PART 2: Progress and Problems

This book is addressed to everyone; economists, scientists, politicians, professionals and the public alike. Everyone , that is, who cares about tackling climate change.

Across the social spectrum, people are starting to lose hope. The poor lose hope because of their precarious economic situations; the public because of a lack of certainty that society can fix critical issues such as climate change. Even the wealthiest in society are showing signs of fear, building bunkers and preparing for the worst. But with careful design and application of policy, and sufficient political will, all is not lost.

What would an economy fit for our children look like? A society and economy that promoted the wealth and happiness of its citizens. Such a framework would define, create, preserve and fairly distribute wealth, both natural and man-made. Fulfilling the happiness requirement needs a different metric, encompassing both economic security and satisfaction of needs. Overall, an economy that is good for people and for the planet is one that functions well.

The Economic Conditions for Wide-Spread Prosperity?

To define such a society, we need first to determine the economic conditions that would be necessary for sustainable and wide-spread prosperity.

Perhaps the most famous book on economics, *The Wealth of Nations*, was written more than two centuries ago. Adam Smith published this book at the time of three revolutions: the political revolution in America and France, the nascent industrial revolution in Britain, and the intellectual revolution that he himself played a part in. The world has seen tremendous technological progress and economic growth since this time. However, significant socio-economic issues persist to this day - namely economic insecurity and pollution.

So why, given this great technological and economic progress, do these issues still persist? Why, despite the growth in global wealth, are many people still existing in precarious circumstances? Why is there environmental pollution, despite having the wealth and technological ability to prevent it? The 19th century writer Henry George tried to answer these questions in his seminal text *Progress and Poverty*. In this, he argued that it was the exploitation of the private ownership of land that caused significant levels of poverty. Evidently, this is not the sole answer for the issues that society currently faces, but we draw from his analysis a few lessons that shape our recommendations. The very structure of our economic system is at fault - one that does not place value on the well-being and happiness of people, beyond the extent to which it impacts their productivity. Our economic system is not allowing us to take full advantage of the technological progress that has been made. It is important then to fight fire with fire; to use the tools of the current system to combat its weaknesses. We seek, therefore, these answers in economics, or, as it used to be called *political economy*.

Evolution of the Political Economy

Economics is the study of activities that are, at least in part, motivated by financial gain. Economics used to be called *political economy*. This term comes from the Ancient Greek. *Polis* 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. Classical political economy includes the works of Adam Smith, David Ricardo, John Stuart Mill and Karl Marx.

Classical studies of political economy considered how the economy distributed its gains amongst participants in the system. Indeed, the question at the very heart of political economy has been one of just distribution. For example, taxation is a means to remedy the situation when distribution is inefficient or unfair, as well as being a way to pay for public goods. This makes the study of political economy, or economics, powerful, as economics is seen to have implications on the wealth of all individuals. 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 economic discourse somewhat fraught, and indeed some might say political, with the risk of undue influences from self-interested parties potentially affecting the veracity of economic theories that are thought to be authoritative.

The works of political economy by often had questions of taxation and property at their heart. Taxation is considered on two grounds: the extent to which it aids efficiency, and promotes fairness. 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, who in fact owns them, and how much tax should they face for doing so are core questions of this field's critique. Desirable economic outcomes depend not only the structure of economic activity but also on the taxation system and the system of property rights. It is also arguable that there is value in self-interest and the free market. Which however is best at providing a desirable outcome?

Our starting point is Adam Smith's model, since his work has helped to define the predominant economic view of the two centuries that followed.

Adam Smith's Model

Adam Smith, in his seminal work *The Wealth of Nations*, set out a model of how economic growth came about and how that could lead to widely-spread prosperity. Smith argued that the division of labour leads to higher levels of productivity. Smith gives the example of a pin factory, where dividing the manufacture of pins into smaller steps leads to more pins being produced for the same level of hours worked. If one is focusing on a single task, one can do this task more quickly than if one has a multitude of different jobs to do. This differentiation of different people's jobs takes place not only in a single enterprise but also across the whole economy. By specialising and trading, we can get more work done in a given number of hours.

Lets illustrate this point with an example. If an entrepreneur makes an improvement in production processes, she can lower her cost of production and still sell at the price of her competitors. In other words, she can make a profit. In the short term, therefore, the advantages of her improvement accrue to her. Thus, the profit motive provides an incentive to make improvements. Her competitors may notice the improvement that she has made and replicate it. To retain market share, they will lower their prices towards the new cost of production. A price war to capture customers may result. 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 long-term beneficiary of the technological improvement would be everyone who purchases the product.

This combination of technological progress, the profit motive and competition would lead to widely spread prosperity. Whilst the initial profit from the improvement would accrue to the entrepreneur, the long-term beneficiary from the reduced cost of production is the customer of this product. Profit in this case is a necessary but temporary phenomenon. It is competed away and in so doing society as a whole becomes richer.

However, this model relies on certain assumptions. One assumption is that 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. If I own a big monopoly with no competition, I can also own a permanent flow of profits that competition will not touch. 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 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. Then wages increase. Rent goes up as wages increase.

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. It is received by the owners of properties in valuable locations and the shareholders of companies. We argue that generalised rent leads to expensive housing, stagnating wages and wealth gains for the already rich.

Wicked Externalities

So what about the problem of pollution? Damage to other people or their interests is usually illegal. Examples could include injury or theft. However, it remains that some economic activities which damage others are legal. Driving a petrol car, which pollutes the environment, is legal and indeed normal, but nevertheless can be damaging to others' interests. Small indirect damages from many independent sources can add up to a significant total. Imagine driving into a major city at rush hour. Each car adds only a little, but together they add up to gridlock.

When one person or company's behaviour damages another, it is termed by economists as a 'negative externality'. Negative externalities are a form of economic theft, if they have not been appropriately regulated. 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. If I play loud music into the night, I damage the interests of my neighbours. I am, in effect, stealing their tranquillity from them.

Moreover, what seems acceptable when societies are small may, prove to be problematic when these societies grow. For example, Newfoundland fishermen could fish without constraints when their boats were small and their numbers low. There were plenty of fish. But then the industry grew in size. Fish stocks are not unlimited, and there is a limit on how many fish can be taken before it damages the fishery. If too many fish are taken, the fish don't get a chance to reproduce, and the fish stocks collapse. This is what happened near Newfoundland. Fish used to be so plentiful that the sea teemed with life and business boomed. The resulting exhaustion of these stocks led to a collapse in both fish numbers and opportunities for the fisherman to earn sufficient livelihoods. This overuse, and the resulting destruction, could be termed a 'wicked externality'.

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. But there is a route out of this economic situation. Growth, where it is in relation to consumption, needs to be dematerialised or physically circular. In other words, we need to decouple the impacts that economic growth has on natural resource use, and the natural world.

A place for Taxation

This discussion of the problems of pollution and precariousness leads to one of how they can be solved. The identification of the two contributory phenomena of economic rent and economic theft is the first step. This leads on to our next question: what should be done, and which policy tools can be employed to effect change?

Taxation is important in our economic model because it alters the distribution of income, and sets economic incentives for the private sector. Classical political economists, from Smith to Ricardo to Karl Marx, have argued that the taxation system or redistribution of property are corrective tools for these issues. Later in the book, this evidence is used to inform recommendations for the design of a better, more functional tax system, both in principle and in practice. However, political feasibility is a key barrier to these changes. Prioritisation of strong policy communication and smooth implementation are key tenets of any successful public policy. Developing principles for a theory of change is therefore a core priority.

Principles for Policy Change

Economists have been aware of rent and externalities for some time, and yet, taxes which would correct these economic distortions have only been imposed occasionally and partially. Here, we make the case for a simple 'change equation', in which the perceived benefits of any policy must overwhelm the perceived costs. We can address this in two ways: to make a sufficiently passionate and positive case for these taxes; or through reduction of the costs and political resistance to these changes.

To illustrate this point, let's consider one example of revolutionary change in the UK's social security system. One great milestone in the history of social end economic progress in the UK was the Beveridge report [@Beveridge1942]. Over seventy years ago, liberal economist William Beveridge presented this report for a new welfare state. It laid the basis for the post-war welfare state in the United Kingdom. Its objectives were to banish 'want, ignorance, squalor, disease and idleness'. Before the Second World War, these social evils ravaged the poor in Britain.

The war itself destroyed many buildings, homes and businesses, and increased the national debt. But yet, the post war government managed to create a comprehensive welfare state where none existed before. The post war welfare state included: the National Health Service, a system of social security (welfare benefits), a state education system, public housing, and a 'Keynesian' method of macroeconomic management aiming for full employment. The focus in this book is the social security system.

Three principles guided the Beveridge report [@Beveridge1942].

- *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.

We adapt and expand these principles to the modern context in which they now operate, through outlining our four-fold-framework for successful political change below.

###Principle 1: A Fundamental Review

Beveridge argued that Second World War and its aftermath was 'a time for revolutions, not patching'. He offered a radical approach, informed by the experience of the past but 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, practical and fair and communicated well so that these aspects are evident.

Thus, one does not make fundamental progress without thinking about what a system should *do* and what it should *be*. We address this in the 'tax in principle' chapter. We need to be passionate about the benefits that reform will bring. We consider these in the next section.

###Principle 2: Solving Great Social Evils

Beveridge 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). As we mentioned before, his report laid the basis not only for the UK's post-war 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 great societal challenges which we face now:

- *Widely-Spread Wealth*: Inequality of income and wealth, and especially that caused by arguably unfair means, and especially in the context of increasing automation.
- *High Rent on Land and Resources*: Unaffordability of renting or purchasing homes.
- *Tax Evasion and Avoidance*: Can a tax system be designed that is simpler and yet difficult to avoid?
- *Debt and Economic Imbalance*: Re-balancing the economy away from high debt and asset inflation, and towards balanced growth and wealth formation.
- *Pollution and Other Environmental Damage*: Climate change, ocean acidification, plastics, over-fishing and habitat loss which all threaten the future.

However, it's not enough to plan to solve these problems. We have to do so in a competent way that involves everyone. We cover this matter in the next section.

###Principle 3: A Social Contract Aligning Reward and Contribution

Our new welfare system should not discourage 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 suggests the case for a system with a universal component: we call this a 'citizen's dividend' (a form of basic income).

Such a system of universal benefits has practical advantages too. It involves the *integration* of the tax system with the benefits system, so there is not a separate system of 'means testing'. Means testing is simply taking money away from individuals and families as they earn more: this function can simply be carried out through the tax system. Rewarding people for full and gainful employment would be a priority for any successful system. Furthermore, we argue for an integrated skills training and work experience system.

###Principle 4: Minimising Barriers To Change

To Beveridge's three principles we add a fourth. Proposed changes should be prioritised: maximising the benefit and minimising the resistance. In short, we need to reduce barriers to change.

One barrier is the worry that some people will be made worse off by any changes. Firstly, there is the question of transitional justice; secondly, political realism; and thirdly the need to transform the interests and specialism of large companies, without provoking resistance from them. We deal with these in turn.

Firstly, there is the matter of transitional justice. 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. Resistance to taxes is typically associated with concentrated losses on specific groups. These groups can easily mobilise to resist new taxes. We need to ensure that no politically salient or vulnerable group is made particularly worse off. One example of politically savvy change is in Iran. When Iran eliminated subsidy on transport fuels such as diesel, it compensated individuals and companies with regular monthly payments. The payments were sent to frozen bank accounts and each individual and company was given a letter with the frozen bank account balance. So, the people could see the direct financial benefit of the reform, and they realised that to achieve this financial benefit, the fuel tax subsidy removal had to come into effect. This reduced the resistance to the reform, and it went through.

Let's focus now on corporate lobbying. Companies can target their own financial interest and have the means at their disposal to defend their existing interests. So an oil company can lobby against climate action. Taxes change the nature of what activities are profitable. 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 companies resist the taxes as they oppose their interests.

This is a catch-22 situation. We can't change the companies without the tax. But sometimes, we can't impose the tax without changing the company, since they resist politically. So instead, we need forms of tax that don't face such resistance, but which lead to the transformation of companies in a positive direction. We describe one option, the feebate, a little later on.

##A Four-fold Framework for Public Wealth

What improvements could such changes make? 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. We argue that our proposals can enhance genuine wealth at the level of the individual, community, nation state and planet. For each of these four realms we also define a notion of social entrepreneurship.

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. 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, but rather conceive of and try out practical solutions to our problems.

###Improvement 1: Power to the People

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).

We argue that we should 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. There would be a 'simplifying' basic income payable to everyone in society. There would also be a simplification of the system of income taxation. A standard rate of 40% is applied to all income up to the point when someone reaches the top 1% of incomes.

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. So 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 their wealth up to this target level.

Our improvements we hope, would lead to skill-based personal and social entrepreneurship. 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).

####**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

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?

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 the value of land. Another way to measure this is it is a tax on property with the value of building deductible. We have a Land Value Tax payable in cash or deferred until sale or death.

Taxing property values rather than property per se would stabilise the current property values. Where land value increases, this increase would be allocated between the local community, the municipal authority and the central government.

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

Singapore shows what has been termed the 'property state' [@Haila2015]: 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 improvements increase the rental value of the land. 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. When the metro station has been built, the property value and rent will increase. In this way, society captures the land value benefit of the new infrastructure [Purves]. We discuss this is part 8.

###Improvement 3: A Prosperous and Wealthy Country

The third 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.

A good tax system 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.

For this, we need to provide an incentive for companies like Dyson to locate into the UK. We would simplify the corporation tax system so that it is progressive but allows real invesment to be deductible. This system is similar to that seen in the USA in the post-war period. 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. There are a number of major environmental problems facing us, most notably climate change and ocean acidification, but also plastics in the ocean, habitat destruction, road congestion, over-fishing, and conventional air, water and land pollution. Environmental taxes have a few challenges: they can be unpopular, hard to design, encourage 'off-shoring' of dirty forms of industry and can be bureaucratic.

Since 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.

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 also encourage other countries to follow the lead. Such solutions should be within international laws and rules as well.

Because protecting the environment 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. Therefore, we propose a Carbon Tax. However, there needs to be an alternative to fossil fuels. 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.

####**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 of some description. Sweden was one of the first to introduce its carbon Tax. 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, the UK has seen a drop in the use of coal in electricity generation. Other environmental taxes include charges for plastic bags, congestion charges and deposit return schemes.

Conclusions

The central concern of the book is the use of the tax system for public benefit. Therefore book is devoted to how to pay for public services and social protection in a world characterised by 'wicked externalities', 'generalised rent', and (as we will deal with later) international flows of money and assets. We wish to solve the critical challenges facing our societies, including climate change, poverty and the complexity, avoidance and evasion in our taxation and welfare systems.

We wish, not just to minimise the costs of taxation, but rather to aim for taxes 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.

Because this book is about taxation and welfare in the context of the real economy and the global environment, inevitably, it overlaps with other systems. Crucial matters of overlapping concern include energy, housing and finance. Our focus is mostly on taxation in relation to the problems seen in these systems. Nevertheless we do not mean to exclude specific policy changes that are not related to taxation. Tax can help us solve our social and environmental problems, but it's not the only method for so doing.