TAXATION FOR FABIANS

Stephen Parsons
www.stparsons.co.uk

(March 2017)

Summary

The language in which taxation is discussed in Britain is inappropriate and misleading. Beatrice Webb's concept of collective consumption helps to clarify the effective operation of taxation for households. The majority of households benefit financially from the socialist nature of collective consumption. Hypothecated taxes would help households to appreciate the value of collective consumption and its progressive character. The instigation of Employment Transaction Tax in place of income tax and national insurance would improve democratic transparency and accountability. Assessed in an international context there is scope for additional taxation to address justified concerns about sustainability of British public finances. The option of developing proposals for self-financing infrastructure improvement ought to be introduced.

Fabian Principle and State Finance

By tradition Fabians have espoused democratic capture of the existing state organisation, and its adaptation to fulfil fresh social purposes.

Consider, for instance, collective consumption as part of the government's responsibilities. The notion of delivering 'benefits in kind' as the result of getting the state to act as a purchasing agent on behalf of the population as a whole, on the principle of an all-embracing consumers' co-operative, owes everything to the influence of Beatrice Webb. She had made a close study of working class co-operation and had identified the crucial distinction between consumer and producer co-operatives as providing the platform for a distinctively democratic British socialism based on people's universal interest as consumers rather than their sectarian interests as producers. And as a member of a Royal Commission concerned with welfare provision (the operation of the Poor Law) she had been struck by the insight that it was only by universal or collective provision that the interests of the poor could be successfully addressed (this subsequently provided a platform for the Beveridge design of a 'welfare state'). The state's role as a vehicle for facilitating collective consumption (of health or education services for example) may involve direct operational management of provision or it may involve commissioning or purchase from private providers.

By establishing itself as the monopoly collective purchaser of health and education the state can determine the quality characteristics of the service to be delivered for everyone and use the market force of competition amongst providers to keep down the purchase price (cost) of provision. This contrasts with the ('pure' or 'free' market) situation in which providers can use the market force of competition between consumers to ration quality of provision according to ability to pay (i.e. cheap low-quality services for the poor, more expensive better-quality services for the rich).

It is fundamental to successful maintenance of a socially purposeful state, one committed to exercising the power of collective consumption, that the operations carried out by government should be financially sustainable. And the sustainability of these public finances is assessed by reference to the level of government debt and to the degree of budgetary balance (or lack of it).

UK Government Finances in an International Context

The situation of the UK public finances has been the subject of political controversy in the wake of the Great Global Financial Crisis (2007-2010). Figures presented in Table 1 can be used to summarise the position of the UK government finances in comparison with countries of similar economic maturity. The countries chosen come from Northern Europe (France, Germany, the Netherlands), Southern Europe (Greece, Italy, Spain) and from elsewhere in the developed world (Australia, Canada, Japan, the USA).

Table 1: The State of Government Finances Before and Since the Great Global Financial Crisis

	Deficit (as % government revenue)			**Debt (as % government revenue)**		
	2007	2010	2015	2007	2010	2015
the UK	-7.6	-24.8	-11.3	134	232	293
France	-5.1	-13.7	-6.6	152	195	226
Germany	0.4	-9.8	1.5	149	196	174
Netherlands	0.5	-11.6	-4.4	114	158	180
Greece	-16.6	-27.1	-15.7	279	308	379
Italy	-3.4	-9.3	-5.5	245	274	330
Spain	4.9	-25.9	-13.3	102	184	302
Australia	1.9	-14.0	-8.3*	53	88	124*
Canada	4.4	-12.1	-3.3	171	220	247
Japan	-6.2	-25.6	-17.2*	534	650	688*
USA	-10.6	-38.8	-12.6	191	305	311

Source: OECD (recalculations by me)
Note: * = 2014

At the onset of the GGFC UK government debt stood at a level equivalent to 134% of its annual revenue. This represented a seemingly unthreatening level fairly similar to that elsewhere in Northern Europe: France (152%), Germany (149%) or the Netherlands (114%). Southern European countries such as Greece (279%) and Italy (245%) had higher levels of debt in relation to income, as did foreign countries such as the USA (191%) and, most notably, Japan (534%).

In terms of the government's budget deficit, however, the UK was not so obviously well-placed ahead of the crisis. The deficit, at 7.6% of total revenue, was exceeded amongst the European Countries, only by Greece (16.6%). Meanwhile, of the other foreign comparator countries, the Commonwealth representatives (Australia and Canada) both had surpluses rather than deficits, but Japan (6.2%) and the USA (10.6%) had deficits more like the UK.

By the end of the crisis, in 2010, both the UK debt and deficit levels had increased significantly. Of course this was true for all the countries considered here. However, the UK's relatively large deficit in comparison with other Northern European countries meant that its relative debt position had worsened, albeit not so in relation to Japan and the USA which both had larger deficit and debt ratios.

Likewise, considering the situation more recently (2015), the UK's budget deficit remains larger than other Northern European states and so UK relative indebtedness has continued to increase. Nevertheless, there are countries such as Greece and Japan (especially) which are still worse performers than the UK.

Over the whole period 2010-2015 the UK's persistent budget deficit has been a central issue of domestic political concern. But although there was an increase in VAT after the 2010 General Election the emphasis has subsequently been put on cutting expenditure rather than raising revenue by additional taxation. This neglected option deserves some reconsideration.

Revisioning the Government's Financial Position

In order to appreciate the government's financial problem it is helpful to distinguish between three main aspects of government spending:

(i) collective consumption – the purchases of important everyday services that the government makes on behalf of the population as a whole, acting like the management of a purchasing co-operative and thus obtaining benefits of scale in buying these services (the biggest elements are education and healthcare);
(ii) infrastructure – the maintenance of the infrastructure within and around which economic activity is built and by which it is facilitated (this includes the 'hard' infrastructure such as transport facilities as well as the 'soft' infrastructure such as the legal system); and
(iii) public alms – payments made to people in recognition of their limited ability to earn sufficient to meet their needs (the biggest element of this being old age pensions).

In order to obtain the money to meet its spending commitments the government uses taxation. The main sources of tax revenue are:

(i) taxes on spending – general transactions taxes (such as VAT) or special sales taxes on particular products (such as excise duties and stamp duty);
(ii) personal or household levies – such as council tax or licence fees;
(iii) taxes associated with employment – levies on payments made to employees (national insurance contributions and income tax); and
(iv) taxes levied on corporate earnings

The Language of Taxation

The terminology in which we talk about taxation is perverse. It distorts perceptions of the way we pay for public services. And it makes a mockery of the political debate about public expenditure and its funding.

Conventional wisdom distinguishes between direct and indirect taxation. Quite absurdly, so-called 'indirect' taxes are those which ordinary people pay directly: taxes such as council tax, excise duties and, most obviously, VAT (paid whenever you buy something in a shop and itemised on every till receipt). Yet it is on the basis of the revenues from these taxes, which we pay directly ourselves (like subscriptions), that the government is able to fund the purchases it makes on our behalf: the major items of collective consumption delivered to us 'free at the point of use' with the state adopting the role of a giant consumers' co-operative and acting as our purchasing agent. And looked at in this way the state is doing a defensibly decent job.

Consider the evidence presented in the following tables.

Households, Taxes and Public Services

Table 2 presents, in skeleton form, the financial situation of households categorised according to levels of income. The 30% of households with least money income are represented as ‘Low-money Households’. The largest category, ‘Middle Income Households’ (40% of the total), consists of those households in the middle of the range. Then the 30% of households with the most money income are subdivided into the 20% described as ‘comfortable’ and the upper 10% described as ‘secure’.

The figures identify original income: mainly take-home pay resulting from employment but also including occupational pensions and investment income. This original income is supplemented by cash benefits: these include state pensions (the largest item for all the categories of household), tax credits and housing benefit. Together, original income and cash benefits give total income out of which households directly pay so-called indirect taxes (such as VAT and excise duties) and official charges such as Council Tax and the BBC licence fee.

Table 2: Taxes Paid and Benefits Received by Households

	Low-money Households	Middle Income Households	Comfortable Households	Secure Households	All Households
n households	8054	10738	5373	2690	26 856
% households	30	40	20	10	100
	£ per household				
Original Income	6 947	22 370	43 903	83 054	28 118
Cash Benefits	8 478	7 090	4 075	2 470	6 441
Total Income	15 425	29 460	47 978	85 524	34 559
‘Indirect’ Taxes + Council Tax	4 868	6 778	9 497	13 291	7 401
Value of All ‘Benefits in Kind’	7846	7131	6117	5614	6 991
within which:					
Education	3150	2550	1893	1651	2 508
NHS	4437	4428	4038	3692	4 279

Source: “The effects of taxes and benefits on household income 2014/15” (ONS, May 2016)

It’s no surprise to find that the households with the most money pay the most tax: because they spend the most. Mind you, the disparity in household income gives Secure Households (£85,524) five-and-a-half times the income of Low-money Households (£15,425) while they pay taxes (£13,291) that are just about three-times as much as Low-money Households (£4868).

But the most important thing to notice is that all-in-all the cost of the public services delivered 'free at the point of use' as 'Benefits in Kind' is completely covered by the taxes paid directly by households. Households as a whole (All Households) pay £7401 annually and in return obtain £6991 worth of benefits in kind (mainly as education and health services). The majority of households (Low-money and Middle Income Households; together 70% of all households) get more back than they pay in.

By convention HM Treasury eschews the notion of hypothecation (i.e. association of particular taxes with particular elements of expenditure). This is understandable as a sensible precaution against the offering of hostages to fortune. However, this prevents an otherwise very useful and potentially effective approach to communication. The association of benefits in kind with taxation paid directly by households out of take-home pay and cash benefits (public alms) would introduce a healthy element of transparency into public debate about the funding of these public services. It would make it very clear that people are collectively getting what they collectively pay for (or collectively paying for what they collectively get).

Households' Shares in Contributions and Receipts

In Tables 3 and 4 the figures are presented so as to allow a more socio-political evaluation. Table 3 shows the percentage share of each household type in each overall total contribution (tax) or receipt (benefit).

Table 3: Taxes and Benefits Expressed as Households' Shares

	Low-money Households	Middle Income Households	Comfortable Households	Secure Households	All Households
n households	8054	10738	5373	2690	26 856
% households	30	40	20	10	100
	figures in percentages				
Original Income	7.4	31.8	31.2	29.5	100.0
Cash Benefits	39.5	44.0	12.7	3.8	100.0
Total Income	13.4	34.1	27.8	24.7	100.0
'Indirect' Taxes + Council Tax	19.7	36.6	25.7	18.0	100.0
Value of All 'Benefits in Kind'	33.7	40.8	17.5	8.0	100.0
within which:					
Education	37.7	40.7	15.1	6.6	100.0
NHS	31.1	41.4	18.9	8.6	100.0

Source: "The effects of taxes and benefits on household income 2014/15" (ONS, May 2016)

From Table 3 we can see that the 30% Low-money Households together only account for 7.4% of all households' original income. The Middle Income Households account for 31.8%. And together, the 30% Comfortable and Secure Households have 60%. The distribution of Cash Benefits, which is deliberately skewed towards the least well off households, increases the share of Low-money Households in All Households' total income, nearly doubling it to 13.4%. Still the 10% most financially secure households account for a quarter (24.7%) of all households' income.

As is only to be expected, given that illness and accident are just as likely to strike households wherever they lie in the income spectrum, the benefits of the health service are shared across the categories of household in line with the proportion of total households that they represent: the 30% Low-money households benefit from 31.1% of health service expenditure; the 40% Middle Income Households get 41.4%; the 20% Comfortable Households get 18.9% and the 10% Secure Households get 8.6%.

Nevertheless, the better-off households do contribute proportionately more to the funding of public services. The 10% of Secure Households pay 18% of the taxes (i.e. they pay nearly double the share of taxation than their share in the total number of households). Whilst the 30% Low-money Households contribute 19.7% of the taxes (i.e. a lower share of taxes than their share in the overall number of households)

It could be argued that the operation of the system of collective consumption described here is providing services to households according to their needs and raising the money to pay for them according to ability to pay. And this may qualify as effectively a version of socialism: a version of socialism that Beatrice Webb would recognise and that Fabians ought to celebrate.

Taxes and Benefits in Household Context

Although, as we have seen, households across all income categories benefit to a similar extent from the collectively-purchased public provision such as education and health services, it is instructive to consider the degree of financial significance these services have in different household financial contexts.

To make this easier to do, in Table 4 the financial data from Table 2 is re-expressed in percentages relating to the total income available for spending by each of the household categories.

Table 4: Benefits and Taxes in Relation to Households' Total Income

	Low-money Households	Middle Income Households	Comfortable Households	Secure Households	All Households
n households	8054	10738	5373	2690	26 856
% households	30	40	20	10	100
	figures in percentages				
Original Income	45.0	75.9	91.5	97.1	81.4
Cash Benefits	55.0	24.1	8.5	2.9	18.6
Total Income	100.0	100.0	100.0	100.0	100.0
'Indirect' Taxes + Council Tax	31.6	23.0	19.8	15.5	21.4
Value of All 'Benefits in Kind'	50.9	24.2	12.7	6.6	20.2
within which:					
Education	20.4	8.7	3.9	1.9	7.3
NHS	28.8	15.0	8.4	4.3	12.4

Source: "The effects of taxes and benefits on household income 2014/15" (ONS, May 2016)

For Low-money Households the value of 'Benefits in Kind' is equivalent to a 50% addition to household income. And for Middle Income Households these 'Benefits in Kind' represent the equivalent of a 25% income increase. But for Comfortable and for Secure Households the value of 'Benefits in Kind' is less significant: 12.7% and 6.6% additions respectively. These evident disparities in financial significance may affect the degree of importance attached to these public services by households in different income brackets.

This observation applies equally to the incidence of cash benefits.

The figures show that more than half (55%) of total income in Low-money Households comes from cash benefits whilst only 2.9% of total income in Secure Households and 8.5% in Comfortable Households comes from this source (mainly state pensions and maternity benefits). This disparity suggests that it will be very difficult for the 30% Comfortable and Secure households to appreciate the degree of importance that will inevitably attach to issues of changes in benefit rates and rules of entitlement amongst the Low-money households to whose incomes these contribute so much more significantly.

However, because nearly a quarter (24.1%) of Middle Income Households' total income is provided by cash benefits, and this group represents 40% of all households, it appears likely that an overall majority of households will have a significant stake and be well-informed if they are allowed to participate in public debate concerning these issues.

Future Prospects for Collective Consumption

Thinking now about the financial prospects of the state in terms of its responsibility for collective consumption in the context of an ageing population (i.e. a larger number of older people with age-associated demands for health and social care services): this prospect is usually, and not unreasonably, expected to require increased expenditure even if there are unprecedented improvements in productivity throughout the system of health and social care. However, the analysis provided above suggests that adjustment to existing ('indirect') transactions taxes would produce increased funding for care-provision in a relatively progressive manner without increasing the budget deficit. In fact, in tune with the report of the Dilnot Commission, the increase in the rate or level of tax would be quite modest. And hypothecation as suggested would make this visible.

The Deficit: Public Alms and Infrastructure

Having demonstrated that the budgetary provision for collective consumption is already closely balanced (with expenditure on these benefits in kind being covered by households' payments of 'indirect' transactions taxes), it is clear that the budget deficit is, by and large, attributable to the other ingredients of public expenditure and taxation: on the expenditure side this means public alms and infrastructure; on the taxation side this means levies on employment (misleadingly labelled and conventionally described as 'income tax and national insurance') and other business taxes (e.g. corporation tax).

Talk About Taxation

Just as it's absurd to describe taxes paid directly by households as 'indirect' taxes, so it's equally absurd to describe income tax and national insurance as 'direct' taxes when they are not generally paid directly by individuals. Most of us (who are not self-employed) do not pay income tax or national insurance personally. That's because our employers transfer money to us through the PAYE system and simultaneously they transfer money to the government, as 'income tax' and 'national insurance', notionally to save us the trouble of doing so. But, in effect, what they're doing is simply paying a levy to the government and leaving us with the amount of money that will persuade us to work for them. In reality we all have what you might call 'rational expectations': we all make judgements about wages and salaries based on 'take-home pay'; we all take decisions about offers of work after making allowance for 'stoppages'. And certainly everybody recognises (in the light of numerous broadcast documentaries and News-items) that unemployed people evaluate offers of work in relation to post-tax earnings *vis-à-vis* out-of-work benefits.

Government Income and Infrastructure

It is deeply engrained within our culture that the government doesn't have any 'money of its own' but only the money that it takes from us (we the people, who shalln't be taxed without representation). But this is nonsense. In fact the government fulfils a valuable economic function for which fees are not only appropriate but actually essential (thus meaning that the government does indeed earn 'money of its own').

In fact one of the easiest ways to levy a tax that is proximately in proportion to the level of activity which an individual business represents is to require payment of a transaction-tax-equivalent on wages and salaries (i.e. employment). And this approach is appropriate because a business's employment of workers is the best available indicator of the level of pressure on the country's infrastructure resulting from the operation of that business. Essentially this tax levied on payments to employees is a surrogate charge for the use of the infrastructure as a business input. It stands in for an explicit rent, payable for using the infrastructure (both hard and soft infrastructure: roads, traffic regulation and policing; courts, contract law and its enforcement, as examples). This is what income tax and national insurance contributions represent in practice. How the government spends the proceeds from this taxation is a decision for us to review as electors (so having, theoretically, an equal or democratic say in how the money's spent) – currently it's predominantly spent as public alms (mainly pensions). Uncoupling employment taxes from the fiction of personal contributions by instigating an Employment Transactions Tax could liberate public discussion of alternative schemes for the distribution of public alms.

From the point of view of footloose business investment, deciding where to locate their operations will involve employers considering not just the payments to workers necessary to secure their services but also the liability for associated taxes and social insurance costs. Crucial to these deliberations must be the productivity of the local workforce, and this will be directly influenced by the quality of the infrastructure within which they will be operating. And based on this understanding, getting employers to pay employment taxes, via PAYE charges linked to payments to employees, is a way of recouping the cost of maintaining that infrastructure. But it should also be recognised that the government bears a significant responsibility to assure the quality of the infrastructure in order to maximise the productivity of the workforce. This means ensuring that the infrastructure represents value-for-money to the employers who are paying for it.

Taxation in an International Context

Recognising the international context in which decisions about tax-rates have to be taken, where countries are competing as locations for business activity, it is interesting to examine the UK's relative position. Relevant data is presented in Table 5.

Table 5: Comparative Tax Rates 2015

	Government Revenue (as % GDP)	**ETT Rate Equivalent (%)**	**Corporate Tax Rate (%)**
the UK	**38.5**	**44.5**	**20.0**
France	53.5	94.2	34.4
Germany	44.7	97.6	30.2
Netherlands	43.3	56.7	25.0
Greece	47.9	64.7	29.0
Italy	47.8	96.1	31.3
Spain	38.6	65.6	25.0
Australia*	33.5	39.7	30.0
Canada	39.8	46.2	26.8
Japan*	35.8	47.5	30.0
USA	33.5	46.4	38.9

Source: OECD (recalculations by me)
Note: * = 2014

The first column in the table shows the overall 'tax take' of the state as a proportion of national income (GDP). These figures include taxes paid by individuals and households in addition to taxes paid by organisations. Because governments in different countries have different portfolios of activities for which they act as agencies, it is difficult to assign much significance to differences amongst these figures. More pertinent, because of their potential effect upon commercial decisions about international location, are the specific taxes related to business reported in the next two columns of the table.

The system of taxation, in which levies are paid to governments by employers notionally 'on behalf of' the workers they employ, operates across the economically developed world. And there are usually also explicit employer payments or contributions in addition to this. The second column in the table illustrates what happens if the whole amount of employment levies (i.e. both those that are being made notionally 'on behalf of' their workers - as 'income tax' or social security/insurance 'contributions' – and those made as explicit payments by employers *qua* employers) is expressed as a transactions tax (an Employment Transactions Tax, something like VAT) explicitly levied on payments to workers (purchases of labour). You can see that it varies quite widely: ranging from 39.7% in Australia to 97.6% in Germany. The UK (44.5%) is towards the lower end of the range.

It's apparent that the taxation cost of employing workers in the UK is currently very competitive (i.e. low) compared with that in other European countries. An increase in the UK's implicit Employment Transactions Tax rate from 44.5% to nearer the Dutch level of 56.7% (and with the increase explicitly imposed on employers not workers) could be expected to eliminate the budget deficit and leave some billions over. And if the UK were remaining as a member of the European Union, being part of the Single Market and benefiting from the same protection as other members of the customs union, this would be a plausible recommendation.

Considering Brexit however, we need to evaluate the UK's competitive position with reference to non-EU countries as well. Direct comparison suggests that there is less scope for increased ETT than in the EU context, since implicit ETT rates in the group of countries considered here are roughly similar to the existing UK rate (i.e. much lower than existing EU rates). But turning to comparison of corporation tax rates, shown in the third column of figures, where the UK rate is clearly lower than rates elsewhere, this suggests that there may yet be scope for the application of a higher ETT rate as a trade-off against this lower corporation tax vis-à-vis the non-EU foreign countries. On the other hand a higher rate of corporation tax may be appropriate instead.

In any case, an eventual transition to explicit Employment Transaction Tax in place of national insurance and income tax would provide people with a more truthful account of economic reality and so ought to be encouraged.

Self-financing Infrastructure Improvement?

It is understandable that, given the persistent UK budget deficit, there will be caution about making extra commitments to government expenditure. However, not all the country's infrastructure is publicly owned: housing, for example, is both private and public. And expenditure that is directly compensated by revenue ought not to be automatically suspect. For example, when the government 'bailed out' the banks, it gave them the money immediately, in return for shares that will be sold at a future date (thus recouping the cash in the long term). So why shouldn't the same principle apply in the short term? Why doesn't the government just commission some house-building from house-builders, and recoup the money by selling the houses at auction? If the time between placing the order and holding the auction was inside a financial year, there wouldn't be any addition to the budget deficit or national debt.

Some Conclusions

The system of collective consumption currently being operated, through the existing mechanisms of the state, effectively (if unintentionally) embodies the thinking of Beatrice Webb. It is essentially socialist and progressive in character.

The costs of government providing 'benefits in kind' (such as health and education services) as items of collective consumption are fully met by households' contributions paid directly as taxes (including taxes misleadingly labelled 'indirect') out of take-home pay and cash benefits. Hypothecation of the appropriate taxes for the purposes of such collective consumption would improve transparency of the financial relationship between people and their public services.

Reform of taxes on employment to create an explicit Employment Transactions Tax would abolish the false conception (embodied in the language of 'income tax and national insurance') that these are personal charges imposed by the state on the working population rather than legitimate fees charged to businesses for the maintenance and improvement of the public realm (infrastructure) which provides the essential framework that facilitates and supports commercial engagement. Such change would also liberate public discussion regarding spending of the proceeds of such taxes by divorcing proposals for public expenditure (other than those associated with collective consumption) from the threat of personal liability.

There is justified concern over the UK government's budget deficit. Government spending on infrastructure and on public alms is not matched by revenue. Because of constraints on levels of taxation, resulting from international business mobility, the government ought to consider options for self-financing of infrastructure improvement (such as the commissioning of house-building for sale at auction).