared by those arguing for a land value tax (LVT). Proponents of an LVT argue for taxing land value (principally urban land, as agricultural land is of much lower value). An LVT separates the value of a property into two components: the value of the physical building (the bricks and mortar) and that of the underlying location (land value). Almost all the major economists, from Adam Smith, David Ricardo, to Milton Friedman and Britain's Mirrlees Review of taxation have argued in favour of an LVT and American journalist Henry George popularised these ideas with his masterpiece *Progress and Poverty*. Recently the Economist has promoted the idea. The ownership of land allows the charging of ground rent, but this idea is implemented sensitively with a view to reducing the cost of housing to low-paid workers.

Singapore has also shown the advantages of the second component: the public sector having a decisive role in developing land. Providing public housing is of course crucial in a rapidly-developing high wage city with limited space. Furthermore, the state development of infrastructure increases those very same land values. The return of a profit to the public sector, thus leads to the replenishment of the funds which can be used to provide further investment, in a beneficial cycle. Contrast this to Britain where public infrastructure such as HS2 is paid from public funds whereas the landowners near the stations, who benefit thanks to increased land values, pay nothing.

The whole tenor of the Singapore approach is pragmatic, putting the public interest first, being sensitive to the interests of individuals, and avoiding concentration of power in any one institution.

Whilst the institutions of the Singapore property state model have evolved over decades, there are policy solutions that could give the benefits of land value tax and of public ownership of land more directly. In the UK, an LVT would replace council tax, business rates and stamp duty. It would be a proportional tax on the value of property paid by owners rather than occupiers, with a deduction for the value of the bricks and mortar. And future *increases* in land rent could be taxed at nearly 100% and the revenues shared between those responsible: the local community, municipal authority and national government. Those with large mortgages would be protected by asking banks to pay the land value tax on the proportion covered by a mortgage. Alternatives to bank mortgages such as building societies and state-backed community land purchase could also be developed.

Singapore shows that public land ownership can be combined with high rates of owner occupation. Low cost and high-quality public housing can be both affordable and beneficial to all parts of the community, including the business sector. In Brexit Britain, where parts of the public sector, such as Railtrack, are still selling off land to the private sector, where public housing provision has declined relative to the private sector, and where property taxation is outdated and arbitrary, the Singapore property state model deserves a closer look.

PART 11: MONEY, DEBT AND FINANCIAL REPRESSION

Summary

- The correct and responsible role of debt is as a useful tool for selective application, to make early use of a longer-term investment that one (individual, firm or nation) has a high degree of certainty one will be able to afford. It should not be a system of dependency to repeatedly shore up insufficient cash-flow.
- Irresponsible private debt can be discouraged through more-regulated lending and a higher tax on bank balance-sheets.
- Economic situations forcing individuals into debt can be mitigated with higher wages and/or higher net income due to a citizen's dividend.
- Financial instability is socially damaging and unnecessary; it can be mitigated with a financial taxes explained here.

This part is split into the following chapters indicating different types of tax on banks/debt, transactions or money:

1. Taxing Banking: the bank balance sheet levy and other ways to tax financial institutions such as a specific profits tax
2. Taxing Financial Transactions: both in finance and more generally in the economy
3. Financial 'Repression': reducing public debt through inflation, growth, monetisation of debt
4. Demurrage: Taxes on money balances

11.1: Taxing Bank Balance Sheets and Profits

Introduction

For many people, financial services are an opaque and mysterious business. For many people, banks are places to store hard-earned money or get a loan. However the relationship between these two, the operation of other financial products and the relationship of banks to the wider economy is a puzzle. A study by ESCP Europe in June 2010 found that the general population is not well informed about the banking system, with little awareness of the status of their deposits and what banks do with them.

The financial crisis of 2007-8, whose interconnected causes are still being teased out and debated by experts, has only exacerbated this sense that understanding 'finance' is not possible for normal people. Several studies have found a substantial deterioration in public attitudes towards the UK Banking Industry following the crisis. A report by YouGov Cambridge in 2013, found that only 4 percent of those surveyed thought that the banks observe high moral and ethical standards - a joint worst rating with betting shops, casinos and online gambling.

Functions of the Financial Sector

Yet despite its failings, the financial sector exists to serve a useful purpose. As Philip Booth wrote in the 2011 edition of Balance, the British Banker's Association magazine,

- "Life would be unthinkable without banks. Not only do banks provide mechanisms to ensure that we can pay each other immediately for the goods and services we consume, they also provide crucial economic functions. These include screening risk, diversifying risk, reducing transaction costs and providing capital for businesses and credit for consumers. The flip side is that they provide safe returns for savers. Without a modern financial system, retirement from work would be more or less impossible." *

Lord Adair Turner, who was the Chairman of the Financial Services Authority from 2008 to 2013 has written in more technical terms on this topic. Turner argues (FSA 2009) that the purpose of the financial system is as follows:

1. The provision of payment services, both retail and wholesale.
2. The provision of pure insurance services, life or general, wholesale and retail, which enable people or businesses to lay off exposure to risks by pooling their exposure with others.
3. The creation of markets in spot or short-term futures instruments in, for instance, foreign exchange and commodities.
4. Financial intermediation between providers of funds and users of funds, savers and borrowers, investors and businesses, an intermediation which plays a crucial role in capital allocation within the economy. This function can be split in turn into four sub-functions: pooling of risks; maturity transformation via balance sheet intermediation; maturity transformation via the provision of market liquidity; and risk return transformation.

We might argue that the wider economic purpose of the financial system is to support the production of goods and services that contribute to personal, social and environmental well-being. We could also say that finance should build up the real wealth of the economy, financing productive investment and export sectors such as manufacturing. Finance should be the servant, not the master, of the real economy.

Reasons for Taxing Finance

The financial system is therefore at the centre of our economy. Taxation of such a sector must be carefully planned as it may have ramifications on many other parts of society. A report on financial sector taxation by the European Commission in 2010 identified three policy goals in taxing finance:

- Reduce the size of the financial sector where its social costs in terms of debt and fragility are greater than its benefit
- Ensure finance pays a fair share
- Pay society back for the financial crisis, which was arguably caused by a reckless financial behaviour of the sector.

We argue there are additional reasons for taxing finance, money and debt. These are outlined below:

1. Finance is supported implicitly by the central bank and that benefit should be paid for.
2. Finance typically caters to the needs of the super rich. Taxing finance can have positive distributive effects, if done right
3. Taxing finance can increase incentives to invest productively
4. Debt does not share in economic downturns, and therefore makes the system more fragile. Taxing debt could reduce incentives to create debt, reducing risk and increasing resilience of the system
5. Helping debtors as opposed to creditors is associated with productive economic situations and peaceful futures
6. The history of public debt management suggests that the government's policy towards interest rates, growth and inflation is highly significant in terms of the evolution of public debt[19].

[19] Between the two world wars, the UK government adopted a system of fiscal austerity and high interest rates to return to the gold standard at pre-war parity. The results were disastrous: mass unemployment and an increase in the public debt-to-GDP ratio. On the other hand, after WW2, growth, moderate inflation and low interest rates were the norm. The debt came down from over 200% of GDP in the late 1940s to around 70% by the 1970s. We might say that the best way to reduce the public debt is not to worry about it

Taxing Finance in the UK

Financial services pay a variety of taxes in the UK. In addition to the taxes that all companies pay, banks are also subject to a bank levy on their total assets (which is to be replaced by a surcharge on profits made by financial companies). The estimated total contribution of the financial sector was approximately £66.6 billion in the year ending 31 March 2015. Banks account for about two thirds of this, other financial institutions the remaining third (PWC 2015).

The Bank Balance Sheet Tax (Bank levy)

Specific to banks, we have the bank levy or bank balance sheet tax. It is a levy on the total equity and liabilities on the bank balance sheet.

A bank balance sheet consists of assets such as loans, and liabilities such as deposits. A loan is an asset because it is hopefully paid back to the bank. A deposit is a liability because it may be recalled by the depositor . The assets are equal to the liabilities plus the bank's equity. And so a bank balance sheet tax is a tax on the total size of these assets and liabilities.

The bank levy was introduced in 2011 with the purpose of raising £2.5 billion a year from banks operating in the United Kingdom. It was justified as a way of forcing banks to contribute more after the financial crisis and to discourage risky borrowing. The levy only impacts foreign banks on their UK balance sheets, whereas UK banks pay tax on both their domestic activities and their global balance sheets. Banking institutions and groups are only liable to pay the levy where their relative aggregate liabilities exceed £20 billion.

After its implementation, the UK levy increased gradually in each year of its existence until 2015, when it was announced that that it would gradually be decreased over the subsequent six years and would stop applying to worldwide assets from 2021. The reduction will be from 0.21% to 0.1%.

The reduction was in response to complaints from UK banks that it put them at a competitive disadvantage. In June 2015, the Chief of the British Banker's Association, Anthony Browne, also warned that the levy was costing London jobs and risked causing banks to move their operations overseas, saying:

- 'The global banks constantly review where they base their business around the world, how much they put in London, New York, Singapore, Tokyo - the trouble is that in London the negative side has got so much longer and positive side shorter. For a lot of them, they've reached a tipping point, and move the operations elsewhere.' *

In fact, although banks threatened to leave the country and HSBC did a long review, none carried out their threat (although the Brexit vote is likely to have a much more serious effect).

The base of the bank levy was initially twofold: both lending in the UK financial system *and* the global lending of UK-based banks. One can see a justification in both but they are very different from the point of view of the incentives of banks to be based in the UK.

The first approach (UK lending) does not discriminate between UK based or non-UK banks - all banks that lend in the UK financial system would be covered. Whereas the second approach discourages large global banks to locate here. Therefore it seems that the first approach could sustain a higher rate without affecting bank location.

Bank Corporation Tax Surcharge

Whilst reducing the bank levy, in 2011, the government imposed a Bank Corporation Tax surcharge. This is an additional 8% tax on the profits of banking companies above an annual £25 million profit allowance.

There is therefore a key difference in operation between the bank levy and the surcharge. The levy is a tax on the bank's total balance, whereas the surcharge is a tax on profits. The surcharge was projected to raise 6.5 billion pounds between 2016/17 and 2020/21. Introduced at the same time as the winding down of the bank levy, the surcharge has received mixed reviews from financial institutions.

Some consider that with the removal of the bank levy, and the relatively low Corporation tax rate of 18%, the surcharge is a manageable cost. Others have argued that the surcharge impedes so-called 'Challenger' banks, which are new banks established since the global financial crises. Many of these formally avoided the bank levy because their liabilities did not exceed the threshold £20 billion. However, they are now subject to the corporation tax surcharge on their profits. Some claim that the surcharge will make it difficult for new banks to enter the market and secure investment.

Bank Levies in Europe

The United Kingdom is not the only European country to have introduced a bank levy. Since 2009, 14 countries almost exclusively in the European Union have introduced levies. Many of these levies were instituted in response to a 2010 report by the IMF which proposed the idea of a bank levy (which they called the 'financial stability contribution'). Its explicit aim was to produce a contribution from the banking sector to compensate government for the cost of guarantees and bailouts, and secondly to reduce the risk of future banking crises.

The below table shows all the European banking levies as of 2015 (Kogler 2015).

	Tax Base	Tax Rates	Exemptions	Use of Funds
Austria 1.1.2011	Total Liabilities	EUR 20bn: 0.09%, EUR 20bn: 0.11%	Equity, Insured Deposits Allowance: EUR 1bn- Surcharge: 45% until 2017	Treasury

	Tax Base	Tax Rates	Exemptions	Use of Funds
Belgium 1.1.2012	Total Liabilities	0.035%	Regulatory Capi-tal,Insured Deposits	ResolutionFund
Germany 1.1.2011	Total LiabilitiesDerivatives			
France 1.1.2011	Regulatory Capital			
Hungary 27.9.2010	Total Assets			
Netherlands 1.10.2012	Total Liabilities			
Slovakia 1.1.2012	Total Liabilities			
Sweden 30.12.2009	Liabilities and Provisions			
UK 1.1.2011	Total Liabilities			

France and Germany have both introduced levies, though they differ from each other in several respects. One major difference is in the basis for the levy, i.e. which part of the bank's holdings are being taxed by the levy. Both the UK and Germany tax the bank's total equity and liabilities, subject to certain exceptions. The French levy, however, is charged on minimum regulatory capital. Another difference pertains to where the collected funds are directed. The proceeds of the UK and French levy are directed into general revenues, whereas the German proceeds feed into a fund, to be drawn upon in the event of a financial crisis. Also the UK and France determine the tax base on a global/consolidated basis, while the German levy is imposed solely on a single entity. There are several other differences between the three levies, not the least being their expected yield and rate. For a detailed analysis of the differences, see the report by Sullivan and Cromwell (Sullivan & Cromwell LLP 2011).

As we discussed, the UK bank levy was criticised on the basis that it placed banks at a competitive disadvantage. The German bank levy has also drawn some criticism, and debate as to whether it is achieving its goals. The German levy was intended to generate resources for the fund, and to internalise bank's contributions to systemic risk. In 2014, Deutsche Bank produced a report, evaluating the effects of the German bank levy on bank behaviour. They found that the revenues raised through the levy were lower than expected, because of low tax rates and high tax thresholds for exemptions. They also found that the levy did appear to influence bank behaviour, with evidence of a reduction in lending and higher deposit rates.

However a comprehensive study of bank levies across Europe produced by Michael Kogler of the University of St Gallen Institute of Economics in 2015 (Kogler 2015) found that bank levies tend to lead to a raise in lending rates but do not significantly affect deposit rates. This suggests that the cost of the levy tends to be passed on to borrowers. They found that the amount passed on to borrowers is determined by bank competition (i.e. where banking markets are concentrated and have low competition), more of the levy cost is passed on to borrowers through an increased interest rate. They also found that less of the levy cost is passed on to customers by well-capitalised banks, possibly because they are less exposed to the levy.

Conclusion on Bank levies/ bank balance taxes

The bank levy is a tax which is in existence and which raises some revenue, albeit at a low rate. Despite threats to move their operations from the UK, no banks have done so for this reason and if the tax was imposed solely on UK lending, they would have no reason for doing so. The tax also meets our earlier criteria for taxes, namely that 'we want to tax things that either we want to go away or that don't go away when we tax them'.We want to reduce the levels of unproductive debt (such as money to buy existing assets), and direct it to more productive purposes. Debt is a form of wealth and should be taxed appropriately.[20]

[20] Add ways to distinguish productive and unproductive debt taxes

11.2 Taxing Financial Transactions

Introduction

Bank levies are taxes on the balance sheets of banks. Transaction taxes on the other hand, are (as the name suggests), taxes on either transfers of money (including on ledgers) or transfers of ownership. This means that the parties to a transaction, pay a tiny percentage of the value of the transaction in tax. These taxes (and in particular taxes on Foreign exchange trading) are also known as 'Tobin' taxes, after Nobel Laureate James Tobin, who proposed the tax as a means of 'throwing sand in the wheel' and slowing down 'excessive' trading.

Of course there are many types of transactions. Some types of transactions are already covered by the existing tax system, for example salaries, dividends and expenditure. (e.g. Income Tax and VAT). Transaction taxes (TT) focus either on other types of transaction, such as the buying and selling of land, financial securities or currencies, or they focus on all transactions mediated through banks. Accordingly, Matheson (2011) distinguishes between types of transaction tax:

- A bank transaction tax (BTT) on the value of inward deposits and/or withdrawals from bank accounts.
- A securities transaction tax (STT) on change of ownership of securities, such as the UK's Stamp Duty.
- A currency transaction tax (CTT) on foreign currency exchanges.
- A capital levy on issuance of new share capital.

Proponents of FTT's argue that the tax discourages economically unproductive activities. FTTs make short-term investments more expensive relative to long-term investments and may thereby reduce excessive speculative short-term trading. This enhances market stability and encourages the financing of real, productive ventures. Proponents also argue that FTTs are effective in raising revenue and are simple to administer.

Critics, on the other hand argue that FTTs increase the costs of raising capital, thereby discouraging investment and reduce the ability for smaller corporations to finance projects. They also argue that FTTs are ineffective, as the research on the outcomes of FTTs in different countries has often had contradictory or inconclusive findings.

FTT Case Studies

Reviewing the experiences and outcomes of FTTs in different countries reveals that the ability of an FTT to raise revenue and its effect on markets is dependent on the particular design of the FTT.

Taiwan

The Taiwanese FTT was instituted in 1965, starting at a uniform rate of 0.15 percent. It has evolved into a system of differentiated rates of taxation, ie different rates for shares, bonds, futures and options. Economist Kapoor suggests that this graduated regime can be considered FTT 'best-practice', as it allows government to fine tune the tax for different products and keeps open the option of adjusting the rates as circumstances require.

The Taiwanese FTT has been very successful in raising revenue, and in 2008, accounted for 5.5% of total tax revenue. Taiwan also has strict anti-avoidance measures including transfer pricing rules and disclosure requirements. as well as fines for failure to register transactions.

According to Beitler (Beitler 2010), 'Taiwan provides an excellent example of a sophisticated FTT that has regulatory effect through a multi-tiered system of tax rates, but also raises significant revenue for the government.'

Brazil

Brazil has introduced and abolished several forms of Bank debit tax since 1993. Their longest running bank debit tax was the *Contribuicao provisoria sobre movimentacao ou transmissao de valores e de creditos e direitos de natureza financier (CPMF)* , which was in place from 1997 to 2008.

The tax was imposed on debits by non-bank depositors from current, investment, time deposit and savings accounts, with some exceptions. Its performance in raising revenue was consistent and strong.

Beitler sites three reasons that the productivity of the tax does not appear to have been affected by rate increases. Firstly, she suggests that the final rate was not excessively high. Also, the banking system in Brazil is sophisticated and widely used and finally, the tax was levied on bank debts only, not debits and credits.

There is some evidence that the CPMF affected investment behaviour, leading to a 40 % increase in demand deposits. It may also have contributed to the migration of business from the San Paolo Stock exchange to overseas markets, although there are likely to have been multiple factors.

Japan

Japan introduced a securities transaction tax in 1953, which underwent several rate changes in the ensuing years until abolition in 1999. The rates in that period ranged from 0.1 to 0.3 % for stocks and 0.08 to 0.16 for corporate bonds.

During the 1980s, the tax raised a significant amount of revenue, at one point reaching US$12 billion per year. After its abolition in 1999, the data suggests that there were increases in trade, and increases in price volatility.

United Kingdom

The government applies a 0.5%[21] tax, known as stamp duty, to the transfer of shares in companies with a UK Stock register. The revenue accrued has been substantial and stable over many years. The cost of collection is low as the tax is collected electronically. Research suggests that the stamp duty has not had a material impact on trading in the London Stock Exchange, although announcements of rate changes are correlated with changes in the UK equity index. (Saporta and Kan, 1997).

[21] (confirm this)

Unlike in the Swedish case below, the stamp duty cannot be avoided through trading in overseas markets as it is required to make the transfer of ownership legally binding. It is an internationally applied tax on domestically registered companies. Contrast this with the Swedish case below, which instituted a domestic tax on international capital.

Sweden

The Swedish case may be cited as an example of 'how not to' design a financial transaction tax. Their FTT was introduced in 1984 as a 0.5% tax on both the purchase and the sale of equities. The rate was increased in 1986 but by 1991, the tax was abolished.

This was largely because of disappointing revenues from the tax and high levels of avoidance. As the tax applied only to transactions undertaken in Sweden, there was a strong motive for traders to move their activities overseas, and after the 1986 rate increase, 60 % of the most actively traded Swedish stocks had migrated to London. According to Beitler, 'The underlying design flaw was that the tax did not apply to Swedish citizens or Swedish assets per se, but to transactions undertaken in Sweden.'

Discussion of FTTs

Thus international experience seems to suggest that financial transaction taxes can be powerful instruments to raise revenue, however much depends on their particular design. Beitler argues that the most successful taxes are simpler and have a lower rate. Taxes that levy only one-way transactions have few exemptions, less evasion and higher productivity.

Similarly, there is a great deal of variation in the market impact of the taxes, which can be alleviated by adjustments to rate and design, as demonstrated by the UK and Sweden comparison. FTTs must be carefully designed to minimise evasion through migration of trades to overseas markets.

There are two general motivations for transaction taxes: to alleviate short term behaviour and to raise revenue. Some have pointed to the very large volume of transactions in developed financial markets such as London. Even at a low rate, it is argued, a transaction tax would raise a lot of revenue. But it seems that the location of these transactions is extremely sensitive to the tax. Even a small tax might cause a large part of these transactions to move elsewhere. This movement of financial activity might even reduce tax revenue from other taxes (e.g. corporation tax) more than the revenue raised from the transaction tax. This effect would only however happen with a unilateral tax.

Therefore, it seems that the most appropriate way to go is to support an international tax at such a level that it would have a beneficial effect on reducing short-term speculation, and assess the revenue raised. A number of countries could coordinate this approach. We do not propose to introduce a transactions tax unilaterally, except in the sense of making the existing tax system more automatic.

11.3: Financial Repression

Growth in GDP is low in European countries, and the level of government 'debt' and of on-going public deficits are of public concern. In such situations, lower or more negative real interest rates become an important policy tool, because they have the effect both of stimulating economic activity and of reducing the interest burden of public debt.

Financial repression refers to government control or manipulation of credit markets in order to achieve fiscal ends, such as a reduction of the interest rate paid on the government debt. Fiscal repression usually involves a lowering of interest rates generally, in order perhaps to lower them on government borrowing. Fiscal repression is often associated with controls on the financial sector.

Purposes of Financial Repression

The main purposes of fiscal repression are

- To reduce the interest paid on government debt.
- Reducing the power of creditors relative to debtors, which has two further objectives:
- Redistributing income from rich to poor
- Stimulating aggregate demand
- Reducing the incentives for financially destabilizing increases in debt
- Focusing lending onto the productive sector

Forms of Financial Repression

There are a number of forms of fiscal repression;

1. Monetization of deficits (The requirements for cash meant that in the 1960s at least 20% of government debt was financed through issuing money)
2. Controls on the interest rates charged (e.g. Between 1600 and 1800, the UK had 'usury laws', which set legal maximum limits for charging interest)
3. Forced saving (e.g. as outlined in Keynes' 'How To Pay for the War')
4. Reserve Ratios (e.g. as practiced in China at present)

5. Negative interest rates on money (for example as proposed by Silvio Gesell and implemented in the Austrian town of Wörgl in the 1930s).
6. Capital controls (restrictions on the ability to move money between countries, as existed in the 1945-1980 period in the UK)
7. Credit controls (restrictions on the sectors in which financial institutions can create credit, as existed in the 1945-1980 period in the UK)
8. Taxes on financial credit creation (e.g. a bank balance sheet tax, as implemented after the 2007 financial crisis in the UK)

History of Financial Repression in the UK

Financial repression in the form of usury laws UK between 1600 and 1815 was probably accidental rather than intentional and was associated with Britain's rise as a world power with no defaults on its debt.

After world war 1, Britain wanted to repay its war debt and return to the gold standard at pre-war levels; and imposed high interest rates and increased taxes producing fiscal surpluses. But the period was disastrous with falling prices, high unemployment and a public debt to GDP ratio which did not significantly fall.

After 1945, Britain used fiscal repression (low or negative real interest rates) combined with growth and full employment policies to reduce its debt, this time very successfully.Government debt from 270% of GDP after WW2 to c. 70% in the early 1970s.

After 1979, interest rates rose and fiscal repression ceased. After 2008: some elements of fiscal repression returned (e.g. QE, low interest rates), but there was also a culture of 'austerity'.

11.4: Demurrage

Nominal interest rates are currently already at or near zero in most developed countries (the 'zero lower bound'). In this case, cutting real interest rates further requires either negative nominal interest rates or higher inflation.

Creating higher inflation in these situations is often very difficult. It is usually expected that interest rates cannot be cut below zero. Having a government fiscal deficits financed by issuing bonds or printing money is an option. But in extreme situations this money or bonds are simply stored. What could convince people to invest in real products or spend money rather than just store it under the mattress or in banks?

One option is that if you don't use it you lose it – in other words, money unspent would carry a small penalty.

But what would a negative interest rate mean in practice? It would mean a carrying cost on base currency, known as *demurrage*. That is, there would be some form of charge for banks and individuals to hold money. Interest on reserves would be paid *to* the central bank.

There are several possible forms of demurrage. One form is a tax on money balances, implemented by requiring that holders of banknotes pay a certain charge every month in order to keep their notes legal tender. In current times, demurrage would be a negative intrinsic interest rate on base money and would therefore, in addition to stamped banknotes or similar, require the payment of negative interest rates on bank reserves held at the central bank. The primary purpose of demurrage is to encourage the circulation of money, ie the exchange of money to for goods and services, rather than the holding of money.

The idea of a monthly charge to keep notes legal tender may seem very implausible and possibly undesirable to the reader. However, demurrage has been implemented in the past with great success. One of the most famous examples is known as the 'Miracle of Worgl'. Worgl was a small town in Austria which was suffering high unemployment and poverty during the Great Depression. To tackle this, the new Mayor case up with a radical solution; he issued a 'Stamp Script' which was a form of money. A stamp had to be applied each month at a cost of 1% of the face value, in order to keep the script legal tender. The stamp script was extremely successful in stimulating the local economy. The fast circulating money enabled Worgl to redress unemployment, compete infrastructure projects and increase tax revenue. Surrounding towns copied the scheme, with success, until the project was forcibly ended by the Austrian Central Bank.

Worgl's Mayor, when announcing the demurrage scheme to the township, rather poetically expressed its purpose and method.

'Slow circulation of money is the principal cause of the faltering economy. Money as a medium of exchange increasingly vanishes out of working people's hands. It seeps away into channels where interest flows and accumulates in the hands of a few, who do not return it back to the market for the purchasing of goods and services but withhold it for speculation.

As money is an indispensable wheel in the machine of production, an accumulation of great sums in a few hands means a gigantic danger for peaceful production. Every time the flow of money is interrupted, so is the exchange of goods and services, with a consequent fall in employment. Uncertainty about the state of the economy makes the owner of money careful, causing him/her to hoard it or to spend it reluctantly. He or she distrusts investment. Money circulation is thus slowed down, the turnover of goods and services shrinks and jobs disappear. Such a situation denies incentives *to the population, threatening peace and wealth with destruction. Whole nations and states are under the threat of ruin.*

Our small place cannot liberate the world, but we want at least to give a sign. In the Wörgl area the sluggish, slow-circulating National Bank currency shall be replaced with a medium of exchange with a better circulating performance than ordinary money. 'Certified Compensation Bills' shall be issued in denominations of 1, 5 and 10 Schillings and put into circulation. The council shall issue the Bills and the public shall undertake to accept such Bills at their full nominal value in payment for goods and services. In order to turnaround the economy of the township, public works shall be planned and paid for with the same Bills.' (Shwarz 1951)

11.5: Conclusion

Money, bonds and other forms of debt involve someone who will pay money back (debtor) and someone who will be repaid (creditor). They are therefore forms of private wealth for creditors and fall under our wealth tax. Finance also involves taking care of transactions between individuals and companies. Therefore, in this section we investigate taxes on money, debt, and transactions.

We apply our general principle that we want to tax things that either we want to go away or that don't go away when we tax them. Taxes on debt, especially unproductive debt satisfy this criteria in the sense that we wish to reduce the overall level of debt and to target it towards productive purposes.

It also seems plausible that debt is a tax base that is less likely to move than one on financial transactions, because lending in international markets is difficult, whereas transactions are easily moved both within international financial institutions and offshore. Therefore it seems that a bank balance tax or a tax on unproductive lending (for example mortgage lending) is the right approach. Detailed proposals will not form part of this book, however due to the complexity of the subject.

PART 12: ENVIRONMENT, HEALTH AND RESOURCES

Summary

> *'Future generations are unlikely to condone our lack of prudent concern for the integrity of the natural world that supports all life'* (Carson 1962)

> *'For the sake of civilized society, it's time we truly figure out how to enable economic growth, while keeping intact the very grounds upon which all prosperity is based; clean air, fertile soil, metals and minerals and all natural resources that enable us to flourish as human beings.'*
>
> — H.R.H. Prince Carlos de Bourbon de Parme (2014)

The earth is facing a great number of environmental problems; many of which are caused or contributed to by human economic activity. Everything - from the lakes we drink from, the air we breathe, and the food we eat - is being impacted by irresponsible human action.

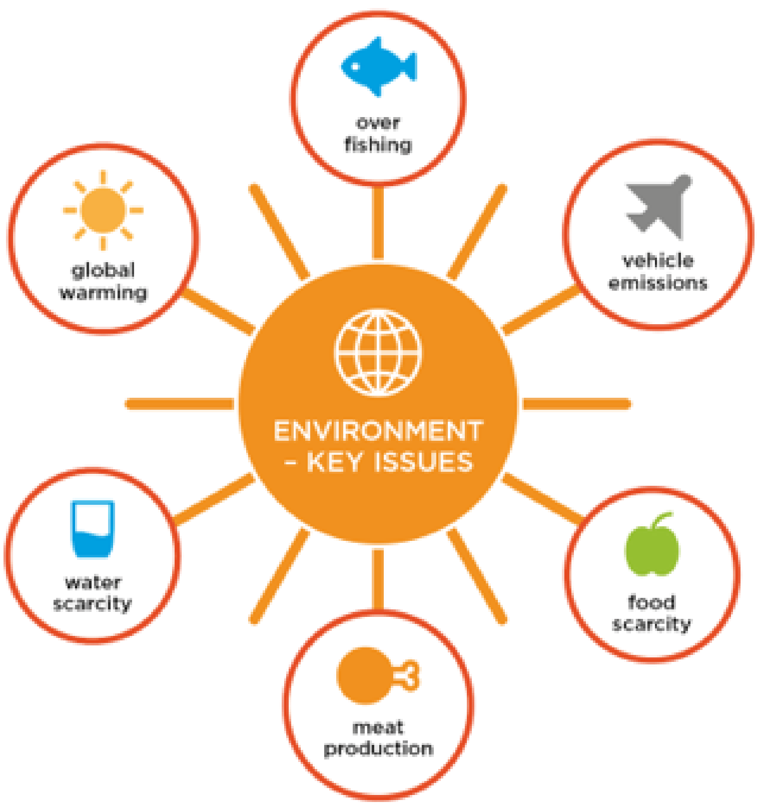


Figure 12.1 Key Environmental Issues

This economic activity often causes damage which is not accounted for by the polluting parties themselves, but rather borne by those who have done little to cause them. Manufacturing businesses in China pumping out CO_2 into the atmosphere have little or no obligation to pay for the damage that climate change causes in communities and countries across the world. Resulting Damage costs often can be ignored because they affect third parties and may be difficult to quantify, and difficult to locate the direct source for. These costs are known as 'negative externalities'

Negative externalities can be accounted for (or 'internalised') if an economic actor has to pay for the cost of the damage via a tax. This is known as a Pigouvian tax (after Arthur Pigou).

Pigouvian taxes disincentivise the damage-causing economic activity. The idea is that people will be motivated to find less damaging alternatives to the polluting economic activities when these damage costs fall on them. They act not altruistically, but to reduce their tax bill (Pigou 1932).

There are some difficulties with applying Pigouvian taxes. Pigouvian taxes can be difficult to quantify, costly to apply, and they may fall harder on those with lower incomes.

We may be able to use Pigouvian taxes to reduce other taxes, i.e. a 'Green Tax Shift'. This could be particularly beneficial if they replace taxes on productive activities (a double-dividend).

12.1 Taxing Bads

The world faces a range of environmental problems which seem to be steadily getting worse. Ocean acidification, It is evident that these are mostly caused or worsened by human activity.[22] We humans have developed bad habits that we cannot seem to break, often because there is no economic incentive to change. Why do we allow such tremendous environmental destruction to result from our economic activity, and why should we care? How could the tax system alter the balance of incentives?

[22] Insert reference about human activity causing climate change

Many of these environmental problems are caused by economic activity.[23] We are familiar with the example of effluent from a factory poisoning nearby waterways for the surrounding community. This is possible because the factory doesn't have to pay for the damage they cause. Another way of saying this is that the factory operators don't have to account for the full cost of their activities.

[23] actions involving the production, distribution and consumption of goods and services

If I chop down a forest to sell the timber, the price at which I sell it will account for my expenses incurred in chopping down the trees, the cost of my labour, and any permits required. The price will *not* have accounted for the cost of destroying the ecological goods and services[24] (Land Stewardship Centre of Canada 2018) that the trees were providing to their local environment.

[24] Ecological goods and services (EG&S) are the benefits arising from the ecological functions of ecosystems. Such benefits accrue to all living organisms, including animals and plants, rather than to humans alone.

The trees may have been slowing the rate of water run off and preserving soil structure. Now they are gone, the soil will be eroded faster and the fertility of the land will be reduced. Further downstream, the flood-risk is increased and the productivity of irrigation infrastructure and a hydroelectric power project are reduced. These trees are no longer absorbing carbon dioxide from the air and storing the carbon in their biomass. If any of the timber is used as fuel, the stored carbon will be returned to the atmosphere in the form of Carbon Dioxide, so I have increased the atmospheric concentration of a greenhouse gas that contributes to climate change.

Yet I have had to pay for none of the costs incurred by these damages. I do not pay to stabilise the soil, or for flood damages to the local village, or for the reduced productivity of farmland in the area. I simply did not have to consider these costs when I was judging whether it made economic sense for me to cut down the trees.

There are a number of underlying reasons why environmental and social damages occur. Rational Choice Theory contends that it is because economic agents[25] tend only to consider costs to themselves. Most, if not all, such damages tend to be incurred upon third parties and so the party causing the damage does not consider them. This was the case in my (hypothetical) example in which I cut down the forest. The damage I caused was suffered directly by others, so I didn't consider it.

[25] individuals and institutions that engage in economic activity

It is also the case that many damages do not immediately manifest or else are not plainly visible and so do not contribute to the knowledge that informs economic value. However, William Forster Lloyd's famous theory of the 'tragedy of the commons' (Lloyd 1833) suggests that even when resource users know that their activities will contribute to collective exploitation and are thus not in the common good, many independent individual actors will continue to pursue their own self-interest.

The cost of raising and harvesting my trees, as well as the costs paid by the distributors and consumers of the timber, are examples of 'private costs'. They are costs incurred by participants of economic activity. We define the full cost of an activity, including damages caused, as the 'social cost' or 'damage cost'. In the example above, the social cost is the cost to the soil, the atmosphere, the fisheries, the irrigation infrastructure, the hydroelectric project, flood security and other attendant costs.

The difference between the two private costs and the social cost 'the costs that are left out of free market prices' are called 'negative externalities'. 'Positive externalities' also exist where environmental or social benefit is provided by activities but not accounted for in prices. The benefit that a landowner gets from developments in nearby infrastructure, public services or the general economy, is an example of a positive externality[26] *received* by a private agent. Private agents can also *give* positive externalities. An example of this might be a beautiful building or a cafe with charm and character.

[26] 'Positive externalities' also exist where environmental or social benefit is provided by activities but not accounted for in prices. The benefit that a landowner gets from developments in nearby infrastructure, public services or the general economy, is an example of a positive externality *received* by a private agent.

This concept was first put forward by a British economist, Arthur Cecil Pigou. In theory this makes for a very elegant and efficient solution to the puzzle. In practice there is a little more complexity involved, but, even so, Pigou certainly led us in the right direction towards recognising and rectifying damages to the environment and society caused by economic activity.

Pigou realised the tremendous implications of this discrepancy in prices. All kinds of activities that appear at first to be profitable might not really be profitable at all, once the full costs are included. We are allowing private profit literally at the expense of others who are damaged by such activity. This, he thought, is simply unacceptable. Pigou then devised a relatively simple solution. All we have to do is calculate the value of the 'negative externality' and levy a tax of that amount so that the private cost is equivalent to the social cost. This is known as a Pigovian tax (Pigou 1932).

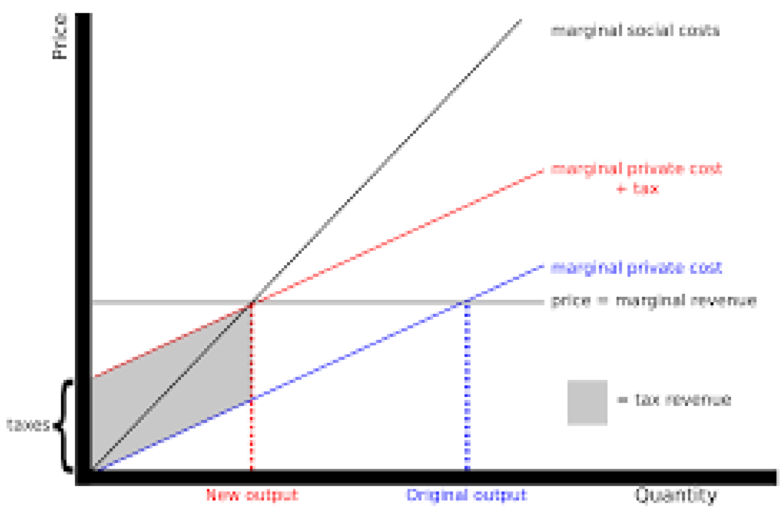


Figure 12.2 Pigovian tax - depicting social and private costs, anda corrective tax

In theory, this makes for a very elegant and efficient solution to the puzzle. In practice,there is a little more complexity involved, but even so, Pigou certainly led us in the right direction towards recognising and rectifying damages to the environment and society caused by economic activity.

12.2 Policy Options for Tackling Social and Environmental Damages

Pigou was particularly concerned that any damages caused to the environment or to people should be paid for. If we get prices right (so that they reflect full social costs), this will in turn discourage activities that would otherwise seem profitable despite causing external damage.

The polluter pays principle is 'the commonly accepted practice that those who produce pollution should bear the costs of managing it to prevent damage to human health or the environment' (Ward and Hicks 2014). This principle is the basis for most attitudes to the regulation of environmental pollution, forming part of the broader set of guidelines on the matter created in the 1992 Rio Declaration (United Nations 1992).

The issue of externalities is of particular relevance to the conservation of natural resources and the environment. These resources - the land, the animals, the air - are vital to continued high quality human existence. If we strive to reflect the true costs of activities in prices, and properly manage these damaging activities, we will quite simply undermine the sustainability of the economy and our prosperity.

However, it's not all bad news. Successful policy initiatives have been put in place to manage a variety of environmental and social issues - from the 5 pence bag 'Tax' to congestion charging in busy metropolitan centres. However, these current policy initiatives are not sufficient to tackle the large environmental problems and ensure our economies are developing in a sustainable manner. The figure below illustrates what has worked before, and areas for future development.

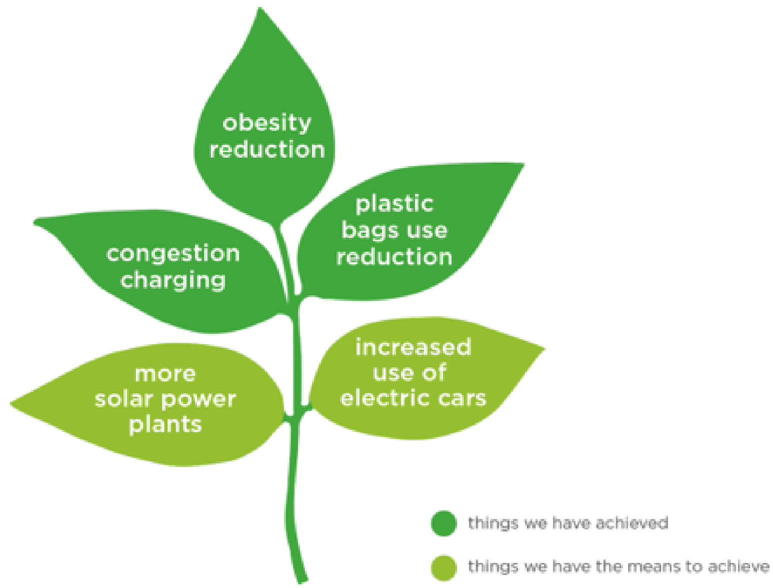


Figure 12.3 Successful Environmental Initiatives

Sustainable development as defined by the Brundtland report is 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs.'(Commission on Environment 1987) Unless we act now to create policy tools to properly account for and manage environmental damage, it would definitely not be fair to future generations.

Policy options

Pigouvian taxes are not the only weapons at our disposal to solve this problem. There are a number of ways we could tackle negative externalities to address social and environmental damages.

- We could ban or regulate the activities that cause harm ('command and control');
- We could directly or indirectly subsidise desirable behaviours;
- We could create market-based instruments (MBIs) which placing an overall limit on the damage we will allow, and then distribute or sell tradable rights to contribute to the acceptable damage total ('cap-and-trade');
- We could levy taxes to discourage harmful activities, as Pigou suggested.

Command-and-Control

The prohibition of ozone-damaging CFCs[27] against damaging Ultraviolet (UV) light in aerosols is an example of a successful command and control policy. It was effective because it applied to a specific production input (CFCs) that directly caused environmental damage, and because alternative substances were available for substitution. This latter quality meant there was minimal disruption to existing production in terms of input cost, design and manufacturing and other changes to supply. To put this another way, producers of aerosols could easily replace CFCs with other ingredients.

[27] Chlorofluorocarbons ' compounds that, when released into the atmosphere, damage the ozone layer that protects humans and other organisms

However this kind of solution would not work with many other kinds of environmental problems. The combination of direct application of regulation to the damaging externality together with very contained and predictable economic effects is unusual within the scope of environmental externalities. While 'command-and-control' solutions may appear to be the simplest and most direct ways to prevent or restrict damaging activities, the economic impacts tend to be complex and difficult to predict and measure in advance. In some cases, restricting one activity or product may simply cause it to be replaced with another that is equally or even more damaging, meaning net social costs are actually increased. In addition, regulatory mechanisms tend to be expensive to administer, meet high resistance from vested interests, and can be difficult to enforce. Stephen Shavell of Harvard University (Shavell 2011) presents a damning summation:

> *Conventional regulatory policies, which have not accounted for economic responses, have been excessively costly, ineffective, or even counterproductive. . . the 'tragedy of the commons' might be better described as the 'failure of commons regulation.*

One possible way to reduce the effects of economic shocks of regulation is to introduce restrictions incrementally or with delayed effect, perhaps in conjunction with development subsidies. One can then observe early economic effects and give industry the chance to adapt and transition. Forward looking regulation can be extremely effective.

However, there are further reasons to seek alternatives to command-and-control approaches. As World Bank economist Staphano Pagiola and colleagues explain:

> *'while regulation can to some extent ensure basic compliance with minimum environmental and social requirements (although enforcement is usually far from perfect), use of positive incentives can unleash creativity and entrepreneurship which can lead to results far beyond the minimum.'* (Pagiola 2002)

Subsidies

Subsidies for innovation and development are an obvious choice to generate positive incentives to protect the environment. As a widespread approach however, this would not only see an untenable strain on public finances, but would also represent an entirely backward logic. It would involve using tax revenue from labour and other productive activity to reduce damage that was inefficient or inappropriate to start with.

Our proposals operate in accordance with the 'polluter pays' principle. It is a core tenet of this book that there should be a direct financial cost on damaging activities. This means that the burden for this damage falls on those that are responsible for it. This would not be achieved by a subsidy approach. We choose therefore not to include pure-subsidies in our proposals, but we do consider a tax-subsidy hybrid later on in this book.

Cap-and-Trade (Emissions Trading)

There still remains an alternative to taxation not yet considered: the emissions trading scheme or 'cap and trade' system. We consider this in the context of greenhouse gases. The current EU Emissions Trading Scheme (ETS) is an example of a 'cap-and-trade' system. It *caps* the total volume of greenhouse gas (GHG) emissions from installations and aircraft operators responsible for around half of EU GHG emissions. It then allows *trading* by affected firms of emission allowances so that the property rights to the collective total emissions are assigned to their most economically efficient use (i.e. the highest bidder). The aim is that collective total emissions remain within the cap, and the system acts as a least-cost mechanism to reduce emissions. If an emitting company undertakes measures to reduce their emissions to a level below their assigned portion of the amount permitted by the overall cap, they may sell the excess allowance to other firms. In this way, the market finds an appropriate 'damage cost' for these emissions, and incentivises technological advancement to find less polluting alternatives to current business practices that are affected by the scheme.

In theory this system works by assigning property rights to the ability to 'emit', and allows free trade amongst market participants to ensure these property rights are allocated in the most efficient way along the pareto frontier i.e. where no party can have a utility increase without decreasing the utility of another party. Simply put, people and firms that have the greatest need or desire to emit purchase the greatest number of permits from other economic actors who can reduce emissions or find less polluting alternative business practices. In this simple model, free exchange leads to a 'pareto optimal division of goods' (Allcott 2018). In reality however, the initial allocation of these property rights can often mean that although the outcome is economically efficient, it is distributionally unfair.

The effect is to reduce the production-damage to companies that find it more costly to reduce emissions and to incentivise firms with a lower marginal cost associated with emissions-reduction to decrease their emissions more than it is required of them to do so.

However, in practice the EU's ETS has highlighted the many pitfalls in this approach. In requiring international negotiations on the terms of the scheme (to ensure that there is a large and diverse enough market to make the system efficient), the ETS was watered down by lobby interests to the point whereby it has been barely effective at all. The cost of credits was too low to dramatically encourage decarbonisation, which was helped by the fact that most were allocated free of charge instead of being auctioned, and the overall base of the scheme covered only half of European GHG emissions. Subsequent iterations of the ETS system have improved on these issues, but it is a long, unwieldy process to fully internalise these externalities.

Environmental Taxation

It is a core premise of this book we should tax unproductive and damaging activities instead of those that are wealth-creating. We are used to taxing goods, but we really should be taxing 'bads'! If we do this well, it is possible to reduce environmental and social externalities in ways that improve on or overcome the crucial shortcomings of command-and-control approaches, and also potentially confer additional benefits.

Well-transitioned environmental taxes can achieve a system that is fair to industry and consumers and that provides sound incentives, whilst also covering the whole tax base.

We will explore this policy option in more detail in the section below as, for reasons of efficiency, ease of application, and incentivising potential technological developments, our proposals predominately focus on environmental taxes.

12.3 *Taxing Negative Externalities*

As mentioned earlier, the concept of externalities was developed by British economist Arthur Pigou, after whom the term 'Pigouvian taxes' was named. In simple terms, Pigou argued that the tax per unit of the pollution should equal the damage cost of that unit of pollution (assuming such a thing could be measured). Since the damage cost of a unit of pollution might vary in the quantity of pollution, we should clarify that this rate should normally be measured at the optimal quantity of pollution (that optimum being when overall benefits-costs are maximised). Once that tax had been imposed, the best allocation of resources in an economy could then be provided by the free market (Pigou 1932).

A 'marginal' cost is the cost increase in producing one additional unit of a product, i.e. in increasing the margin of production by one increment. A marginal damage cost is therefore the cost associated with the damage of producing one additional unit of the externality-causing product. For example, in the case of carbon dioxide (CO_2) the marginal damage is the present value of future (worldwide) damages from an extra ton of emissions, accounting for the gradual uptake of CO_2 from the oceans and delayed adjustment of temperatures to higher concentrations (Parry, Norregaard, and Heine 2012). These taxes are theoretically efficient solutions to environmental and social problems because they manipulate price mechanisms in order to modify activities, encouraging more efficient damage-reduction at a lower administrative cost.

Calculating Damage Costs

It is notoriously difficult however to calculate damage costs, given that this involves evaluating complex systems with multiple feedbacks, predicting damages that have not yet happened, and including factors that are difficult to quantify and measure such as psychological impacts and aesthetic value. For example, to correctly tax a unit of CO_2, we must know precisely how a unit increase in CO_2 emitted today would affect social welfare at different points in the future (Pagiola 2002). Yet the authors of a recent IMF working paper argue that inefficiency due to inaccurate damage costs may be overstated:

> *'Even if the tax is set at, say, 50 percent above or 50 percent below marginal damages, a large portion (roughly three-quarters) of the welfare gains from the true corrective tax are still achieved. Or put another way, given inherent imprecision in externality measurement, a tax that is 50 percent above or 50 percent below true marginal damages may still perform reasonably well in terms of expected welfare gains.'* (Parry, Norregaard, and Heine 2012)

According to the IMF therefore, the measure of damage doesn't have to be exact for the Pigovian tax to be effective. We will further discuss the difficulties and implications of accurately calculating externalities later in the chapter within the context of carbon taxes. First, we will complete our introductory review of Pigouvian taxes as the preferable means of internalising social costs, and explore criticisms they have faced and their potential to contribute to a tax system that better serves society and the environment.

12.4 Addressing Inequity

Pigouvian taxes have sometimes been criticised for being regressive (disproportionately affecting the less-well-off) and exacerbating social inequity. For example, a flat-rate tax in the United States on carbon might appear to be unfair because data suggests that the percentage of income going to fossil fuel consumption in the lowest decile of income is 10.1% versus 1.5% in the highest decile (Shome, 1995). This is to say that a greater proportion of poor people's income is spent on fossil fuels than that of wealthy people. However, these figures may be affected by the way income is calculated.

The effect of any specific environmental tax on lower-income households might be evaluated by considering a combination of impacts;

- The direct impact when the price of the taxed good rises and affects household expenditures
- The indirect impact of price increases when taxed goods are used in production of other goods
- The net impact given any improvement in the environment and its effect on welfare and given behavioural changes resulting from changes in the price of the taxed good (OECD 2011)

How should revenue be used?

Another important decision affecting the overall social benefit of Pigouvian taxes concerns what should happen to the revenues that are raised. If the tax is regressive, it may be seen as appropriate to use some of the income to provide subsidies that protect low-income households from price increases. However, the effect of this equates to simply exempting some people from the tax who nonetheless contribute to the externality. They are not, therefore, incentivised to change their behaviour. This runs counter to the Pigouvian ideal because it reduces the overall effectiveness of the tax. The Organisation for Economic Co-Operation and Development (OECD), a major intergovernmental organisation promoting trade and economic progress, advises that:

> *'Attempting to address both environmental issues and distributional concerns within the tax itself risks undermining the ability of the tax to do either. For example, an exemption for low-income families from a tax on heating fuel eliminates the incentive otherwise provided to economise on fuel use and to consider alternatives. . .*

> *. . . Where there are significant negative impacts on, for example, low-income people, these usually are better addressed by other redistributive policy responses*'.

Some welfare-enhancing options could be to allocate money to public services, or invest in economic growth such that society as a whole is better-off. Alternatively, we could make the tax revenue-neutral by using the money raised to lower other kinds of taxes. This would have the potential to address equity concerns. Economists have also discussed how this kind of 'revenue-recycling' could also make the economy work better by reducing taxes that are damaging to production, thus leading to a 'double-dividend'.

The 'Double Dividend'

Labour taxes are often criticised for their distortionary qualities because, while central to government revenue, they effectively punish people for working in that they reduce people's effective income and their resultant welfare. Such taxes also affect the 'work versus leisure' judgements of individuals that are assumed to determine people's willingness to work, and in turn impact the overall labour supply. In increasing the marginal cost of labour, they can also have a negative impact on employment. These issues were explored in the Core Tax System chapter. Our concern here is to review the viability of using such revenues from environmental taxes to reduce the impact of distortionary taxes such as these.

Parthasrathi Shome of the International Monetary Fund argues that:

> *'The attractiveness of garnering a double dividend, of reduced environmental damage and revenue without social cost from environmental taxes,should not be underestimated. Many estimates for the United States suggest that the marginal welfare cost of taxation is about one third or higher. Thus taxes such as carbon taxes which have relatively large tax bases, could dramatically improve the efficiency with which revenues are raised.'** (Parthasarathi Shome 1995)

However others have argued that because environmental taxes tend to raise the cost of producing output (thus reducing labour supply and investment) they in fact may exacerbate the efficiency costs associated with tax distortions in labour and capital markets. This means that that the perceived efficiency benefits from revenue-recycling could be outpaced (Pagiola 2002).It has been suggested that if the negative tax-interaction effect does exceed the positive effect of revenue-recycling, the real-world Pigouvian rate should thus be set somewhat lower than its theoretical optimal in order to compensate, making a tax both revenue and efficiency-neutral, but no longer environmentally optimal (Bovenberg and Goulder 2001)

One study assessed the potential for recycling revenues to reduce labour taxes in order to reduce unemployment, and concluded that a positive effect would depend on very special conditions, specifically that the impact of the tax on after-tax profits is low (Boehringer et al. 2004) Similarly, another concluded that employment benefits would depend on the initial Pigouvian tax rate being lower than the wage tax rate.[28]

[28] Koskela, 1998

Ideally, the distorting effects of individual proposed taxes and the potential of revenue recycling need to be properly evaluated before a judgement can be made on a case-by-case basis. Doing so is complicated by the difficulty of assessing deadweight losses.

Coordinated Resource Rent Taxes as LVT at a distance

One thing that is missing from this discussion is the possibility of coordination amongst fossil fuel importing countries to reduce the pre-tax price of fossil fuels. It may seem perverse but to prevent fossil fuels being extracted, their pretax price should fall below the cost of production. This means that the'resource rent'would be reduced to zero.

An internationally-coordinated tax on resource rents (e.g. oil and other fossil fuels) is therefore something of a 'super-LVT'. It's as efficient as a land value tax, but more so because it prevents the flow of resource rents out of the country. It is the opposite of the 'oil price shock' of the 1970s. It could be used to subsidise efficient urban transportation, which is also likely to have positive co-benefits.

The Perfect Market: Should We Reduce Deadweight Loss at All Costs?

A market with no distortion whatsoever 'a perfect market' is theoretically created by the conditions of 'perfect competition'. Taxes and externalities both represent distortions that defy these conditions, but there are other factors involved when attempting to evaluate net distortion effects from a new tax.

Perfect competition (the market optimum) also relies on perfect information (producers and consumers know prices and the benefit of ownership), there being a large number of buyers and sellers, on no firms having market power to set prices above marginal cost (whereby they could raise prices without losing as many customers to competitors as they should), and on factors of production being fully internationally mobile. It also relies on the assumption that the economic behaviour of individuals is perfectly rational, i.e. people always optimise the benefit they get from their transactions. It also assumes that people are predictable. This is a core assumption of 'rational actor theory' that lies at the heart of neoclassical economics. It is well beyond the scope of this chapter to critique this theory, but it is sufficient to make two key remarks.

First, accurately assessing deadweight loss approaches impossibility when given incomplete knowledge and multiple factors influencing net distortion effects, more so when we can question whether or not some factors are even theoretically predictable. Second, and more importantly, to place the primary impetus on reducing the absolute magnitude of deadweight losses incurred by taxation is to assume both that perfect competition creates the welfare maximum across society, and that any lessening of distortions from that ideal is necessarily desirable. If that assumption were held consistently, it would also follow that governments would levy no taxes on labour at all, or indeed on any elastic factor of production (i.e. factors for which a change in price affects the level of supply or demand). In this book we argue for a shift in the overall tax-base toward things that are inelastic in both supply and demand, but not for the shrinkage of the state because some level of redistribution is necessary to provide an acceptable standard of welfare for all. Also, if we take the example of a progressive tax that disproportionately affects the better-off and redistributes benefits to the less-well-off, the overall welfare gains to society may be increased even though the amount of economic distortion has increased.

These points serve to demonstrate that the reduction of economic distortions,including the deadweight loss of taxation, is only desirable in so far as that reduction represents welfare gains to society as a whole, most notably through redistribution benefits.

12.5 A Green Tax Shift

We are proposing that a broad suite of environmental taxes should represent a 'green tax shift'in the UK tax system, whereby increased taxes on resources to internalise environmental and social damages can be accompanied by reduced taxes on labour. This notion resonates with the ideas of Dutch entrepreneur Eckart Wintzen for a 'value extracted tax', which taxes the value that a certain product or raw material extracts from the environment through human use (Van Kamp et al. 2003). Wintzen proposed that such a tax could form the basis of a new system that promoted services above material goods. These ideas have become the basis of the Ex'Tax project, which has explored how such measures might operate across the tax system and provided a case study plan for implementing such a scheme in the Netherlands (Groothuis 2014).

There is a potential issue with replacing labour taxes with environmental taxes in the potential that this has to undermine the stability of government revenue. If an environmental tax discourages a certain kind of behaviour, that tends to reduce returns to the treasury. If a tax rate is linked to damage costs under evolving circumstances and shifting behaviour, it is dynamic and possibly more difficult to rely on than is a levy on labour. Ex'Tax respond to this difficulty with diversity, setting out abroad range of environmental taxes that collectively help to secure stable revenues. Taxes on energy and natural resources are relatively inelastic compared to labour taxes, which means that there is room to increase the rates without causing a decrease in government income.

Ex'Tax also point out that the assumption that labour is a reliable and stable source of government income no longer holds as true as it once did. We live in a globalising world in which jobs move across the globe, and high rates of unemployment, ageing populations and increasing health costs all weaken the stability of traditional labour tax revenues. This reality is certainly applies to the UK (TUC 2017) where the growth of insecure employment is estimated to cost the Exchequer '£4bn a year. For the case study in the Netherlands, the group outline a $33.7b shift in the national tax base from labour to natural resources and consumption. Below is a summary of the measures they suggest:

Decreases in Labour Taxes	**Increases in Natural Resource & Consumption Taxes**
Exemption threshold of '16,300 for income tax and employee national insurance contributions	Flat VAT rate at 22%
Allowances for the retired and unemployed/underemployed	Excise duties on fossil fuels (transport fuels including jet fuel, natural gas)
Zero VAT rate for environmentally 'best-practice products' and for labour-intensive services	Tap and groundwater tax
	Electricity tax for large-scale consumers
	Deposit system for metals

12.6 Focusing Tax: The Case of Vehicle Emissions

The difficulties of assessing true damage costs have led to two common adaptations to the original Pigouvian ideal.

- The first is to use direct taxes that are aimed at meeting specific regulatory standards and priced according to abatement costs rather than set according to the full cost of the externality per-se. In theory this can provide a degree of choice to damaging agents to either pay the tax or (if it is better value) to reduce damages, or a combination of both. If the tax is set high enough, it will be an effective way to meet specific damage-reduction targets. There can be issues if the costs borne by agents are significantly unequal, which we will discuss later in the context of carbon taxes.

- The second response has been for policymakers to impose consumption taxes on goods that are implicated in environmental damages, rather than directly taxing the sources of the externalities or targets that are commensurate with the damage (where damage increases in direct proportion to the amount of activity undertaken or product used). The issues with this approach are outlined this section using the example of fuel taxes.

Policies to reduce vehicle emissions provide a useful set of examples for us to explore the question of where best to target taxes. Vehicles arguably generate at least eight externalities.

1. Vehicles emit carbon dioxide emissions, which contribute to the greenhouse effect.
2. Vehicles use petroleum products (petrol or diesel) which are imported (or use products which could be exported) from unstable and authoritarian countries. This is costly in financial and political terms and has security implications (Sallee, 2011)
3. Vehicles pollute the local air, harming people and the environment
4. Driving contributes to traffic congestion, which slows down other road-users.
5. Vehicle use increases risk of accidental injury to pedestrians, cyclists, animals, other motorists and accidental damage to property.
6. Driving wears down road surfaces and increases other infrastructure maintenance costs.
7. Roads use high-value land that could be used for other purposes.
8. The construction and maintenance of roads costs money that could otherwise be allocated elsewhere.

Given that the first two externalities are directly proportional to the volume of fuel consumed (assuming conventional petrol or diesel fuels. Biofuels complicate the overall emissions flux). Their ideal Pigouvian solution is a fuel tax. Taxing fuel directly will discourage its use leading to efficient reduction in those damages. Given that emissions vary with fuel use (because they are also factors of engine efficiency, road surface etc.), the optimal solution here is an emissions tax,but that would be impractical given current technologies (Anderson and Sallee 2011). However, a fuel tax still has an estimated two-thirds of the benefits of an optimal tax on emissions (Fullerton and West 2000).

Congestion is linked to overall vehicle use but is strongly focused on busier times and locations, so a time- and place-based congestion charge, such as has been introduced in London, is the most effective practical solution. However, congestion charging would only be optimised if it accounted for all times and places that congestion occurs, imposing responsive per-mile tolls on congested roads, which may become more feasible with future monitoring technology (Parry, Norregaard, and Heine 2012). Injury risk is a composite of a suite of factors including overall mileage,average speed, weather conditions, prevalence of other road-users, and safe driving technique. It therefore evades an optimal tax, but is certainly correlated with overall vehicle use, so its reduction is aligned with taxes that incentivise reduced vehicle use. Infrastructure use and wear is optimally addressed with a mileage tax. The current system of road tax is unfair because it charges all road-users within the same tax-band evenly despite widely different levels of road-use. The tax-band system itself is a form of tax on fuel economy, which is intended to incentivise the use of more fuel-efficient vehicles to reduce pollution effects. This is also flawed.

A US study of tax policy and fuel economy concluded that:

> *'Fuel economy taxation shares the weaknesses of fuel economy regulation in that it induces a 'rebound effect' by lowering the cost of driving, which erodes gasoline savings and increases congestion and accident externalities. . .*
>
> *. . . while they do work to improve vehicle fuel economy,the same goals could be achieved at a lower cost to society if policy makers instead directly taxed fuel'* (Anderson and Sallee 2011)

These eight externalities, taken together, drive us towards some conclusions on vehicle taxes. We support per-mile congestion charges, once appropriate supportive technology becomes available. In the meantime they should be rolled out across cities and other major areas for congestion. We suggest that that the existing road tax with a band system based on engine capacity, plus the existing vehicle excise duty (VED) with exemptions for low-emission vehicles, are inefficient at reducing emissions and can cause rebound effects. Replacing both with a fuel tax would retain universal incentives to reduce vehicle use, (excepting electric vehicles, but they would still be equally liable to pay congestion charges) increase manufacturer incentives to improve fuel efficiency to meet consumer demand, and create a more efficient system for emissions-reduction. The example of vehicle emissions highlights the importance of recognising where multiple externalities are associated with a product or activity and of assessing appropriate optimisation of tax effectiveness.

A fuel tax is a type of consumption tax, and consumption taxes can be very effective at driving consumer behaviour whilst being efficient Pigouvian taxes if a large proportion of the externalities tackled are confined within a particular sector or product class. If an externality has multiple sources 'many ways in which the same kind of damages occur across different types of activity' such a tax will not be optimal unless it tackles all of those sources.

An important environmental purpose of a fuel tax would be to reduce pollution emissions, and a key category within those emissions are greenhouse gases. Yet in the UK, emissions from road transport represent just a quarter of overall greenhouse gas (GHG) emissions (CCC, 2016) so a fuel tax only tackles a quarter of the damaging activities responsible for GHG emissions. So should we not just add taxes on the other causes of GHG emissions? We should certainly tax those things, but for an effective Pigouvian tax, we need to ensure that the price attributed to the externality itself (the marginal damage cost) is consistently commensurate with the marginal tax rate. In other words, the tax imposed on the other GHG sources needs to be the same, per unit of damage, as the fuel tax. What we need is a price for GHG emissions per unit and a way to apply that cost across all sources.

12.7 Opportunities and Challenges of a Carbon Tax

There is an overwhelming consensus in the scientific community that anthropogenic (human-created) GHG emissions are leading to increasing global average temperatures through the greenhouse-effect. Atmospheric CO_2 is by far the largest contributor to the rapid rate of warming that must be stemmed rapidly if we are to avoid a suite of climate-related issues.

> *'The most important anticipated consequences of climate change are changes in precipitation, decreased snowpack, glacier melting, droughts in mid to low latitudes, decreased cereal crop productivity at lower latitudes, increased sea level, loss of islands and coastal wetlands,increased flooding, greater storm intensity, species extinction, and spread of infectious disease... Estimates of economic impacts of unrestrained climate change vary, with most falling in the range of one to three percent of world GDP per year by the middle of*

> *the current century (with large regional differences), assuming 4C warming'* (Shavell 2011).

There is therefore a global imperative, including a strong economic argument, for large systemic changes to our activities to meet these challenges. Yet, even a staunch climate skeptic can find very good reason to support a well-designed fiscal policy on carbon. Fossil fuels, the primary source of current CO_2 emissions, are non-renewable resources, so there is a need to transition to renewable energy sources for medium to ensure long-term energy security. A well-designed carbon plan can catalyse that transition and help to incentivise the innovation and early-adoption of sustainable energy technologies. Further to this, the approach we propose can lead to significant welfare gains for every citizen because of the shift in state revenues it can help to facilitate.

The difficulty of calculating the external costs of Carbon emissions

Because of the sheer unpredictability of the integrated feedbacks between the earth-system and social and economic responses, given unprecedented climate change, compounded by the difficulties of distributing the burden of spending along a projected future timeline, the problem of estimating damage costs is found here at its zenith. Estimations of the external costs of carbon emissions vary hugely and find little consensus. For example, one study placed the cost of a ton of CO_2 at over $300 USD (Stern 2006) while another suggested a much more modest tax of $30 per ton of carbon, increasing to about $85 USD in 2050 (Nordhaus 2007). Gregory Mankiw, Professor of Economics at Harvard University, explains an important quirk of the economics of projected costs:

> '*Suppose I were to tell you that some event 'it could be global warming, or it could be a falling meteor ' is going to lower permanently real GDP by 100 billion starting one century from now. How much would you pay today to avoid that future event? The answer depends on how you trade off dollars today against dollars in the future, which is measured by the discount rate. At a discount rate of 1 percent per year, you would be willing to pay 3.7 USD trillion today. At a discount rate of 5 percent per year, the answer is a mere $15 billion. Plausible changes in the rate of discount can easily change the answer by more than 100-fold. This simple numerical example goes to the heart of a difficult problem: the issue of global warming involves taking costly actions today to avoid adverse outcomes that will occur far in the future. Economists have not yet figured out the best way to calibrate that trade-off.*'(Mankiw, Weinzierl, and Yagan 2009)

The models that economists build to simulate the social cost of carbon (SCC) are known as 'integrated assessment models' (IAMs). They combine a climate science model, describing GHG emissions and their impact on temperature, with an economic model, which includes projections of abatement costs and a description of how changes in climate affect output,consumption, and other economic variables. Many are not convinced that these models are reliable. In a (2013) review of IAMs to date, Robert Pindyck, MIT Professor of Economics, concluded that:

> *'The models are so deeply flawed as to be close to useless as tools for policy analysis.'* (Pindyck 2013)

Trying a different approach: Choosing a set level for CO_2

If we cannot rely on these models, how can we hope to get the price of a carbon tax right? We need to bark up a different tree. Instead of persisting with the impossible task of estimating CO_2 damage costs, we should instead say that the marginal tax rate could perhaps most feasibly be set to equal the marginal cost of reducing CO_2 to a set level[29] as determined by reviewing national 'carbon budget' emissions targets as part of commitments to longer-term goals set in multinational agreements under the Kyoto Protocol. So, instead of attempting to evaluate the full costs of a complex system of damages and feedbacks, we are then faced with a somewhat more manageable question of the short-term cost of reducing net emissions to a more acceptable level. This would be the first stage of an eventual transition to a carbon-neutral economy, in which growth would induce zero net gain in the atmospheric carbon pool. Depending on the time this takes, it may be necessary to move to a position of net sequestration in order to bring the desired stability to the climate.

[29] Here we talk of CO_2 prices as a direct tax on the causes of emissions that also discourages the unsustainable extraction of high-carbon natural resources

The cost of reducing net CO_2 emission to a set level can be approached from two angles. On the one hand are the costs of reducing the current rate of human-caused emissions (abatement costs), and on the other are the costs involved in increasing the rate at which atmospheric carbon is captured and stored (sequestration costs). Consider for a moment that we could calculate both the available sequestration capacity and the marginal cost of additional sequestration. If we did this we would know how much it would cost to capture an additional ton of carbon from the atmosphere and store it such that it is not contributing to the greenhouse effect. We could use this knowledge and this potential capacity to increase sequestration to make an offer to CO_2 emitters using the tax system. An emitter could choose either to reduce their emissions to the required level (and incur abatement costs), or to pay for the service of having the equivalent carbon sequestered (pay the tax), or some combination of the two, according to relative costs.

This would mean that whatever happens, the emissions target will be reached, and the price attributed to carbon as a marginal damage cost is accurately equated to the cost of negating the damage, i.e. once the target moves to zero net emissions the tax would be one-hundred percent efficient at internalising the externality. However, it is obvious that the feasibility of this policy is dependent on two key conditions.

- If the sequestration cost is too high, such that it completely exceeds emitters' abatement costs, the resulting high carbon tax rate could leave emitters with no option but to bear the full up-front costs of abatement. The economic shock of this would likely cause a lot of damage to production, including rendering firms bankrupt. Similarly, if the sequestration cost was much lower than most firms' abatement costs, there would be no incentive to decarbonise production and the concurrent benefits for promoting sustainable resource-use would be lost. This scenario is much less likely than the first for the foreseeable future.
- There must be enough capacity for additional sequestration to meet the demand, otherwise the target would not be met or the carbon price would be inflated.[30] Therefore, the most feasible scenario in which this system would work would involve additional sequestration capacity that can be provided at an acceptable and relatively stable price.

[30] The scenario of a sequestration supply capacity that is both smaller than demand and cheap to provide, with appropriate supply: demand and abatement: sequestration cost ratios supporting only a moderate carbon price increase seems highly unlikely. Therefore, we assume supply must be able to meet demand

There is considerable future promise for establishing sequestration services which could allow us to set a carbon dioxide price that reflects the cost of negating the emissions externality, and is not simply based on guesswork regarding the damage costs.

For a practical transition policy, we could implement a broad-based carbon tax at a relatively moderate rate which increases with time. There are several reasons for starting with a lower rate. First, it would establish that there is a social cost of carbon, and that social cost must be internalized in the prices that consumers and firms pay (Pindyck 2013). Second, it gives polluting firms time to adapt to abatement and develop new technologies toward that end. Third, it allows us to monitor economic impacts more gradually rather than introducing a large shock with unpredictable consequences.

However we need go one step further. A major issue with even a moderate carbon tax is that it will increase domestic electricity prices. The risk is that we'll end up paying more for our household bills until renewable low-carbon energy sources become cheaper. So called 'feed-in tariffs' have been used in the UK and other European countries to subsidise low-carbon energy sources in the short term, but these are falling out of favour because of their cost. There is potential here to kill two birds with one stone. When we introduce our carbon tax, we could also introduce an electricity subsidy. This would mean that all producers would receive a subsidy payment per unit of electricity produced. Those hit by the carbon tax, the fossil-fuel power stations, would initially have some of those costs mitigated,while low-carbon sources would receive the same subsidy for electricity without having to pay the tax. Over time this subsidy would reduce and eventually be removed, but meanwhile we will have incentivised a smooth transition to low-carbon energy without hitting household bills.

The UK in fact already has a form of small carbon tax in place, called the 'carbon price floor', which was introduced in 2013, and is set as a 'top-up' tax on top of the European Union Emissions Trading System (EU ETS)[31] (Grover, Shreedhar, and Zenghelis 2016). Howevrer it does not apply to all domestic imports and, in particular, it does not apply to imports. As Dieter Helm of the University of Oxford explains:

[31] (HMRC, July 2016)

> *'The UK and EU targets are all based upon production and not consumption. They therefore do not link in any clear way to the CO_2 ppm[parts per millimetre] concentrations at the global level. Hence the abatement cost measures are not strictly carbon ones...*
>
> *...it is possible to hit the domestic production targets whilst at the same time increasing global emissions.'* (Helm and Tindall 2009)

To be comprehensive and effective, then, a carbon tax must have a broad tax-base. In other words,it should apply to many things rather than just a few select areas. It also needs to actively incentivise decarbonisation. The carbon emissions implicated in producing most of the products we consume in this country occur in other jurisdictions, because those products are imported. The UK runs a trade deficit, which means we import more than we export. In 2015 we exported £284 billion and imported £411 billion of goods.[32] A carbon tax would ideally cover the emissions implicated in all of the goods we produce as well as the goods we import. These CO_2 emissions resulting from the production, transport and use of goods are known as 'embodied emissions'.

[32] ONS, 2016

Next we ask what would happen if we started taxing embodied emissions and increased the rate of the carbon tax to better incentivise decarbonisation.

12.8 Borders and Competition: Making a National-Level Carbon Tax Feasible

If we levy a moderate carbon tax on goods and services produced in the UK as a standalone policy, it will negatively affect domestic competition in international markets. We will have incorporated the carbon externality into pricing, but other jurisdictions may not have, or may have to differing amounts, so while our price is 'right', the global market price will be lower and UK firms will struggle to compete.

We could potentially avoid this issue by having a carbon tax based on consumption, not production. If we do not impose the carbon tax on things produced in this country, but we do impose a tax to reflect the embodied carbon of things consumed here, there are fewer unfair negative competition effects for UK firms. It would, however, drive competition between both domestic and foreign firms that supply the UK market to reduce embodied emissions and thus reduce the price to consumers. Taxing UK consumption but not UK production would also be likely to drive exports, which in turn would be good for our economic growth.

In an ideal world this would actually be doing things the wrong way around. An 'upstream' carbon tax, at the point of extraction, refinement, or electricity production, is the most efficient tax base, because the carbon stored in fossil fuels can be precisely quantified and taxed without having to calculate embodied emissions. This would also lead to savings in administration costs of the tax. A system of rebates could incentivise the development of 'downstream' emissions capture technology (Parry, Norregaard, and Heine 2012). The ideal for global CO_2 emissions reduction is to arrange a global price for carbon that is taxed upstream. International coordination toward this end should be promoted.

However, for now we need to find an approach that works on a national level. Because of the efficiency losses and generally high administrational costs of downstream tax bases relative to upstream bases, it is still desirable for us to impose a carbon tax on domestic production in high-carbon industries, rather than taxing at the point of consumption, but in order to negate the international competitive effect, we would also need a subsidy on exports, which could simply be arranged as a tax refund. Imports would need to be taxed based on embodied carbon in order to correct for the domestic carbon tax. Systems like this are known as 'border tax adjustments' (BTAs).

Border Tax Adjustments: Feasible and Legal?

Concerns have been raised in discussions about the feasibility of these policies. We address some of them here.

Complexity and Administrational Cost

As the above diagram shows[33], our proposed BTA system is in prin-

[33] add diagram!

ciple very simple. The greatest complexity comes in assessing the embodied carbon of imports. To do this thoroughly would require consideration of the tax policies of all countries exporting to the UK in order to assess the extent to which embodied emissions of imports have already been taxed under other jurisdictions. We suggest that this is indeed a messy affair and we should instead tax imports according to the full embodied carbon cost, regardless of the effect of policies of the exporting country. As more exporting countries respond to the subsequent incentive to reduce embodied emissions, the rates charged at our borders could be uniformly decreased.

A fairer alternative system to this gradual rate reduction would be to form mutual agreements with other nations that also impose a tax on embodied emissions of imports, such that both sides refund these taxes at the border. However, such an arrangement could be considered a violation of international trade agreements because it would mean offering preferential treatment to some trading partners but not others.

WTO and GATT Legality

The General Agreement on Tariffs and Trade (GATT) is multilateral agreement between 128 countries (including the UK) on the terms of fair international trade, and is regulated by the World Trade Organisation (WTO). A detailed analysis by the German Federal Ministry for the Environment found that in principle BTAs seem to be acceptable under GATT, and it is permissible to impose a tariff on imports concurrent with a subsidy on exports of comparable goods and services.

A central tenet of the agreements is that there is no policy discrimination for imports based on country of origin, but the authors argue that there are exceptions written into the agreement that might be feasibly invoked with the justification of protecting the environment as a global resource (Hilbert 2009).

12.9 Resource Rents

Resource rents represent unearned income in the form of natural resources yet to be extracted. Resource revenues are different to general government revenues in two key ways. First, revenues are volatile because they are driven largely by volatile commodity prices, and they are, in principle, temporary. Secondly, natural resources represent the commons: all citizens have an equal claim on them, and unlike income-based government revenues, they have not been appropriated from anyone so represent ‘distributions’ as opposed to 'redistributions' (Segal, Segal, and Paul 2012).

However, a large body of work suggests that having a large resource sector has adverse affects on a country's economy, institutions and politics. These effects are collectively known as the 'resource curse (Ploeg 2011). A key part of these arguments is that resource revenues are frequently misused, wasted, or lost to corruption (Segal, Segal, and Paul 2012). A statistical review found that in general resource wealth does not cause poor institutional or political outcomes such as a tendency for authoritarianism (Haber et al. 2011)[34]. Resource rents also have significant potential to increase the welfare of citizens, if correctly managed.

[34] What is being said here?

The notion of 'resource nationalism', in the sense that resources belong to the country in which they are located and should be used for that country's benefit, is a principle codified in numerous international treaties on human rights. This is actually a relatively recent development. Paul Segal of King's College London explains this historic shift (Segal, Segal, and Paul 2012):

> *'The twentieth century saw a dramatic reorientation of resource ownership rights. First the principle that subsoil resources are owned by governments as opposed to private landowners was settled in almost all countries (private land in the US being the only major exception), with private agents gaining access to them through regulated contracts...*
>
> *...More dramatically, decolonisation led to an assertion of the rights of developing country governments and a massive swing in bargaining power in their favour, away from the international mining companies and their rich-country owners that had dominated the industry. The development of national oil and mining companies was part of this trend.'*

In some parts of the world, resource rents have been used to create schemes known as 'severance tax trust funds', which have specific remits to invest in projects for various kinds of public benefit. The Alaska Permanent Fund created in 1976 is perhaps the best-known example. The fund pays a per-capita dividend to citizens, based on the principle of common ownership. Severance tax trust funds are also in place in Montana, New Mexico, Utah, North Dakota and Wyoming.

Philosopher Thomas Pogge has advanced an alternative vision for resource rents that is based not on resource nationalism, but resource globalism. Pogge presented his idea of a'global resources dividend' as a means of tackling global poverty (Pogge 1998). However, such a system would require significant international coordination,and critics have suggested the distributive effects could anyway harm poor nations that are not resource-rich (Hayward 2005). We propose that UK resource rents could help contribute to a national citizen's dividend.

PART 13: PROPOSALS

13.1 Overview

In this book we have compared the Tax and Welfare system to an operating system; a mechanism of levers through which society is run, funds are raised, and public services are delivered. Using this metaphor, we have been able to troubleshoot the bugs in the current system and illustrate why the UK has seen increasing inequality of outcomes for the best and the worst off in our society.

We have an unwieldy, overly complex tax and welfare system in which the rich get richer, while those on the bottom see their income and wealth stagnate. By delivering benefits on a means-tested basis, our benefit system doesn't encourage re-entering employment.

Early on in this book we outlined the framework we choose to structure the evaluation of the UK tax system, by building on Beveridge's work in fighting his five great evils of society. These guiding principles structure our analysis. We argue for a tax system that is fair, and lead to greater equality of opportunity amongst its members. It should be beneficial and contribute to the sustainable and ethical development of a society. Finally such a system should be practical in its administration and application.

Taxes, amongst their other roles of nudging incentives and redistributing income, are predominately aimed at financing public provision of goods and services - including welfare for the most needy in society. Therefore, we emphasise that these three balls need to be balanced carefully so as to ensure that the UK's Tax and Welfare system helps us build the society that we aim to achieve.

Discussed extensively in the book, it's important to summarise the findings from our discussion. These are expanded upon below. Broadly, on the whole, we plan to simplify the income tax and benefit system, and augment taxes where there is a social outcome that needs to be achieved through discouraging negative behaviour. A comprehensive Land Value Tax (LVT) would be phased in, so as to ensure that land was successfully developed, and any excess rent could be captured and that windfall redistributed.

Our proposals below should be considered interim, since we have not yet completed accurate modelling of all their effects.

Summary

The following table shows both the final strategic objective and the intermediate/transitional one.

Policy Area	Initial, Intermediate Approach	Final Objective
Income Tax	Simplify rates structure, make existing benefits universal and add in means testing using tax system instead of benefits means testing.	Income tax is only paid by the upper half of individuals
VAT	Remove Exemptions, SImplify	Transition to a profits tax based on UK sales
Carbon Tax	A system that gives general incentives based on a high implicit carbon price that does not raise significant revenue	A high carbon tax used for general revenue
Money Balance Tax	No change from existing system	Electronic deposits are taxed at approximately 5% per annum with a significant tax free personal allowance. Cash are registered and are time limited and a small fees are paid on withdraw
Citizen's Dividend	Use existing benefit rates that simplify the system and reduce conditionality.	In the long term, build up a personal sovereign wealth fund to pay individuals are larger citizen's dividend
Guaranteed Training and Employment	Short term, high quality master craftsman level courses for specific groups to optimize the system	Long term, rolling out the guaranteed training to all sections of the population

13.2 The Mirrlees Review

Our starting point in building our proposals were the recommendations of the Mirrlees review (J. Mirrlees and IFS 2010). This document suggested a number of key reforms of the UK tax system, so as to create effective incentives for a better functioning society. It also discussed different approaches to the taxation of income invested, with particular reference to whether whether gains or the final consumption are taxed. The review does not cover the benefit system. The recommendations of the summary reportare as follows:

1. Replace Business Rates with a Land Value Tax
2. Reform Council tax (and transactions) into a single simple tax on property.
3. Remove exemptions from VAT and refund by increases in benefits and allowances
4. Introduce congestion charging
5. Rationalise the approach to greenhouse gas (carbon) taxation
6. Remove transaction taxes (stamp duties) as highly economically distorting.
7. Introduce a consistent approach for dealing with the VAT exception of financial services (especially when bundled with other services)
8. Simplify where possible.
9. Introduce an allowance for corporate equity (ACE) to eliminate the favouring of debt financing over equity.

We use these proposals to guide our own recommendations for new policies.

13.3 Philosophy of Our Proposals

In this section we explain the guiding philosophy behind our proposals, and define a simple set of proposals that may help achieve an ideal taxation system. The guiding principles here are that the system will be beneficial, fair, and practical.

Beneficiaries

Our new tax system considers the citizens of the UK to be akin to the 'shareholders' of a company, with a stake in the outcome of the country. These citizens are therefore the intended beneficiaries of the tax system. The 'paying customers' of this system should be the property owners, particularly the owners of UK land and anyone profiting from, or otherwise building wealth by selling goods and services to, UK consumers. This also should apply to those individuals/organisations which are otherwise receiving payments from the UK. The tax system should charge them for this benefit received.

Changing Incentives

Income, Wealth and Environmental Damage of Consumption should be taxed. Personal Incomes are already adequately taxed, while Wealth and Environmental Damages are not. The main goal of our wealth taxation proposals is to tax the top 1% (and particularly the top 0.1%) by wealth. This can be achieved by taxing all forms of wealth, with allowances/subsidies granted to those who remain resident in the UK. We also propose to properly regulate environmental damage through the application of a Carbon tax, which should help incentivise more sustainable consumer behaviour.

Avoiding Avoidance

Under the new system, you would receive *tax benefits* from residing in the UK. Land is an inelastic base of taxation, as it is unable to be moved, and alongside the profits from consumption by UK customers. Non resident foreigners who own UK assets will be treated in an equivalent way to the UK super rich - with high levels of taxation applied to their UK holdings.

Simplicity is key

The tax system should be as simple as possible. Thus we simplify wherever possible. Moreover, where and if there are options for making the tax system automatic, we should take them. This system should not need or involve any 'self assessment', which can often act as an extra barrier to engaging fully with the system.

Privacy and Transparency

The new tax system should have privacy for ordinary members of the public. That could be achieved by the assignment of secure identities to taxpayers which are independent of their real identity (so that name or address would be separately stored than the 'tax' identity). This would ensure the safety of the citizens of the UK. There may however be a case made for the complete transparency of the very rich (0.1% by wealth or income) and major companies. This would be part of a check-and-balance mechanism is in place to regulate political and financial influence within the UK.

13.4 Institutional Reforms

Residency Allowance

As mentioned above, the new tax system would shift incentives to ensure that there were strong tax benefits to maintaining UK residency (i.e. a residency allowance). This would replace tax benefits for offshore or non-dom status. The super rich and the offshore resident owners would therefore be treated equivalently, with steep tax rates, unless the offshore residents reside in a trusted partner country with good disclosure mechanisms on taxable assets (e.g. an EU country).

Local Taxation

Taxes on housing should be transformed over time into a 100% Land Value Tax, plus a wealth allowance. The exact size of this wealth allowance could be decided by local authorities. Local authorities would therefore be funded by a progressive land wealth tax. Any uplift in land rental values should be distributed 50-50 between local authorities and national authorities. This LVT could be adjusted for the effect of any infrastructure investments on land values, where 100% of the uplift would be captured by the authority making the investment.

Strategic Tax Reform

Instead of having an annual budget, the tax system should be treated strategically. In other words, it would be run much like the strategic spending and defence review - namely a 'strategic tax review'.

13.5 Transitional Questions

To ensure that these new proposals are implemented successfully, any transition to the new taxation system would need to to account for the following three effects.

1) First the transition must be *practical* and *simple* to understand.
2) Second the transition should be, and be seen to be, *fair*.
3) Third the transition should be seen to be *beneficial* in the short term as well as the long term.

Asset value effects are important in this. These are important both from the fairness persective and from the perspective of economic benefit. Volatile rises and falls in asset values are arguably unfair - rises because the people who receive these rises are not necessarily deserving of it; and likewise for any falls. Both of these impacts can be amplificed through ineffective application of government policy. For example, two major government policies -not revaluing Council tax and reductions in long term interest rates - have caused national house price increases.

13.6 Options for Taxes on Personal Income

Income Tax and National Insurance together account for around half of all revenue raised. These taxes are likely to be important for the foreseeable future. Income tax is important as a tax on wage income and on income from investments. It is also the primary means of affecting the distribution of income using the tax system. However the existing approach is, like the rest of the tax system, unnecessary complex. Income tax, and its close cousin National Insurance (which we combine into a single tax) are also extremely efficient ways of raising revenue.

At present, the wage income is largely deducted at source in the 'Pay as You Earn' (PAYE) system. This means that companies administer the payment of income tax. They know how much tax to deduct because every individual has a tax code. The tax code indicates whether the taxpayer pays basic or higher rate tax.

Some income does not fall under PAYE for example: dividend income. It is impractical for a company to know all the tax codes of its shareholders. Thus, income from dividends needs to be declared by individuals at the end of the tax year alongside income tax paid by the individual concerned. At present, corporation tax is paid on profits, and the income tax paid on dividend income is reduced by an equivalent amount to compensate.

Simplification Options

We can distinguish between tax simplification and the addition of a basic income.

First, lets look at tax simplification. We can simplify the tax code through the following procedure. First put the income tax and NI system together for earned income, and apply the same rates to unearned income as earned income. Then, you would consider the top rates of tax (Income Tax + NI). We keep these as they are now, and then apply it to lower tax bands. At the same time increase the personal allowance. The two procedures can ensure that nobody pays more tax on their earned income than they do at present.

- Option 1 is this zero-high rate system (ie a large personal allowance plus a top rate)

- Option 2 is the same system, but with a low rate (no personal allowance) plus a high rate. A small basic income can be added.
- Option 3 is a basic income plus the high rate flat tax

With a flat system, everyone faces the same tax rate. There is no need for a separate tax code for each individual. All income can thus be taxed at source. This would also brings the taxation of dividends into the income tax system, which would therefore mean there is no need for a corporation tax on the part of company profits hich is paid out as dividends. We still, however, need a tax on retained earnings.

The disadvantage of a flat tax system is that it is less progressive than the other system.

Conclusions

We propose to combine the current National Insurance and Income Tax systems so that there is a single tax on income. We also propose to simplify the rate structure so that there is only one rate above the allowance. Having a single rate allows the tax system to be made considerably simpler, and permits taxes to be deducted at source.

13.7 Overview of Possibilities for Taxing Wealth

Source-based Private Wealth Taxes

In general, we prefer to recommend source-based wealth taxes rather than residence based taxes. In other words, we propose to tax income-generating assets located in the UK. The advantage of this approach is that these assets are typically less mobile than the individual. This reduces the risk of tax avoidance. However, there may be a case for an internationally coordinated residence tax as well.

Residence-based Private Wealth Taxes

Because of the source-based wealth taxes we have suggested above, such a tax would not need to be set as stringently. However, risk of avoidance by the rich may be high because of their access to skilled legal advice and mechanisms to move their assets to the most advantageous locations. It may therefore be necessary to impose an international residence-based wealth tax.

We propose to consult with European and other partners so as to put in place an internationally coordinated wealth tax. The objective would be to ensure that the richest in society do not get richer faster. As outlined in previous chapters, the increased rate of growth in wealth as compared to the growth in average incomes contributes to the compounding of inequality. For a variety of reasons, this is not a desirable outcome. To that end, we aim to form a coalition with other countries to promote transparency, and create a single coordinated residence wealth tax. However, getting international agreement consensus on such a policy would be difficult and time consuming, and so should not be relied upon.

Conclusions

We will apply a source based approach which minimises the possibilities for avoidance, including a land value tax.

13.8 Taxes on Corporate Profit

We propose the reform of the corporation tax system. Our goal is a system of company taxation that rewards exporting companies and all those that invest in physical capital expenditure in the UK. We also want to find a solution that avoids the'race to the bottom' mentality of international corporate tax rates. Here, we suggest a reform of the VAT and existing corporation tax system that achieves just that. Our proposal here is to unify VAT and corporation tax under a company cash flow tax.

A corporation tax is a tax on company profits. It generally covers both profits retained within the company (retained earnings) and those paid out as dividends (distributed earnings). A credit is applied to distributed earnings so tax is only paid once. But should we have a corporate tax at all? Since companies are owned by individuals, might it not be simpler to tax individuals rather than companies?

What, in fact, is the purpose of the Corporation Tax system? It functions as an at-source tax on company profits made in the UK. It therefore has a few purposes:

- To tax foreigners on profits made in the UK and so mitigate the flow of wealth overseas from for example monopolies owned by foreign owners.
- To prevent companies being used as tax free savings devices.
- To ensure that companies pay a fair share of the cost for the government services provided to the company (eg. enforcement of property rights, education of the workforce, health care provision).

Some options for corporation tax then that ensure that these aims are upheld are listed as follows:

- Publicly quoted companies should have the option to pay the cash flow tax in shares. These shares would accrue to a sovereign wealth fund which would pay the Citizen's Dividend.

- A 'monopoly charge' of 5% of the company value (proportional to value added sold to UK consumers,i.e. like VAT) would be imposed on all large companies and on trusts. This tax would be payable in shares to a sovereign wealth fund for children, so that1/20th of the shares of a company or trust would go to such a fund per year.
- International wealth transparency tax of 0.1% of assets greater than 5 million pounds
- Capital Gains Tax: If the tax paid on retained earnings is less than the average tax paid on dividends, company owners will have an incentive to retain those earnings within the company. The owner of the shares could later sell them. They would therefore pay less tax than if the earnings had been paid out as dividends. Capital gains tax on shares ownership can be thought of as a crude way to prevent tax avoidance through this route. Capital gains tax also allows those who have achieved unearned capital value increases (for example, due to the fall in long-term interest rates) to contribute properly. Capital gains tax rates should be set consistently to avoid tax advantages or disadvantages based on legal structure.
- Applying an Immigration and Citizenship charge

Proposals

We propose to replace Corporation Tax and VAT with a 'cash flow' tax and taxation at source of all dividends. Whereas a corporation tax is a tax on 'economic profit', a cash flow tax is a tax on net receipts (i.e. retained cash flow). Cash-flow is a destination basis corporate tax, exempting exporters, capital investment and R&D but including interest payments. The basis of the cash flow tax is UK sales and borrowing minus costs, dividends, interest and principal repayments. It therefore exempts capital expenditure and exports. It is similar to a value added tax, where wage expenditures are deductible. The advantage of the cash flow tax is that can be applied to the financial sector and it encourages investment and exporters. With corporation tax, companies can move the jurisdiction they are registered in, and charge losses to high-tax locations and profits to low tax locations. With a cash flow tax, all sales in the UK are taxed, and only UK wage payments are deductible. It applies to all companies that sell in the UK, and 'transfer pricing' becomes irrelevant. It avoids the international 'race to the bottom' among corporate tax rates.

Radical Reform of the VAT and Corporation Tax system

Our objectives for reform of VAT and Corporation tax are as follows: Help exporters Help companies with large investment needs Remove the tax advantage of debt over equity

In this section we keep our overall goal in mind – to reform the tax system so that it rewards wealth creation in the UK (in particular capital formation and exports). We also want to find a solution that avoids the 'race to the bottom' of international corporate tax rates - that is good for the UK and yet does not lead to a sub-optimal Here we suggest a reform of the VAT and existing corporation tax system that does that. A corporation tax is a tax on company profits.What is the purpose of the Corporation Tax system? The Canadian Carter commission report argued that the purpose would be "(i) to be a backstop to the personal income tax, and (ii) to tax foreigners on their income earned in the domestic country (i.e. Canada). So corporate income is taxed first and then the tax paid is credited back when dividend payments are made. Cash-flow, destination basis corporate tax, exempting exporters, capital investment and R and D but including interest payments. Corporation Tax has problems. First we outline the approach to the two taxes at present. It's purpose is to tax foreigners on cash earned in the UK; and perhaps to prevent various forms of tax arbitrage (for example keeping profits in the company). Our proposal here is to unify VAT and corporation tax under a company cashflow tax. This is similar to a VAT. It is described in detail by Auerbach (ref). Under a cashflow tax, incoming payments are taxed (including domestic sales, wages, borrowing), and outgoing payments are refunded (including cost of sales, sub-contractors, wages, dividends, interest and principal repayments). This is similar to a VAT, except that wages are deductible and debt is treated on a consistent basis to equity. Just like VAT, exports would not be taxable (we ignore EEA issues for now), and imports would be taxable. Moving to such a system has potential advantages. It would favour exporters and those willing to invest. Rather than the distinction between large and small companies, we would make the distinction between exporters in competitive markets and domestic producers which may or may not be competitive. If an exporter is earning large profits from exports, that is something to be celebrated and that money should be available for investment (and the investment should be tax deductible). Combining a cashflow tax with a source-based flat or single-rate tax (I define a 'single-rate' tax to be a flat tax with a personal allowance - a residency-based work based tax rebate), makes a lot of sense. A flat tax collected on a source basis can cover. So one example set-up would be to combine a 40% single-rate tax with a 40% corporate tax (0% on exports and with investment deductible). VAT would be abolished. In this case, a domestic-sales company (including foreign-located and foreign-owned sellers in British markets) would pay 40% on retained earnings. 40% might sound a lot, but it's important to note that exporters pay nothing and there are much greater deduct-abilities than before – and VAT is being combined with corporation tax here. Concerns One concern is that VAT is required at a European level; however, since what we are doing is simply exempting income tax, the same result can be achieved by higher VAT and lower income tax - unfortunately the VAT rate would be VERY high (since VAT is charge additively, the equivalent additive rate for a 40% subtract is (0.6/0.4)-1, i.e. 50% (quite an increase on current VAT rates). If such a tax were introduced, some account would need to be taken of domestic rents exported (e.g. foreigners buying fossil fuels or staying in hotels). A source based rent tax would be even more necessary.

Radical Reform of the VAT and Corporation Tax system This section considers reform of the corporation tax system. Our goal is a system of company taxation that rewards exporting companies and all those that invest in physical capital expenditure in the UK. We also want to find a solution that avoids the 'race to the bottom' of international corporate tax rates.

A corporation tax is a tax on company profits. It generally covers both profits retained within the company (retained earnings) and those paid out as dividends (distributed earnings). A credit is applied to income tax on

But should we have a corporate tax at all? Since companies are owned by individuals, might it not be simpler to tax individuals rather than companies? What, in fact, is the purpose of the Corporation Tax system?

The Canadian Carter report argued that the purpose is " (i) to be a backstop to the personal income tax, and (ii) to tax foreigners on their income earned in Canada".

If foreigners own a British company,

Here we suggest a reform of the VAT and existing corporation tax system that does that. First we outline the approach to the two taxes at present.

It's purpose is to tax foreigners on cash earned in the UK; and perhaps to prevent various forms of tax arbitrage (for example keeping profits in the company).

Our proposal here is to unify VAT and corporation tax under a company cashflow tax. This is similar to a VAT. It is described in detail by Auerbach (ref).

Under a cashflow tax, incoming payments are taxed (including domestic sales, wages, borrowing), and outgoing payments are refunded (including cost of sales, sub-contractors, wages, dividends, interest and principal repayments). This is similar to a VAT, except that wages are deductible and debt is treated on a consistent basis to equity. Just like VAT, exports would not be taxable (we ignore EEA issues for now), and imports would be taxable.

Moving to such a system has potential advantages. It would favour exporters and those willing to invest. Rather than the distinction between large and small companies, we would make the distinction between exporters in competitive markets and domestic producers which may or may not be competitive. If an exporter is earning large profits from exports, that is something to be celebrated and that money should be available for investment (and the investment should be tax deductible).

Combining a cashflow tax with a source-based flat or single-rate tax (I define a 'single-rate' tax to be a flat tax with a personal allowance - a residency-based work based tax rebate), makes a lot of sense. A flat tax collected on a source basis can cover.

So one example set-up would be to combine a 40% single-rate tax with a 40% corporate tax (0% on exports and with investment deductible). VAT would be abolished. In this case, a domestic-sales company (including foreign-located and foreign-owned sellers in British markets) would pay 40% on retained earnings.

40% might sound a lot, but it's important to note that exporters pay nothing and there are much greater deduct-abilities than before – and VAT is being combined with corporation tax here. Concerns

One concern is that VAT is required at a European level; however, since what we are doing is simply exempting income tax, the same result can be achieved by higher VAT and lower income tax - unfortunately the VAT rate would be VERY high (since VAT is charge additively, the equivalent additive rate for a 40% subtract is (0.6/0.4)-1, i.e. 50% (quite an increase on current VAT rates).

If such a tax were introduced, some account would need to be taken of domestic rents exported (e.g. foreigners buying fossil fuels or staying in hotels). A source based rent tax would be even more necessary.

Incidence of tax/

13.9 Taxes on Land and Property

Because land is fixed in supply, it can be taxed without causing significant economic distortion. A land tax subtracts the value of the premises from the tax on the land itself. It can be imposed progressively, reducing the return to landownership (capital gain plus rent) to around a zero nominal return.

The implementation of a land value tax can be achieved in two main ways. Firstly, a simple tax on land values and secondly, the public ownership of land combined with short-term lease sales. The successful city states of East Asia: Hong Kong and Singapore, adopt one of these two options. Hong Kong, due to the new territories being originally leased from China to Britain, never had private land ownership simply because the land was to be returned to China eventually. So the government of Hong Kong receives a large part of its revenue in the sale of leases of 20 or 30 years term.

This tax is best introduced in 3 separate ways:

1. Implementation as a national replacement for as many existing taxes as possible (council tax, stamp duty land tax, inheritance tax on land, TV license fee, etc.).
2. Use of this tax as a macroeconomic stabilizer (the bank of England could increment this tax in order to avoid propose and to ensure that real terms house prices decline gradually to more reasonable levels).
3. Introduction of 'land value covenants', similar to 'government mortgages' but with the interest paid proportional to local land values. Those who have difficulty paying the tax(for example because they are asset rich or income poor) would have the option to roll up the tax into an indefinite 'interest payment' index to the value of the land.
4. Some time threshold for any residual freehold ownership (e.g. 99 years).

A land value tax on built up land would take the total value of the property and subtract the value of the building. Both values are easily assessed: for example there are multiple websites accessing overall property value. The advantage of subtracting property value is also that beautiful and historic buildings, and those that contribute to the character of areas can be recognize as such. This subsidy on building size would work well as a way to mitigate the increase of fossil fuel taxes on household energy bills.

13.10 Environmental, Fossil Fuel and Congestion Taxes

Some economic activity causes significant harm to people or the environment, for example:

- overfishing
- pollution (such as greenhouse emissions)
- congestion (caused by driving at rush-hour)
- smoking
- consumption of high levels of sugar or salt.

We propose to tax these abuses and behaviours. For example, we propose that a greenhouse gas emissions tax should be imposed.

Such a tax should avoid making industry in the UK uncompetitive so it should be taxed on a consumption basis (i.e. based only on UK sales, wherever they are produced). This tax can be implemented upstream on fossil fuel extraction and import and on embodied emissions in imports. It should refund taxes paid on exports. The refund for a good being exported and the tariff on the same good being imported need to be the same, to prevent import-export tax arbitrage. Other taxes should be imposed according to similar principles.

Moving specifically to fossil fuels, there are four main reasons for fuel taxes: 1. Greenhouse Gas Emissions 2. Resource Rent 3 Costs of Roads, Airports and other Infrastructure 4. Congestion i.e. use of Road Space 5. Environmental and Health Damage 2-4 are dealt with under 'Environmental taxes'. We just consider resource rents here.

So unlike in countries without resources where the incentives are to work hard and produce valuable products, in resource-rich countries, the incentives are to be powerful enough to control the resources. This is called the resource curse and we can see that those regions which contain great oil reserves also contain repressive regimes and political instability.Furthermore, high resource rents involve a transfer of money from consuming to producing countries which is against the interest of the consuming countries. Therefore, it would be in consumers' interests to reduce the rent by limiting consumption of oil through taxes and other measures.

Resource rent taxes can be charged both by consumers and by producers. In that way there is competition between the two. There is already a tax on profits from extraction of north sea oil and an aggregates levy. These should be retained.

There could also be a rents tax on oil imposed by coordinated internationally between oil-consuming countries. We propose an internationally-coordinated tax on oil consumption. This should be increased to reduce the open-market price of oil. Such a tax is essential to reduce new exploration and the environmental damage it may cause. It would also reduce trade deficits. Taxes on extraction of oil should be retained. In principle they should include extraction of any other high-rent natural resources, although oil appears to be the only relevant natural resource in the case of the UK. Such taxes should be coordinated between oil-consuming countries. Also, tackling climate change requires that fossil fuels are no longer extracted. In order for this to happen, the value of those fossil fuels on the open market needs to be low or zero. In other words, the rent needs to be captured by taxes in the consuming countries. A resource rent tax is, in effect, a land value taxon resource rents which would otherwise be captured overseas.

Land use and Maintenance Costs

Typically, roads are provided free at the point of use by the government for all car and other users to enjoy. In the UK, there's only one toll road (and a few toll bridges);all other costs are paid by the government. However, the revenue raised by fuel and vehicle taxes is more than a cost of roads so this taxes are revenue raising and behaviour changing more than just a cost of the infrastructure.

Congestion Charges

Cars travelling at peak times take up limited road space and prevent other car users from reaching their destination in a timely fashion. Road fuel taxes can be seen as implicitly charging for congestion; however, they do so highly imperfectly (because congestion and its cost are concentrated very specific times and places which do not constitute a large proportion of the fuel use)and so we suggest a separate congestion charge.

We propose to adjust the existing road tax to become a congestion charge. This would work on a tax and rebate system. Everyone would pay the charge but people would have the option to have a black box in their car which would prove through acceleration, location or time that the driver was not driving in a congested area. Every day that the vehicle was not in congestion would be refunded from the overall tax.

Other Local Pollution Taxes

Burning fossil fuels causes both global and local environmental problems. In addition, burning oil products in cars causes health problems and car travel is relatively dangerous. A tax on fuel is a way of paying for those costs. Additional local pollution caused by coal, for example SO_2, soot (including PM_{10}s), needs to be controlled by taxes or tradable permits.

Carbon Tax

Carbon dioxide,methane, nitrous oxide, CFCs, SF_6 and other gases cause global warming. Carbon dioxide also causes ocean acidification: the reduction in pH of the upper oceans. The likely magnitude and severity of these global effects is somewhat uncertain but likely to be severe in the long term. CO_2 is produced on combustion of carbon-based fuels, such as fossil fuels (natural gas, petroleum and coal).

We propose that carbon tax should replace existing taxes on fossil fuels (except road fuel duty). It should be implemented 'upstream' on imports and extraction of fossil fuel according to carbon content. Rather than a slow increase in carbon tax rates we suggest implementing revenue neutral reform that compensates losers.

Summary of aspects of tax on greenhouse gas emissions:

1. Tax upstream: tax precursors like fossil fuels as they enter the country
2. Tax base should be consumption,not production

Upstream taxation is about the administration of the tax. Carbon is conserved so every molecule of CO_2 relates to a single atom of carbon in the original fuel.Hence, a CO_2 tax is also a carbon tax. CO_2 can therefore be taxed on the carbon content of the original fuel. In general greenhouse should be taxed 'upstream' on relevant precursors if possible because it's usually simpler that way; and this is always the case with carbon/carbon dioxide.

Most proposals for carbon taxes focus on the production of greenhouse gas (GHG) emissions. However, if one taxes the production of GHG emissions, it will encourage industry to move to those locations which have low emissions taxes. We therefore propose to tax consumption instead, so the tax base would be all greenhouse gas emissions produced as a result of British consumers' activity. This tax base would then include products manufactured overseas and consumed by British citizens. Therefore, to implement an upstream carbon tax with a consumption base requires adjustments at borders. These adjustments need to tax imports and exempt exports from the carbon tax.

There are two types of adjustments that could be made on imports. The first would neutralise the effect of the tax while not discriminating between different countries with different emissions. The second option makes a distinction between the efficiency of different countries and the emissions they produce. We propose at present the first and less aggressive option.This is intended to neutralise the competitiveness effect of the domestic tax. It is not necessarily to distinguish between products made in different countries, hence, it is not intended to be an aggressive trade policy.

There should be an adjustment on exports and imports. Only UK consumers should be taxed. So all products that are consumed in the UK are going to be taxed.

CO_2 produced during the manufacturing process of a product needs to be estimated and the tax on the product must be proportional to CO2 emissions.

To make this concept more tangible, we can make an example for UK-made steel. The CO2 produced per kg for this product can be estimated. A corresponding amount would be charged on imports and the same amount would be refunded on exports. For products that are not manufactured in the UK, tariff can be estimated based on general estimation of how much CO2 is produced in making that good.

Exports would be exempted from the tax. However, since the tax is charged upstream on import and extraction of fossil fuels, a system of refunding similar to VAT needs to be in place. However, the refund for a good being exported and the tariff on the same good being imported need to be the same, to prevent import-export tax arbitrage.

Stacked Carbon Pricing:

Stacked Carbon Pricing Is A Method of Charging for Carbon at the Border for High Carbon Intensity Goods. It also allows prioritisation of high-importance Carbon taxation. Most of all it is norm-based, it allows the separation of the tax paid from the incentive effect.

A layered carbon tax is a way of implementing a carbon tax that maximises the incentives to reduce emissions whilst minimising the political and economic barriers to a carbon tax's imposition. It does this by layering, and prioritisation.

It achieves this through a layered norm based approach. Each layer is revenue neutral and combines a tax on carbon intensive inputs with a subsidy on the outputs of that layer.

The production subsidy on the output of a layer is cancelled out in most cases by an equal and opposite tax on the consumption of that good in the next stage of the energy food chain.

So for example there might be a tax on fossil fuel inputs to electricity generation. Those taxes are used to fund a per kWh subsidy on electricity production. In stage 2, the consumption of electricity would then be taxed in exactly the same way .

Note therefore that at each stage there is the possibility of production that is not consumed within the country (exports) and consumption that is not produced within the country (imports). Note also how naturally these are dealt with by the tax system.

Production that is not consumed in the home country would be given a carbon tax combined with a per unit subsidy. Thus production at the average carbon intensity would face no net taxes, whereas production more dirty than average would face net taxes and production cleaner than average would face net subsidies.

In order to transform the effects of a carbon tax on the economy, we introduce a high level of incentive. Even a low level carbon tax has positive effects. The UK introduced a carbon tax, known as a carbon price floor in X. It eliminated coal power from the uk gwneation mix. Carbon tsaxated work. nut xcan we do better? Perhaps they can. The issue is: how high can your carbon tax be? So normally we say that a high carbon tax is politically difficult or economically challenging. I want to suggest a couple of ways in which it doesn't have to be so.

The first way is through output subsidies and the second is historical norms. You can move from one to the other. Output subsidise can be layered: the tax on one layer can be a tax on the next layer. Why have it at all, since it's cancels. Well firstly prioritisation and secondly imports and exports: it provides a useful way to deal with imports and exports of high embodied carbon goods.

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13.11 Food And Sin Taxes

Alcohol and Tobacco

Alcohol and tobacco taxes would be retained as today. There may be a case for harmonisation across Europe, to prevent 'booze cruises'.

Sugar Tax on Processed and Prepared Food

Excess sugar intake causes multiple health problems including obesity, type-II diabetes and tooth decay. We propose a simple sugar tax on the manufacture or importation of sugar based on three categories of sugar-like compounds.

- Class A: 'sugar' (i.e., sucrose, glucose and fructose), including contents of fruit juice.
- Class B: 'near sugar', including maltose etc. and synthetic and natural sweeteners with unclear health impacts.
- Class C: 'unprocessed' sugars in raw fruit and vegetables; starch and other carbohydrates.

Class A would have 100% tax (ie. £0.01 or 1p per gram sugar); class B, 50% (ie. 0.5 pence per gram sugar); and class C 0%.

Salt Tax on Processed and Prepared Food

We propose a simple salt tax on processed foods. This would be charged according to salt content.

13.12: Options For Welfare System

The present benefit system is a mixture of unconditional, conditional, means-tested, taxable and non-taxable payments. It is illogical and ill-thought through. Additionally,different means-tested benefits are means tested in different ways. The sum total of the system creates perverse incentives and does not encourage work effectively. Indeed, dealing with the benefits system is like a job in itself,both for the person claiming benefits and for the people administering benefits. This complexity is unnecessary because means-testing is just a tax in disguise: it takes away money from people as wages increase. Such a function is best performed by the income tax system, which also takes away money from people as wages increase.

We propose a return to universal benefits with 'means testing' performed by the income tax system, rather than the benefits system, in an integrated and smooth way. The basic universal benefit in our proposed system is the Citizen's Dividend. It is a universal payment to all UK citizens. The Citizen's Dividend is a per capita payment to all citizens of the country, paid regardless of employment status. It is a universal payment to everyone in society who is a citizen of the UK. The payment would be initially equal to current income support levels, i.e, around £75 a week, or £3800 per year.

There will be different rates for children (replacing child benefit and child tax credit, paid to mothers), working-age adults (replacing income support) and pensioners (equivalent to the existing state pension). It provides all UK citizens with the minimum amount of income. We also propose to offset payment of Citizen's Dividend against other taxes so taxpayers only receive a net bill or payment.

In addition, there will need to be further payments for particular categories of people with specific needs – for example, disabled people, the elderly, carers and mothers with children. We propose that these payments would be made on a similar and consistent basis to the Citizen's Dividend described above. There will obviously need to be changes to the tax system in order to pay for these universal benefits but the system of government accounting should account for a means-tested benefit and a taxable universal benefit with increased income taxes the same way.

We also propose to offset payment of Citizen's Dividend against taxes. This would specifically apply to those taxes that are highly visible such as property taxes, so that individuals will receive or pay only the net amount of either taxes or benefits.

Integrated Skills Training-Workfare Schemes

The ideal education and welfare system include not only a (low) citizens income, around the current level of income support but also an integrated training, entrepreneurship and workfare scheme. The workfare system would be a system that pays a small wage but also develops the claimant's skill-set. This is also the purpose of some further education courses. Integrating workfare with training allows continual upgrading of the skill-set. Such training should always prepare the recipient both for employment and for entrepreneurship/self-employment. For example,mini-economies can be created in schools and universities to allow older school children to trade between themselves. The training-workfare college should develop these entrepreneurial skills further, removing one major barrier to entry to all industries, a general lack of entrepreneurial skills.

13.13 Introducing a Basic Income

Basic Income

This section describes the Citizens Income (a.k.a. Basic Income; Citizens Dividend) and a couple of ways that it could be introduced. The citizens Income is a per capita payment to all citizens of the country, paid regardless of employment status. It is intended to simplify the tax-benefit system; rather than means testing,the rest of the tax system is used to tax away the benefit. This Citizens Income provides everyone in the society with a minimum amount of income to live on. It's a way of compensating people for the inevitable costs resulting from the scarcity of natural things that are vital to life. The level of the Citizen's income might be, for example, around £75 per week, or around £3800per year.

The citizen's income pays scarcity rents. If the fundamental things in life were not scarce for example if there were an infinite amount of land to grow food and live on and if the atmosphere was completely unlimited then there would be no need for a citizens income, just as there is no citizens income for the hunter-gatherer.In principle then, the citizens income compensates man for that which he loses when and he multiplies and lives in cities rather than being in the wild and living as a hunter gather.

A Citizens income can be introduced as a simplification of the existing tax and benefit system.It would be paid from the tax department and replaces some existing benefits.It could be taxed away using income tax, so maxing explicit the effective taxes implicit in means testing, and allowing those rates to be smoothed and optimised. Also, as you increase taxes that the unemployed do not pay, also introduce a citizens income and net off the two. People with tax bills would only receive a net tax bill.

Our goal for the value of the Citizen's Dividend is the current level of income support. We would abolish this benefit and replace it with a Citizen's Dividend paid to all. However, since the introduction of this dividend is expensive, it may need implementing slowly. For simplicity and political purposes, the dividend should be netted off against taxes paid, for example on property and land. Hence, people will receive only the net benefit or pay the net tax.

Different ways to fund a Basic Income

This article argues that there are *different types* of basic income, depending on what the basic income replaces and how it is funded. Those types are a *simplifying* basic income, a *compensating* basic income, a *redistributive* basic income and an *extra* basic income. A simplifying basic income is paid for by changes to income tax and pre-existing benefits; a *compensating* basic income is paid for by increases in other taxes that are paid by all, such as a carbon tax. A redistributive basic income is paid for by taxes on the rich; whereas an *wealth fund* basic income is paid for by a wealth fund.

I argue that these are not just 'different ways to fund a basic income' but rather they are inherently different overall propositions. A 'simplifying' basic income does not change incomes very much but it does simplify the benefits system. A compensating basic income's main rationale is to remove the regressive effect of independently worthwhile policy. A redistributive basic income moves money from rich to poor. And a wealth fund basic income increases national savings by funding the transfers with asset purchases.

A Simplifying Basic Income

The main goal of a simplifying basic income is to simplify the existing system of welfare provision with lower benefit withdrawal rates and a more universal aspect, so as to prevent the bureaucratic checks that accompany means testing and conditionality. A strategy for implementing the simplifying basic income would be to remove the personal allowance and find the 'common feature' across many different schemes. Then add a basic income and at the same time reduce benefits and allowances by the same amount across the board.

Typical tax increased: Income tax (personal allowance)

A Compensating Basic Income

The reasoning behind a 'compensating' basic income is to compensate for changes to taxes that would otherwise be undesirable because of their regressive effect. Environmental taxes are desirable because they attempt to properly price externalities. Health taxes aim to change behaviour of consumers and modify the composition of produced foods. However, sometimes these taxes have a regressive effect, because the poor spend more as a proportion of their income on food or energy than the rich. A *compensating* basic income would redistribute these tax revenues using the mechanism of the basic income. Examples of this approach include a carbon tax combined with a basic income, referred to as the 'tax and dividend' approach.

Typical tax increased: Carbon tax

A Redistributive Basic Income

Like a compensating basic income, a redistributive basic income is also paid for out of increased taxes. But in this case, the taxes that would be increased would be taxes primarily on the rich. So for example, a Land Value Tax or property tax falls more heavily on the rich.

There are variations of a redistributive basic income that can be tailored to make a land value tax more palettable. For example, there could be a personal allowance for property owners, and a basic income for non-property owners. In that way, a property tax is made to favour those who own just one property. Those who own more than one property will pay extra tax, whereas those that own none get a compensating payment. This allowance would be equivalent to a 'basic income for property owners' could then be extended using the funds raised by the multiple property owners to those who are renting.

Typical tax increased: Land Value Tax (new tax)

A Wealth Fund paying a Basic Income; Basic Property

Whereas the previous three example would be funded by increased taxes and/or reduced other benefits, a wealth fund basic income would be funded by a wealth fund. Wealth funds already exist, for example the Norwegian sovereign wealth fund. In this case the wealth fund would buy assets such as equities, bonds, land or property. The wealth fund would pay out dividends according to the return (dividends, interest, rent) on the underlying assets.

But how would the assets themselves be financed? From which source? There are a number of options: Taxation, Financial Surpluses from some other activity, Government Borrowing, and Quantitative Easing.

An obvious example in this case would be corporation tax. Increased corporation taxation would be used to purchase additional equities. In effect, companies would be asked to pay an increased corporation tax in shares. This approach was tried in Sweden for some time, and proved successful and popular. Companies paid a portion of their taxes in shares, and this enhanced a fund that paid a basic dividend to everyone.

Surpluses from local development are another method to fund the basic income. For example, a local bank could be set up. This bank would purchase land/ lend on land, and the surplus that it generates would be stored in a local social fund. The dividends from the fund would then be used to pay a basic income. The advantage of this approach is that the assets paying the fund would be themselves useful to provide capital for the bank, and the dividends would also be helpful

Another indirect way to fund a wealth fund basic income would be Quantitative Easing or Bond Issuance, used to buy up assets, perhaps at the same time as taxes were used to reduce those assets. Purchasing assets and taxing them act in opposite directions in regards to the sale price of assets. Taxing an asset in general would reduce its market price; purchasing that asset tends to inceease the price. The introduction of taxes on assets at the same time as purchase of assets, allows for financial stability at the same time as capture of surplus by the authorities.

One step beyond a basic income is basic property. This would be a basic requirement for property for all.

The Case For Retaining A System of Contributions and Contribution Records in a Basic Income Scheme

The Beveridge report and the system of national insurance that it brought in, amongst other things, have at its heart the dual ideas of universal benefits and that of contributory benefits. Universal benefit is a benefit that is paid at the same level whatever happens. Contributory benefits are those where tax or national insurance contributions affect the future amount of benefits provided.

The Beveridge report argued *against* means testing, which can be defined as taking away benefits as income increases. But the UK welfare state has introduced means testing, a second income tax but this time only on the income of those on benefits. Of course, taking money away from people as their income rises is what income tax does, and it is odd that in the uk there are four separate systems for doing this (income tax, employers and employees national insurance, and means testing of benefits, soon integrated into a single benefit, universal credit)

A simple and *integrated* tax and benefits system recognises that taxes and means testing are essentially the same thing. A benefits system with a basic income at its heart recognises that the high benefits withdrawal rates of the current system. So a transition to a ?4000 per year basic income could be financed (say).

Contributory Basic Income Increases

It will be assumed here that we can fund a basic income from environmental taxes. This would pay a basic income of £4000, but this would not be uprated with inflation. In order to acheive our target of a basic income of £6000 per person, the addition would be funded by actual securities purchased in the market. The money raised to fund these purchases would be from the following sources: taxes on company profits or wealth, money purchase of overseas securities. The allocation of the tax paid would be to everyday people according to the tax paid, up to some maximum value per year.

So for example if £2000 saving would be put into securities yielding 5% per year, then the basic income next year (and thereafter) would be 5%*£2000 = £100 extra per year. There would be two ways to earn these credits.

There would be two methods for saving this £1000. First, for every £ you pay in income tax, you might get £1 of securities set aside for you. Second, the local authority or national government could pay you for doing various community actions.

Communities need maintenance. Public goods need to be paid for. This creates a basic income scheme very much like the sort of scheme Beveridge intended, and also the welfare schemes that many countries have, which have a 'contributory' component. In other words, if you don't work,

It is intended to be the sort of scheme that represent the and financial interests of 99% of the population and the value set of 80% of the population, that build a broader coalition than egalitarianism alone to include community, the work ethic, as well as simiplification and the national interest. Over time, the scheme would move to being 'funded' perhaps by taxing multinational's shares apportioned by sales so that ownership over time moves to the fund(s) paying the basic income - a sovereign wealth fund in other words.

In summary, the scheme encourages community involvement, eliminates the disincentive effects and deadweight cost of income tax for everyone earning less than £50K per annum, and makes BI more palatable to people that subscribe to ideas that our communities, public physical infrastructure and public goods need maintenance and that work should be rewarded. All at no additional cost.

A basic income with a tax contribution record.

The basic idea is as follows:

- Every current citizen is granted a right to a basic income of £4000 per year.

- Income tax paid (at 40%) between 0 and 10K is set aside to buy securities and thus increments additional amount to the basic income
- Whilst income between 0 and 10K is taxed, the taxpayer increases his or her benefit entitlement in so doing, with an exactly equivalent value.
- Community actions could also be paid in this benefit

Politics of Basic Income

It seems to me that the major problem with basic income is that people aren't happy with giving money for nothing. If however, it was funded, and there were local organisations with balance sheets paying basic income out of a funded balance sheet, then this would be perfect, because the income would not be seen to be coming out of taxation. It would of course then reduce the tax burden for the state. Taking the population seriously means that taking seriously the idea that people will not just be interested in 'money for nothing'. Perhaps it also means that people are interested in value for value created. But if you create value in a community you should get a reward.

For the last few years, Britain has struggled with the idea of freedom of movement. The UK, and particularly London, are attractive places for people across the EU to move to, partly because of the English language, partly because the economy was booming, and partly because the international and multicultural nature of London in particular was very welcoming. But it has become clear that some portion of the existing population did not feel much economic benefit from this. A basic income if related to a real or notional personal wealth fund could allow smooth earning of basic income by citizens and then for new residents to 'buy in' to this fund.

Implementation

Step 1: Introduction of Payment Card

The citizen's dividend system would be introduced as a payment card for all citizens (similar to an oyster card).

Step 2: Simplifying Universal Credit

Universal credit works like this: You can opt into the system, if you have been on another benefit and you are in an area that UC has been rolled out to. Universal credit replaces the following benefit types: Child Tax Credit; Housing Benefit; Income Support; income-based Jobseeker's Allowance (JSA): income-related Employment and Support Allowance (ESA): Working Tax Credit. Once you are in the system, it works like this: You have a standard payment, that is set up as follows: - If you are are getting help with housing: you get a payment of X per year, not including housing costs. - If you are not getting help with housing: you get a payment of Y per year.

For those people in the universal credit system, replace it with a universal payment and a standard benefits withdrawal rate of 40%. Now, a benefits recipient would receive a universal benefit of ?4000 per year , and pay a standard tax of 40% on all income coming in.

Step 3: Simplifying Income Tax

For people working, replace it with a basic income and the elimination of the personal threshold. Simultaneously simplify the income tax, employees and employers system to a standard rate of 40% and a higher rate of 60% for the first percentile only. If you are in the PAYE system you get the basic income.

Now these two groups are on a basic income: - People earning over the personal allowance - People qualifying for universal credit (how many are there?), and legacy benefits to be replaced by universal credit. The participation basic income would be paid in two circumstances. First, you are in work. Second, you are in receipt of universal benefits and the legacy benefits that universal benefit allows for.

Step 4: Reduce Income taxes, Increase Externality Taxes

The third step is to reduce again the basic rate of income tax, and replace it with the carbon tax, at the same time bringing into the scheme those people who aren't either recipients of universal credit, or full time workers above the personal allowance (as was prior to the introduction of the scheme.

Step 5: Basic Property Tax Free Allowance

We adopt the same approach to property as with income. We first consider the people who are taxed and the people on benefits and we adopt the same allowances for these two groups. Those owning property and those on housing benefits should have the same benefits. We then extend this allowance to all.

Further Research

So to start to model this we should try to find how many people are in each bracket. How many people are in the working population, how many are in the universal credit system and the prior legacy systems, and how many are in no system at all?

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13.14 Gordon Policy Ideas List

- Central Monetary Authority (CMA) responsible for the creation of all monetary credits. Credits are uniquely numbered and traceable. Credits are constantly analyzed for duplications. Potentially located in Leeds not London. Possibly move the financial capital of the UK to Leeds.
- All financial services companies nationalized without exception. This should lower the cost of banking and insuring.
- All private vehicles to be automatically insured by the State Insurer for 3rd Party injury and costs - regardless of the nature and cause of the incident. Comprehensive insurance cover becomes mandatory for all drivers. To not acquire it is criminal. This will ensure that the 3% of drivers that fail to insure do not cause uninsured injury and costs to 3rd parties. (I think it is Switzerland has this.)
- Corporation of the City of London abolished once it has been completely encircled as discussed.
- All assets of any kind in the UK must have a beneficial owner that can be phoned/written to, and taxed where necessary. If a beneficial owner cannot be identified the asset will be sequestrated by the state and passed to the Citizens Dividend Trust for disposal or exploitation. (PRC)
- Non-residents can own no property of any kind in the UK. The resident must be the beneficial owner. If there is any suspicion that the resident is house-sitting to enable a non-resident to speculatively own property in the UK the property will be sequestrated by the state and the resident concerned prosecuted for fraud. (PRC)
- No property can be owned at any point in a chain of ownership by any listed secrecy/tax haven including the CCL or Delaware, for example.
- Once nationalized, the London Stock Exchange will be promoted as a –Traditional Stock Market– for real investors. Once purchased, a stock must be held for a minimum of 3 months, thereafter no more than 1% of any company can be sold in one week by a single investor, and there will be a one week delay on the sale with the final sale price being set at the end of that week. We will sell the benefit of the LSE as being real growth in share price due to the fundamental value of the company increasing, and a revenue stream from dividends. I believe that 'real' investors and companies will flock to London for such an opportunity. In a way it is a niche play in a global market. We will actively assist companies that want to relocate to the LSE.
- Smaller markets can be set up in other regional hubs e.g. Leeds,

Birmingham etc. for smaller companies e.g. AIM, and a new Micro-AIM

- RBS, Lloyds, Barclays (and possibly HSBC assets in the UK) and other bankrupted banking interests to be absorbed into four new State Banks. Scientific, Industrial & Manufacturing Bank of the United Kingdom (SIMB-UK); Property, Infrastructure & Construction Bank of the United Kingdom (PICB-UK); Savings & Loan Bank of the United Kingdom (SLB-UK); and International Development Bank of the United Kingdom (IDB-UK). Each bank will borrow money directly from the CMA and lend according to a national lending plan. Savings will be underwritten by the state and guaranteed savings rates set. Aimed at loans and overdrafts in excess of £50,000 so as not to compete with local Savings and Loan Mutuals.
- 650 locally owned Savings and Loan mutual organisations to be formed for each political constituency. Each SLMO will have a local resident as Managing Director, two additional local directors (each with skin in the game – possibly £50,000 for the MD and £25,000 each for other Directors), and a board (aufsichsrat) made up of the local MP, council representative, Union representative, and other key interested local parties. It will follow the Bank on Dave model. It will be allowed to do micro-loans up to £50,000 to any individual entity, with a maximum deposit of £50,000 by any local resident. No constituency outsiders may deposit or borrow from any SLMO – they must be completely local operations aimed at the local economy. Burnley S&L: 5% AER on savings, and 8.9 to 14.9% interest on loans. No bonuses of any kind to any staff. Surpluses go to local charities.
- A massive apprenticeship-training program to be developed in direct consultation with UK businesses. At least 250,000 apprentices entering formal technical apprenticeships each year with a minimum of 1,000,000 people under full-time hardcore technical instruction at any one time. This will require the importation of English speaking trainers from all around the World. The UK simply does not have enough people available to train our future generations. A minimum of 100,000 trainers will be required, possibly as many as 250,000 employed in training and administration.
- Most prisons and detention centers to be turned into apprenticeship training hubs. Qualifying inmates will be trained to Master Craftsman Level and, if deemed safe, will qualify to train other inmates, and eventually civilians in adjacent facilities. Exceptional progress will be rewarded with early release if deemed appropriate. Prison apprenticeship programs will be coordinated in close consultation with regional industry.

- University education to be made free or heavily subsidized for courses considered being in the 'national interest'. This will cover a wide range of scientific, academic, and technical disciplines. A grading system will determine the amount of subsidy from 100% free through to 100% paid.
- Citizens Dividend to be paid unconditionally to all UK citizens. New citizens must wait five years to qualify. (Prisoners to pay 33% of their CD to the state to compensate for their keep. The rest will be held in trust with 5% AER to cushion their release into society. If they perish in captivity the money reverts to the CDT.) Suggested payments: £250 per month for 0-16 years of age; £500 for 16 to 65; and £750 thereafter. (numbers completely open to debate, as always with me)
- CD to be paid into an account at the SLB-UK. All citizens that apply for and claim their CD must apply in person and present themselves for interview in private (if a person is considered to be vulnerable in any way, they will be provided with free state legal representation for the purposes of determining their wishes). Each successful applicant will be issued with a banking card that doubles for a biometric Citizens Identification Card. If a person does not want to subscribe to the ID Card system, they do not qualify for the Citizens Dividend.
- Police will have the right to ask any person to present their ID Card upon request. Failure to do so may result in detention and further investigation. Alternatives to presenting the card will be voluntary scan of the iris or fingers veins to determine identify.
- Police to revert to the Bobby on the Bear model. Velvet zero tolerance policing worked spectacularly in Hartlepool and Middlesbrough under Ray Mallon. That approach halts the progression from minor misdemeanors to major crime in a highly effective way.
- Youth offenders and their families should be offered the opportunity to trade custodial sentences to technical apprenticeships on probation.
- Courts to introduce fast-track/short-form sentencing for youth offenders. Under 25's should be sentenced within one week of any minor to moderate offense; any longer and the perpetrator often ceases to connect the punishment to the crime. This fast-track process could be elective.
- Qualifying adults sentenced to a custodial term may elect to convert their sentence to national service in the military. Specialized military units can be formed to take these individuals.
- One of the greatest criticisms of Government is that loud pressure groups, lobbyists, and leaders of big business have too much di-

rect access to Numbers 10 and 11 and adversely influence decision making in Government. To combat this I propose the following: Number 10 will create a 200-person strong –Public Concern Project Management Team (PCPMT)– which receives submissions and calls from the public, pressure groups, lobbyists, foreigners and big business. (All submissions will be entered on a database that is accessible directly by the Prime Minister. The PM will have his own personal team reviewing all submissions and auditing the PCPMT to ensure that projects cannot be buried.) Each 'customer' will receive a 'case number' and be assigned a Personal Project Manager. The Project Manager will take up the issue personally and seek to resolve the issue without additional resource. If the issue remains unresolved it will be elevated to a Senior Project Manager. If the senior project manager is unable to resolve the issue it will go up to an Expert Committee chaired by a Cabinet Minister. Each of these ten committees will have a team of highly skilled researchers and assistants to call upon. Level 7 will reorganise the cabinet and government departmental responsibility around the ten books with one cabinet minister for each of the ten books. Each cabinet minster will chair an Expert Committee of ten experts drawn from outside Government. One of their tasks will be to review unresolved complaints to the Senior Project Managers of the PCPMT. If the Expert Committee is unable to resolve the matter it will elevate to the Prime Minister, and that's when I get involved personally. Each month all complaints will be analysed for patterns, summarized and presented in a four-hour session each week to the Prime Minister. The benefits of such a system are, 1) reduce corrupting influence by pressure groups, lobbyists, and big business, 2) prove to the public that we are there to help, listening to everyone, and genuinely serving the wider public through pragmatic action, 3) head-off social and political unrest before it gets out of control, and 4) ensure that corruption and incompetence in wider government and the public sector cannot metastasise and is stamped out early.

- **TEAR**: A Level 7 system for the reduction of 'Bads' when initiated by Government – (Possible meme: tearing down the old system before it reduces us all to tears):

1) **T**ax the 'Bad', this is a common and acceptable method

2) Widespread **E**ducation over a protracted period of the citizens

3) The citizenry reaching broad **A**greement, and finally if all else fails

4) Forced **R**estrictions and quotas on the 'bad'

or

EATER: Education, Agreement, Tax, Exercise, Experimentation, Experience & more Education, then Restrict.

- Another key policy that will negate the need for Government paying out for future pension contributions is the implementation of mandatory Social Welfare payments that we intend implementing for all registered 'tax payers'. As in China, even if they don't pay tax, people will be required to pay a mandatory 5% to 10% of their salary into a Social Welfare fund that can be used primarily as a pension. It will be tax free up to 10%. That's very high. The taxpayer can choose to receive a fixed 5% interest from the Government, or they can put up to 66% of it into riskier investments such as stocks and shares. Then there is every incentive to save for retirement. It will only pay out at 65 years of age. Even putting 5% of income away for 20 or 30 years with 5% to 8% interest, and assuming we can keep inflation to 3% or below, and added to the Citizen's Dividend, should provide most people with a livable pension. This removes much of the liability from the Government outside of the Citizen's Dividend of GBP 9,000 per year for 65+ people. # 13 Simple Policy Proposals

This section proposes a simple tax system which aims to fulfils our requirements of being beneficial, fair and practical. These proposed policies, and the related transitional arrangements, aim to resolve issues around incentives and redistribution in the current UK tax system in a politically achievable way.

Main Taxes

1. Replace Business Rates and Council tax with a norm-based LVT consisting of a 100% LVT on increases in land rent. Transition the residual tax to a tax on land wealth.
2. Replace VAT and Corporation tax with a 'Dyson' Tax (Cashflow Tax) with half deductability for imports from VAT compliant non-tax havens.
3. Introduce a corporate wealth tax on the same principles as the Dyson tax (i.e. combined with a witholding tax on payments abroad from the UK)
4. Introduce a layered upstream consumption based Carbon Incentive. Transition this over time to an upstream Consumption based Carbon Tax plus Citizen's Dividend.
5. Simplify Income Tax and NI with a simple progressive income tax system with a very simple rate structure. (The exact details of the rate structure and basic income depend on accurate modelling of

the tax system)

Benefits

1. Replace unemployment benefit with a payment by results conditional work-training hybrid
2. Slowly introduce a citizen's dividend as a compensating payment for additional consumption taxes.
3. Pay for housing benefit automatically out of LVT.
4. Retain other benefits, but fold all means testing into the income tax system, with maximum means testing amount equal to the tax paid on the personal allowance
5. Once this is acheived it is easy, if required, to abolish all personal allowances and replace the whole system with a basic income with additional payments conditional on disability/carer/age status.

Further minor taxes

1. Introduce congestion charges in lieu of a carbon tax on transport fuels.
2. Introduce comprehensive environmental and health taxation (packaging tax, sugar, meat tax, and others if needed).
3. Increase the bank balance sheet tax and adapt it counter-cyclically and alter it to favour lending to real businesses.
4. Introduce a comprehensive wealth register. This may take the form of a disclosure requirement on all UK wealth owned by foreigners and on ownership of foreign wealth by uk residents. Combine with a small 0.1% wealth tax on both of these classes of wealth.

PART 14: CONCLUSIONS

14.1 Framework for Reform

With this book we have tried to outline the purposes and principles behind the UK tax and welfare system as it stands today, and we have attempted to address where exactly it has been going wrong. Over complexity, poorly communicated purposes, administrative hiccups and lack of public buy-in are all issues with the current structure.

Throughout this book, we have shown how the flaws in this system have played out into reality. Principles do not remain abstract. Growing inequality, insufficient retraining and work-friendly support for the unemployed, tax evasion and avoidance. We need to apply a simplified and principled approach in how we fix these mechanisms. By taxing revenue sources in a simplified way, and by taxing unearned wealth so as to lessen the distortive impacts of the tax system, we can help fight inequality and build a better future. Through removing means-testing from welfare provision, and supplying better support in helping people back to work, we can ensure rewarding employment for all.

These are not pipe dreams. By making our voices heard at the highest levels, and bringing these ideas into popular opinion, we hope to help shift the dialogue away from the hyper-capitalistic rhetoric that is heard loudest by decision makers these days. We want to make a society that is more equitable, fairer, and less unstable than the one we have today. We know our operating system; we know what we want to achieve; and we have the toolkit at our disposal. It's just up to us to learn how to use it properly.

The tax and welfare systems are both powerful tools by which to effect social change. Use them properly, and we could see a society where housing became affordable through use of a land value tax, those who pollute paying for damage they cause, and where people were supported into gainful, decent employment by a state that wants to encourage people to succeed.

Above all, we emphasise the importance of the idea that any reforms should follow the three principles we outlined at the beginning of the chapter. This is, namely, that any changes should be practical, beneficial and fair. Ensuring that this happens is something that we consider to be a matter of morality. It is also, in a sense, an essential component of success. Through linking the achievement of these to the idea of political acceptance, it becomes clearer to see that these principles are indicative of each other. For the transition to be practical, a concept we can interpret as politically feasible, it needs to be fair, and to be fair it needs to be overarchingly beneficial.

Maintaining the principles of fairness in both the transitional phase and the outcome would allow us to really make substantial changes in the way the system operates. A just process, with just effects, is the goal. We build on the Rawlsian ideas of improving the welfare of the worst off, without sacrificing that of the middle or the top. Change is possible with minimal harm, so long as we combine clever policy design with clear communication about its purpose.

Understanding tax as an essential component of living in society, as a useful tool for nudging social behaviours and protecting public goods, and for raising revenue to protect those who most need it in society is the first step towards change. We hope that this book has helped to communicate this message; the first pebble thrown in what could be a landslide.

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