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Report On The Funding And Structure Of Local Government

Part II - Philosophical Issues

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1. INTRODUCTION

This part of my report addresses the more philosophical issues relating to the proper roles of Local and Central Government, (section 2) as well as the principles that should underlie any taxation designed to fund them, (section 3). I believe that any discussion of taxation, which does not also address the issue of **representation**, or any discussion of representation that does not consider the issues surrounding taxation, is likely to be futile. It is worth remembering that the American Declaration of Independence was precipitated by just this issue. This becomes particularly important when considering the proper balance of funding and the proper balance of power between Local and Central Government.

It is almost traditional for any paper addressing the issues around taxation to contain a few paragraphs dealing with the principles which “ought” to underlie any taxation system. There are good reasons for this. Although many books and pamphlets have been written on the subject, it is extraordinarily difficult to remove one’s own political prejudices when discussing this subject. Whilst I have tried to disentangle my own prejudices from other views when writing this report, I recognise that I may well not have succeeded. I have therefore included this section in order that the reader may see “where I am coming from” in this regard.

Very few people would argue that taxes ought to be “unfair”! However, people do differ quite markedly on what they consider to be “fair” or “unfair”. Like schoolchildren in the playground, the terms “fair” and “unfair” are often bandied about virtually as synonyms for “what I like” and “what I don’t like”. Many people appear to believe that those taxes which force they themselves to pay more are less “fair” than those which enable them to pay less. However they can only all be right if taxes are virtually zero! It would seem that “fairness” in taxation is a nebulous concept lying mainly in the mind of the person doing the thinking.

In addition to the confusion between “fairness” and “what I like”, there is also a confusion between “fairness” and “ability to pay” and between “fairness”, “ability to pay” and progressive versus regressive taxes, as well as between “fairness” and a lack of “hardship”. I have therefore included a discussion of what I mean by the terms “fair” and “ability to pay”, in section 4 and progressive *versus* regressive taxes in section 5 to this part of my report. Finally, because of the important role played by property based taxes in funding Local Government, both currently and in the past, I have included a general discussion on property taxes as section 6 to this part of my report. This particular section also contains a brief discussion of what I mean by “local” taxes.

2. THE ROLES OF LOCAL AND CENTRAL GOVERNMENT

The growing belief that Local Government is “failing” in some way is probably the main reason for the commissioning of the “official” Lyons Inquiry. There are two main symptoms of this concern:

- Turnouts at local elections have been very low of recent years.

- Local taxation has become increasingly unpopular with the electorate.
 - We only got the Community Charge, (*a.k.a.* the poll tax), because the Rates became so unpopular and we only got the Council Tax because, in its turn, the poll tax also became unpopular.

Most of the pressure from the electorate seems to be in favour of **reducing** the share of local revenues collected locally and increasing the share contributed by Central Government. Paradoxically however, most people also seem to want **more** local autonomy or local democracy! These apparently contradictory views probably represent an inchoate feeling that the state is too big and that Council Tax is unfair and / or too high. These views are most definitely **not** contradictory, (although they may not necessarily be right!).

2.1 What is the purpose of Local Government?

Any proposals for the reform of the relationship between Central and Local Government needs to begin by addressing the question of what Local Government is really **for**. Is the purpose of Local Government simply to manage, (the **how** of), local services or is it to prioritise and choose which services to offer, (the **what**)?

If the purpose of Local Government is **management** of local affairs, then there is little point in either local elections or local democracy. The history of elected management is pretty discouraging, (consider what happened to the Co-op and compare this with the performance of the supermarket and other retail chains). Indeed, for reasons of **clarity** of accountability, local people should know whom to blame when things are not to their liking. If they elect local managers then Central Government can say that it was all the fault of the local electors for choosing such idiots. On the other hand the local managers can say that Central Government gave them an impossible job given the constraints and so on. If Central Government selects its local managers for itself, then there is only “one bottom to kick”. On the other hand, there is much to be said for electing local **advisors**. If we elect such local advisors and they **publish** their advice, then local people will know whom to blame when they are dissatisfied. If the advice was followed, then it is the locals; if not, then it is Central Government

On the other hand if Local Government is expected to **choose**, then one of the choices that they must be allowed to make is between high tax and high spending on the one hand and lower tax and lower spending on the other. Equally they need to be able to choose what to **prioritise** for any spending. This is not something that Central Government can choose for them. It is something where local democracy is **vital**. Unfortunately if we mix up management with policy, we tend to get the worst of both worlds. If Central Government funds are mixed up with local funds then local taxation becomes a myth. All that we have is locally **collected** tax but not locally **determined** tax. Central Government can always adjust its portion of the funding so as to make a choice of how much tax to raise locally irrelevant to the services that can be delivered, (as has now happened). If Central Government funding is to continue, then it should probably bear a **direct** relationship to the funds collected locally, (and not an inverse one)! This is essential if we are to have a truly local tax.

I would suspect that what most people want is **local** decisions about, and **local** funding of, **local** affairs coupled with **national** decisions about, and **national** funding of, **national** affairs.

Unless there are **some** taxes which are collected locally and particularly whose **rates are set locally**, then any local autonomy that still remains is likely to become a sham. Only if those who decide how to spend the money are able to decide **how much** to spend and collect by way of tax are they truly **accountable**.

2.2 How can we ensure accountability?

There are really only three basic approaches to **clarifying** the issues surrounding **who**, (i.e. Central Government or Local Government), is responsible for **what**. Without this clarification there can be very little true **accountability**. The three basic approaches available are:

- **Basic approach 1** - Central Government collects all the taxes for local services and distributes the resulting funds according to some measure of “need”
 - This would make it absolutely clear who was responsible for any under-funding or waste and put accountability where it belongs - with Central Government in this instance.

Unfortunately, under any arrangement of this sort, if local people or local councils were to have any say at all they would have a perverse incentive to inflate their budgets / statements of need in competition with others. As a local you would get all the benefit but only part of the costs - unless others play the game as well as, or better than, you do. This is likely to lead to local profligacy - and higher taxes overall. It is probably no accident that the Audit Commission said in a recent report: *“We found that increases tend to be higher in authorities that are not directly elected – 13 of the 20 highest increases in Council Tax were agreed by police authorities.”*

One would suspect that the reason that unelected bodies are responsible for the largest Council Tax precepts is that they have no real accountability. They do not collect the taxes and cannot be dismissed when the taxpayers find the corresponding tax bills too high. This “solution” really does remove local accountability.

If all taxes were to be set and collected centrally, then we would need to ensure that, so far as is possible, local expenditure is made wisely and reflects local needs. One way of achieving this is by using the type of information and control tools common in industrial conglomerates to bring the management of their **subsidiaries** to account in terms of **efficiency**. In such a situation local management **proposes** but central management **disposes**. Typically local management prepares a budget for the subsidiary for which it is responsible and top management allocates resources after considering how much is available in total, what the priorities for its different subsidiaries are, and whether the amounts being requested are “reasonable”. The reasonableness of any request, and the performance of the subsidiaries concerned, are often judged by what are known as management ratios.

With wholly centralised funding, the use of management ratios would enable local and national electorates, (and governments), to get some sort of “handle” on which Local Authorities tended to be frugal and which ones tended to be extravagant. Without some sort of approach like this, it would only be possible for the electorates to see that Local Authorities **in general** were overspending. It would not be possible to see **which ones** were.

However, even with such an approach, local management is really only accountable to the national taxpayers through the agency of Central Government. Local people will be able to see what is being done in their name but they will, at best, only be able to **influence** it. They certainly could not **control** it. In such a situation, where Local Government is really only the agent of Central Government, there would be no real point in local elections.

However, even with 100% Central Government funding, the relationship between Central Government and Local Government does not form an exact parallel between a holding company and its subsidiaries. No sensible holding company wants any of its subsidiaries to fail. They want them all to do as well as possible. Would this also be true of Central Government’s “subsidiaries”? One might suspect that the temptation to make one’s political opponents appear incompetent and stupid might prove to be irresistible. This is where the subsidiary model might break down - although such breakdown is by no means inevitable.

This type of approach is **not** what the Local Government Association wants. They recognise that the balance of funding is inseparable from the balance of power - “*He who pays the piper calls the tune*”. Local Governments want more power and so, quite logically, they want more of the tax burden to be determined and collected locally - e.g. by “repatriation” of the business rates, (the NNDR). However, given that businesses do not have votes, it is difficult to see how such a move would improve accountability. This is very much a **political** issue - and in the end it won’t be possible to fudge it. In many ways it resembles, on a smaller scale, the recent unease over what was the proposed European Constitution.

- **Basic approach 2** - Local Government collects all the taxes for local services and decides how the proceeds should be spent
 - Once again this would make it absolutely clear who was responsible for any under-funding or waste and put accountability where it belongs - with Local Government in this instance.

Unfortunately, unless what are currently deemed to be the responsibilities of Local Government were to be reduced substantially, then under any arrangement of this sort local taxes would have to increase quite sharply. The increases would be largest in those Local Authority areas which currently receive the largest subventions from Central Government. Although it is not always the case, the size of these subventions is often driven by genuine need or social deprivation.

- **Basic approach 3** - Local Government sets a local tax rate and Central Government provides additional funds to Local Authorities according to some multiplier of local taxes. Local Government would decide on all local spending priorities. The multiplier could be different for different Local Authorities according to some measure of “need”
 - In this situation accountability would belong with Local Government. However, unless the multiplier could be varied, there would be little accountability to the general, non-local taxpayer who would be providing the additional funds.

Unfortunately if the multiplier could be varied, there would be a real and perverse incentive for Central Government to manipulate this multiplier for political purposes. (Many people believe that this already happens under the existing FSS and Resource Equalisation systems). This would remove **local** accountability - without replacing it with **national** accountability

Moreover, if the local multiplier were not the same everywhere, then those Local Authorities which raised the smallest proportion of total expenditure locally would have an incentive towards extravagance - particularly if they could return much of the locally raised money to their electorates in cash or near-cash forms, (e.g. in vouchers). This problem would also be exacerbated if much of the locally raised tax were actually paid for by a specifically targeted benefit - like Council Tax Benefit!

On the other hand, if the multiplier were uniform across all Local Authorities, then those areas with the greatest “need”, whose residents are, on average, also likely to have the least ability to pay, will end up having to raise more local tax and at higher rates, than Local Authorities in a more fortunate position. Such a situation would probably only be tolerable if local expenditure covered only the “extras” with “essential services” being the responsibility of Central Government.

From the above it is clear that none of the basic solutions is ideal. What we need is some sort of hybrid. The existing Council Tax system is, of course, a hybrid - but a peculiarly bad one!

There are some fundamental problems associated with any system that is reliant on Central Government grants. These become more apparent the larger the proportion of total expenditure financed by Central Government becomes. The extreme case would be where Central Government collected all the funds and decided what should be done with them, (as with basic approach 1).

- It is obvious that the greater the proportion of local expenditure that is funded by Central Government then the greater is the scope for redistribution. Areas which meet with Central Government approval, (perhaps because they vote the “right” way), can always be subsidised by other areas.

- Local Authorities tend to become less efficient. It is true that councils are required under the 1999 Local Government Act to deliver continuous improvement through the application of best value, including the identification of savings through more economic, efficient and effective ways of delivering services. However this seems to be a law more honoured in the breach than in the observance! To rely on a law of this sort when removing some of the sanctions on inefficiency looks to be optimistic in the extreme! Most of those who have worked with both public and private sectors believe that there is enormous scope for efficiency savings in the former.
- Whenever there are problems with the national finances, Central Government can simply reduce the amount that they give to Local Government. This is particularly tempting when there is an elected Local Authority in a position to take any flak. “Ring fencing” specific central taxes for Local Government is not really much of an answer to this.
 - Ring fencing (hypothecating taxes) is really an illusion. When new taxes are introduced they are often presented as though they are hypothecated to something of which the taxpayer will approve in order to soften the blow. However such hypothecation rarely survives. As long as the majority of taxes are unhypothecated, hypothecation itself is really an illusion. The Government can always divert general taxes that would have been spent on the hypothecated activity to other purposes, (consider what they have done with respect to funds from the national lottery). Only when the total take from the supposedly hypothecated tax exceeds the amount spent on the service, (for example: roads and the taxes on motorists; NHS expenditure on smoking related diseases and tobacco tax), to which it is sometimes presented as if it were hypothecated, is the hypocrisy of the Government clear for all to see.
 - The only ring fencing mechanism that is bound to work is when:
 - Those who spend the taxes also collect them
 - Those who collect and spend these taxes have no other responsibilities. Central Government does not tell them what services they must provide
 - Those who collect and spend these taxes receive no subventions or funding from any other source, nor do they have to pass on any of the revenue raised to anyone else.

There is no reason why, in the interests of savings in collection costs, Local Authorities should not band together to collect, on a central basis, any taxes designed to replace the Council Tax.

It would appear that there needs to be a complete **separation** between Local and Central Government: a complete separation of **powers**; a complete separation of **funds**; and a complete separation of **people**, (councillors as well as civil servants). If councils and Central Government each had separate and well defined responsibilities and separate sources of funds, then councils would have to **manage** and fund **their** decisions and Central Government would have to do likewise.

In such a situation Central Government would be responsible for fully **funding** and **managing** all “essential” services, like education, social care and policing. Local people could be represented through elected advisory bodies, (as used to happen in Hong Kong - where it worked well), which would be quite separate from the local council. However it would be Central Government that would have the final say. Even then, there will always be a requirement for local input. Central Government, on its own, cannot provide this. An advisory body and a separate executive body would appear to be the way forward. The executive body could then make local choices and decisions.

Local Government would be responsible for providing all those little “extras”, like culture, sport, parks, car parking, local traffic management (?) and local planning that make communities what they are. At one extreme they could even do nothing and spend nothing - if that is what the local electorate wanted! Some increases in local spending are desirable but the choice about whether those are to be met by reducing spending on other services, increasing charges or increasing local taxes are decisions elected local councils should make.

3. PRINCIPLES OF TAXATION

3.1 The purpose of taxation

The primary purpose of taxation is to raise revenue in order to fund those activities that Local and Central Governments think that they “ought” to undertake for the “benefit” of their electorate. It is **not**, at least in my opinion, simply to extract money from individuals however rich or poor, or however deserving or undeserving they might be. This is not to say that help for the “poor” or the “deserving” is not necessarily a “proper” activity for either Local or Central Government. Any such help will inevitably have to be funded from taxes on the “less poor” and / or the “less deserving” - whoever they might be. It simply says that any criticism of an otherwise desirable tax on the grounds that it helps the “rich” is simply stupid. On the other hand, an otherwise desirable tax that might **harm** the “poor” needs to be much more carefully considered. Such a tax could quite legitimately be criticised on these grounds. The “rich” can look after themselves, (whether they gain or lose), whereas the “poor” probably can not. It seems to me to be likely that most people would agree that a community “ought” to take care of those of its members who, for one reason or another, are not able to take care of themselves.

However, listening to some people, one could be excused for thinking that many of those who advocate redistribution of wealth or income are more interested in **confiscating** wealth and / or income, than they are in giving the proceeds to others. I wonder how many of our inveterate class warriors have ever asked themselves what would happen if all those people with highly paid jobs in the City of London were to decide to take six months unpaid leave. They could easily afford it. But could the rest of us cope? Remembering that these people are responsible for a very significant proportion of our total foreign exchange earnings, (approximately \$19Bn net p.a.), and also that this country can not grow enough food to feed itself, might not the rest of us starve? The Exchequer would also be faced with a difficult problem. More than 20% of the yield from Income Tax comes from the top 1% of earners. Would the Treasury go bankrupt and would public services have to be cut drastically? Perhaps we should cherish those private sector people who earn high incomes. We certainly shouldn't denigrate them.

Having said this, I will concentrate mainly on the revenue raising aspects of taxation in this part of my paper - subject to the proviso that the methods adopted should be “fair” and “socially just” as well as being economically sensible. I discuss the meanings of these terms in later parts of this section of the report.

3.2 Good and bad taxes - which taxes are “sensible”

In devising any tax, regardless of which form of Government, Central or Local, it is supposed to finance, attention should probably be paid to four main criteria if it is to be a “good” tax:

- It should be "fair", non-discriminatory and acceptable - especially by those who have to pay the lion's share of it and to those whose ability to pay is lower
 - Unfortunately people differ in their concepts of what "fairness" actually means. It is a sad reflection on our society that people don't vote to pay taxes. They vote for **other** people to pay taxes. If we want more of our own money to be spent on (say) the NHS, then all that we have to do is to write out the appropriate cheque. We only need to resort to the morally dubious expedient of coercion through the ballot box if we want to force others to pay more for our own pet projects.

Taxes which are widely seen as "unfair" tend to be evaded and / or avoided. In extreme cases they can even lead to civil unrest.

- Taxes that are paid by the many, like the poll tax or petrol fuel duty, tend to be very unpopular whereas taxes that are paid by the few, like Higher Rate Income Tax, tend to be much more popular with the selfish majority. It is noteworthy that, as more people get caught by them, both Higher Rate Income Tax and Inheritance Tax are now appearing to become less popular. One suspects that this is indeed purely selfishness. It was OK, and even popular, when only a small number of other people's incomes or estates were hit. Now that house prices have risen to the point where the many are faced with the prospect of paying Inheritance Tax for the first time it suddenly becomes “unfair”. Similarly as more and more “ordinary” people like policemen and schoolteachers are having to pay higher rate income tax through the effects of so-called “fiscal drag”, opposition to it is growing.
- It will not cause undue hardship for any of those who have to pay it - taxes have to be affordable and related to “ability to pay”

- Its imposition will do minimum damage to the economy
 - No **transaction** based tax really meets this criterion. Sales taxes, customs and excise taxes and taxes on earned income are all transaction based taxes. The whole economy is based upon transactions. Indeed, this is the main basis for measuring GDP. Without transactions no economy would exist. Equally no economy would exist if everybody had the same tastes and abilities (so much for equality!) The transactions that do take place in a free market economy are those where each side values what it receives more highly than what it gives up. Any taxation levied on such a transaction tends to eat into this surplus of value created for one or both parties. With high taxation, there are simply bound to be some transactions which become unattractive to at least one of the parties. Such transactions would not then take place and the economy would suffer.

Most local transaction based taxes are especially damaging to the local economy since they tend to **displace** economic activities to other localities where transaction based taxes are lower. This is especially true of local sales taxes and becomes truer the smaller the local areas that are allowed to set their own taxes become.

- Classical economic theory would suggest that **all** subsidies or taxes designed to encourage or discourage particular forms of economic activity, being transaction based, should actually harm the economy. This means that taxing "bads" like road fuel, tobacco or alcohol, or subsidising "goods", like railways, ought to cause real damage. In practice however, taxing road fuel, tobacco and alcohol is not nearly so damaging as classical economic theory would indicate, because these goods have a very low price elasticity of demand. This is what makes them such a good source of revenue - and taxing them such a correspondingly bad way of reducing consumption!
- The tax must be straightforward and be easily understood both by those paying it and by those collecting it
 - Complex taxes that are difficult to understand are often seen as “unfair” - largely because they are thought of as either being “haphazard” or being manipulated for political purposes. For example, such strictures are widely levelled at the Council Tax.
 - Complex taxes are also relatively easy to avoid and tend to be difficult to collect cheaply, easily and efficiently. Indeed, these criteria of ease and low cost of collection and difficulty of avoidance are often seen as the key criteria for a “good” tax.
 - In terms of these last two criteria, all real estate based taxes are “good” taxes - real estate cannot be moved away! Other sorts of wealth are too easy to conceal so other forms of wealth tax are not so attractive from this particular perspective.

- Income taxes, and indeed all transaction based taxes, at least as currently implemented, do not really meet the criteria of ease of collection and difficulty of avoidance - incomes and transactions can be made to look as though they were earned, paid for or took place **elsewhere** or were **different** types of transactions from those that they were in reality. Income tax and VAT are both widely avoided and evaded. If this were not the case and if income tax were really straightforward as well as being easily understood by those paying it and those collecting it, there would be no need for such an army of highly paid accountants and tax experts, not to mention tax inspectors, employed to deal with it. Every budget is accompanied by numerous anti-avoidance measures for both income tax and VAT. Obviously the tax can not be particularly cheap to collect either, (those same tax inspectors, needed to deal with all the anti-avoidance complexity again).

4. FAIRNESS AND RELATED ISSUES IN TAXATION

4.1 Some principles underlying “fairness”

Clearly, if we are to have any sensible discussions about “fairness” and “social justice” in taxation, we need to have some **objective** tests, or at least **principles**, that we can apply to any proposed or actual situation.

I believe that that there are (at least) three principles that need to be satisfied before any tax can be regarded as “fair”. I also believe the vast majority of those who use the terms “fair” and “unfair” would agree that these were, at least, the **minimum** requirements.

- I, (and probably most other people), would regard one of the criteria of “fairness” as being a situation in which people in broadly similar financial circumstances pay broadly similar amounts in tax.
- Another criterion for “fairness” which is likely to meet with almost universal agreement is that people who have a greater **ability** to pay tax should not pay less in tax than those whose ability to pay is lower.
- A third criterion for “fairness” which applies specifically to **local** taxation (and with which I think most people would agree) is that people who receive better services from their Local Authority should, in general, pay more tax than those resident in other Local Authority areas who do not receive such good services.

These three principles can be summed up in two key words / concepts. These are **symmetry** and **equality**:

- By **symmetry** I mean that: “what is sauce for the goose is sauce for the gander”. If Janet and John are treated in the same way, or in a way such that any difference is the consequence of their own actions, then it is not “unfair” - however much they may dislike it

- There are three types of **equality** which I believe to be relevant. These are equality of **contribution**, equality of **sacrifice** and equality of **benefit**.

4.2 Equality of contribution

Contribution can be measured in two different ways. We could measure it in **volume** terms or in terms of **effort**. In a primitive hunter-gatherer society we might well expect to find both forms of equality. The gatherers would probably be judged on how **many** berries or whatever they contributed to the common pot, whereas the hunters would probably be judged on how much **time** they spent on the common hunting endeavour.

An example of equality of volume in our more monetary society would be provided by the television licence, vehicle excise duty or the poll tax. Everybody pays exactly the same, so, from this particular perspective, these taxes are clearly “fair”.

An example of equality of effort would be a flat rate income tax regime in which every single pound of anybody’s income from the first pound to however many millions they might actually earn, is taxed at exactly the **same** rate. Insofar as incomes from work are concerned, then if (say) the rate were to be set at 20%, this would be equivalent to everybody working one day a week for the common good and four days a week for themselves. Being non discriminatory, (as between one pound and another), this is also manifestly “fair”.

4.3 Equality of sacrifice

Nobody likes paying taxes. The equality of sacrifice approach to taxation is based on the idea of sharing the pain equally. It is generally regarded as axiomatic that taking a pound from a rich man by way of taxation hurts him less, (because he has more of them), than does taking a pound away from a poor man. This is probably true in most instances. However, it is also true that different people value money differently. This is self evidently so in the jobs market.

There are many factors which affect the attractiveness of different jobs to different people - of which pay is just one. Other factors include: power/influence; security; status; the degree of autonomy; the opportunity to be creative or use one’s intelligence or expertise; the degree of intellectual or physical challenge; the opportunities for self development; affiliation; the meaningfulness / contribution it makes to others and so on.

To some people pay is very important. To others the other aspects of the job itself may be of more significance. In general, for a given level of capability, the more intrinsically “attractive” jobs will pay less than the less inherently attractive jobs simply because the latter will have to offer higher rates of pay to attract sufficient people to do them. In practice this means that, at any particular level of capability, the more attractive jobs will tend to appeal to those who place a relatively low priority on pay, whereas the otherwise less attractive jobs will tend to appeal to those who place a higher value on monetary rewards.

As a result, people who place a higher value on monetary rewards will, other things being equal, tend to receive more money than those who have other priorities. This means that the pain of taking a pound from someone who works primarily for money, (perhaps a salesman on commission), is greater than taking the same pound from someone who ranks pay as very low on his criteria for job selection, (e.g. a vicar). It is far from clear how considerations such as these can be incorporated into any tax system. What such a discussion does do however is to call into question the rather glib assumption that “the rich” should **always** pay more.

To take a very simple example, suppose that one individual can earn what he regards as an adequate income by working only three days each week whereas another person has to work five days a week, possibly with overtime, to secure a similar income. Most people, (whether or not they follow the equality of sacrifice approach), would regard it as not unreasonable to tax the first individual somewhat more highly than the second. However, the income tax system treats the incomes of the two individuals in exactly the same way, with both paying the same amount in tax. Now let us imagine a third person who earns the same hourly or daily rate as our first individual who only worked three days a week. This third individual has such a love of money that he works the same hours as our second individual - and thereby earns considerably more than either of them. Should he pay more tax than the first individual? On the equality of sacrifice principle they should both pay the same. Both have, by their own actions, provided clear evidence as to how much each pound is worth to each of them in exchange for leisure. Our income tax system however taxes the third individual much more highly than the first although the “pain” of losing a pound is identical for each of them!

This shows that there are real practical difficulties involved in assessing how much of a sacrifice any pound of taxation is to different individual taxpayers. There is clearly no simple relationship between income or wealth on the one hand and the willingness to give it up on the other. Indeed, over much of the ordinary range of incomes and wealth, there is probably an **inverse** relationship, (for the reasons just discussed). A particularly clear example of this is provided by the drop-out or “benefit junkie”. Although many of those on benefits would prefer to be in employment or not permanently disabled, there are definitely some people who prefer the drop-out life-style. Far from making a sacrifice by paying taxes to society, these people actually increase their well-being at society’s expense. This causes considerable anger on the part of many people who actually **do** pay their taxes. Redistribution that allows or encourages drop-out behaviour certainly does **not** represent an equality of sacrifice. On the other hand, redistribution between the so-called “hard working families” might well be a different matter altogether.

Apart from considerations like these, the equality of sacrifice approach would suggest not only that the “rich” should pay more than the “poor”, but that they should also pay a higher **proportion** of their income (or wealth) in taxes as well. This raises the question of how progressive, (or regressive), the taxation system should actually be.

4.4 Equality of benefit

Although it might at first appear a little strange to be discussing benefits when discussing fair taxation, we should be aware that cash benefits are in theory, (and now sometimes in practice), nothing more than negative taxation. It would therefore seem to be sensible to look at the overall incidence of taxation and the cash benefits system on particular groups of citizens. From the point of view of "fairness", does it really matter if somebody pays £1000 more tax than is really "fair" if, at the same time, he also receives £1000 more in cash benefits than he really "should do"? In our hunter-gatherer society considered above, equality of benefit would probably be expressed as everybody having equal helpings from the communal pot. However, it is possible to argue that those with bigger appetites should get a bit more - the supposed benefit being an absence of hunger! In our more monetary society, equality of benefit, when coupled with equality of contribution in volume terms, becomes similar to payment for services in the private market - and therefore similar to the benefits approach to taxation.

The benefit approach sees taxes as being analogous to prices charged for using services rendered by Local or Central Government. In this approach it is usually regarded as axiomatic that the tax charged should be commensurate with the benefit received - the greater the value of the benefit conferred, the higher is the amount of tax that should be payable. For example, in financing a communal flood prevention scheme, it would be regarded as reasonable that those who live on top of a hill should make little or no contribution, whereas those whose homes are most likely to be flooded in the absence of such a scheme should pay the most.

Financing roads by tolls or petrol taxes also gives some link between benefit received and tax paid, as people's contributions will rise as their use goes up. Even so it can be argued that charging tolls for uncongested roads is inefficient as it discourages use, although use of uncongested roads is not costly. Property taxes also have some attributes of the benefits approach, because local residents pay them and are also likely to be recipients of most of the local services that they finance.

The problem with the benefits approach is that it is often difficult to identify the benefits that individuals actually receive from public services. In the private market, benefit received is quite accurately indicated by expenditure through the market mechanism, but when services are provided collectively, this information is not available. Indeed a judgement that the price mechanism will not work for certain services, or is inappropriate, is often the reason for public sector provision in the first place. So, although the benefits approach has some similarities with the price mechanism in a free market, the individual concerned does not usually have an **individual** choice about whether to purchase the benefit or not.

In the private market, benefit received is normally greater than (or at least equal to) the cost of its provision. If people don't think that the benefit is worth the cost, then they don't buy. However, when services are provided collectively, this may not be the case. In fact there is a strong argument to suggest that, at least for those services that **could** have been supplied by the market, the value of public services, (at least to those who pay in full, or more than in full, for them), is **always** less than their cost. If the people who actually pay (in full) for these services really want them, then they would purchase them for themselves. If they have to be **forced** to pay for them through taxation, then clearly they don't think that they are worth the cost (to themselves)!

Those who tend to take the benefit approach to taxation would normally argue that the imposition of any tax should bear a direct relationship to the expenditure that it is supposed to fund and who benefits from, or votes for, that expenditure. To people of this persuasion it would seem to be eminently sensible that:

- Those who use non-essential public services, (like television), should pay for them through a licence or some similar means.
- Giving people the power to vote for taxes which they do not pay themselves is very dangerous. If the taxes can be spent on things that benefit them, (and some of them will be), they have a perverse incentive to vote for high taxation and correspondingly high expenditure even though this might be inefficient or economically damaging.

Unfortunately governments dislike hypothecated taxes, (which is what the benefit approach implies), whereas the electorate tends to prefer them. People dislike paying taxes for activities of which they disapprove. For example, pacifists dislike paying for armaments whereas pro-life campaigners dislike paying for abortions on the NHS. Hypothecated taxes reduce a government's freedom of manoeuvre and their means of exercising power over us.

5. PROGRESSIVE AND REGRESSIVE TAXATION

5.1 Definitions

According to the dictionary definition, under a **regressive** tax system, the rate of tax charged falls as the size of the **taxable base** increases. This does not mean that the total **amount** of tax chargeable falls as well. For example somebody with a taxable income of £100,000 p.a. paying a 20% tax rate would contribute £20,000 p.a. to the exchequer whereas somebody on a taxable income of £20,000 p.a. paying a 30% tax rate would contribute “only” (!) £6,000 p.a. A **progressive** tax is simply the reverse of a regressive tax. One pays a higher rate of tax as the size of the taxable base rises. By way of illustration, the Council Tax is a regressive tax. Although the total **amount** payable rises as the value of a property rises, tax also falls as a **percentage** of the property's value, (and it is the value of the property, as expressed by its Council Tax Band, which forms the taxable base). On the other hand the present form of income tax is progressive. Those on higher incomes pay a higher **proportion** of their incomes in tax than do those on lower incomes.

However, many people use the terms “progressive” and “regressive” to describe the proportion of **income**, (and not the tax-base), that is taken in tax. Many of these people go on to argue that taxes should **always** be progressive on this measure. This is often presented as if it were a matter of “fairness” or “social justice”.

5.2 “Should” taxes be progressive or regressive ?

There is nothing inherently right or wrong, with progressive, regressive or even flat taxes. However, it would be difficult to argue that anything other than a flat tax would be “fair” in the sense of being **non discriminatory**.

Taxes are really the price that we pay for having certain public services. Nobody suggests that the rich should pay more than the poor for the same groceries at the supermarket. Why then do we wish to treat public services differently? Technically, there is very little difference between taxing incomes and taxing expenditure. Politically though, the differences are enormous. There would almost certainly be real opposition to raising basic rate income tax without raising higher rate income tax as well. However nobody has ever seriously proposed that “the rich” should pay a higher rate of VAT! VAT is the nearest thing that we currently have to a flat tax. Other taxes like road fuel duty, (one pays the same per litre however many litres one consumes), and television licences, (which gives one the right to watch television at a particular address regardless of how often it is watched or how many televisions there are there), are also essentially flat rate taxes.

In discussing the question of whether taxes should be more or less progressive than they currently are, we need to bear in mind two main considerations. These are the effect that any changes might have on the national, (or local), economy, and on what is often termed “social justice”.

Economic considerations

I am persuaded that progressive taxation, particularly at the top end of the income distribution, is almost always harmful from an economic perspective:

- There is little doubt in my mind that Britain would benefit from a somewhat more entrepreneurial culture than we have at present. A progressive taxation system affects the attractiveness of being an entrepreneur in two different ways. At the bottom end of the income distribution the presence of a sort of “safety net”, (which a progressive taxation system implies), tilts the balance between risk and reward in favour of risk and entrepreneurial activity. One may legitimately question whether the activity encouraged is **responsibly** entrepreneurial - but that is another matter. At the top end of the income distribution a progressive taxation system tends to have the opposite effect. For people who can earn relatively large, almost risk-free incomes, the “safety net” looks a long way down and the upside is limited by the higher rates of tax that they would have to pay if their venture is successful.

It would seem, therefore, that a progressive taxation system **encourages** risk taking at the **bottom** end of the income distribution but **discourages** it at the top. If those who can earn good risk free incomes are more intelligent and better informed than those who can't, (as they tend to be), then a progressive taxation system would appear to **encourage** entrepreneurial activity from those who are **least** likely to be successful and **discourage** those who are **most** likely to succeed!

- There is some empirical support for this rather theoretical view. Most of the well-known entrepreneurs are **not** from the professional classes. They tend to come either from those who are already independently wealthy or from those who would otherwise earn relatively low incomes. Both of these classes of people are those who are, in effect, risking very little, (provided that their ventures are conducted through **limited** companies!)
 - Those at the bottom end of the income distribution really need virtually all the money that they can get. Taxing them heavily means that they have to work harder or work longer hours in order to get the same standard of living as they would enjoy if they were to be taxed less heavily. In complete contrast, those at the upper end of the income distribution don't really need all the money that they earn. Taxing them lightly would tend to encourage them to work harder or smarter than if they were taxed heavily - when all the incentives would be towards their taking extra leisure time.
 - Although this means that a regressive tax will increase GDP per head in **statistical** terms, it is worth remembering that the economy does not exist for the sole benefit of statisticians! Its primary purpose is to provide goods and services that people want - amongst which **voluntary** leisure is an important component. I would therefore suggest that while lightly taxing the "rich" does indeed improve the performance of the **real** economy, heavily taxing the "poor" only improves the **statistical** economy!
- There is ample empirical evidence that low taxes on the rich **do** tend to improve output. Indeed the almost universal experience is that when **top marginal** rates have been reduced, the total **tax** collected from those affected increases. Since tax rates are lower, the total output / earnings must have increased even **more**.
- In a genuine free market, those who get the largest rewards are also those who make the largest contribution. (If what they did represented poor value for money, people would not buy). As I have already argued, **all** transaction based taxes tend to be harmful to the economy. A progressive income tax system takes proportionally the **most** out of those people who engage in the **largest volume** of transactions and / or those who make the **most valuable** transactions. It seems likely, therefore, that a progressive tax system, particularly one that is most progressive in the upper income ranges, will prevent many of the potentially most important economic transactions from ever taking place at all.

Progressive taxes tend to exacerbate the tendency towards wastefulness, inefficiency and over-spending endemic in all parts of government and the public sector. If I only pay 50% of the cost of a service that actually costs 50% more than it "should" do, then I get a very good deal. I only contribute 75% of the value that I actually receive. Of course somebody else has to make up the difference. In such a situation, if I were selfish and hypocritical, I would vote for more public spending and higher taxes! The danger comes when he who calls the tune pays too little of the piper's wages.

It would appear that, from this brief discussion, the ideal taxation system from an economic point of view, at least so far as transaction based taxes are concerned, would be regressive at the top end of the income distribution. It is unclear however whether a progressive or regressive system would actually be better at the bottom end. The case for progressive taxes in this part of the income distribution is really a **social** one.

“Social justice”

Many people argue for progressive taxes on what they claim to be “moral” grounds. However, I can see no real “moral” case for progressive taxation at the **national** level. Even if one thinks that the “rich” owe some sort of duty to the “poor”, why should this duty be restricted to national boundaries? Why is it a moral duty for rich Britons to help the poor of Birmingham and Manchester but not the much more needy poor of Bombay and Madras?

Again at the national level, what right have I to a share of my neighbour's wealth? If I have done something that has materially contributed to my neighbour being wealthy, then I might indeed have a claim. Likewise, if my neighbour has done something that has tended to make me materially poorer than I would otherwise have been, then I may again have some sort of claim. If both of these conditions are fulfilled, then any claim will be that much stronger. However, if, as is usually the case, neither of these conditions applies, then the claim is wholly without moral foundation. My neighbour's well-being and my own ill-being are completely unconnected.

Unfortunately, many of those who argue in favour of progressive taxation are usually, but not always, driven to do so by the unattractive motives of avarice, envy or selfishness. Yet they tend to try to pin the last epithet on those who created the wealth in the first place! They tend to argue that the “rich should pay more”. In fact the “rich” would probably pay more even under a regressive tax system. I have already used the example of somebody with a taxable income of £100,000 p.a. paying a 20% tax rate contributing £20,000 p.a. to the exchequer and somebody else on a taxable income of £20,000 p.a. paying a 30% tax rate contributing £6,000 p.a. In this example the richer person is still contributing nearly two and a half times as much as the poorer one. There does not seem to be anything **inherently** “unfair” in this example - unless perhaps it is unfair to the richer person. It all depends upon what the taxes are used for and the relative sizes of the benefits that each party receives.

To be sure, some services are of more use to the “rich” than the “poor”. For example, those with very little property don’t have that much interest in policing aimed at protecting property. This is a clear case where the tax “ought” to be in the form of a charge for services. However, I suspect that the real issue is one of equality of benefit.

5.3 General discussion

In considering issues like “fairness” and “social justice”, I believe that it is most useful to consider how society would organise itself in the **absence** of money. This can give us some useful pointers as to whether taxes really “ought” to be progressive or regressive. In this context, it seems to me that a primitive hunter-gatherer society would organise its communal affairs on the basis of equality of contribution and equality of benefit.

As I have already discussed, contribution can be measured in terms of either volume (number of berries collected) or effort (time spent hunting). It should be noted that neither of the “taxes” in our supposed hunter-gatherer society is at all progressive. Indeed the “tax” on the gatherers is regressive while that on the hunters is “flat”. A progressive tax on the hunters would require the exceptionally good hunters to spend more time hunting for the common good and be given less free time for themselves. It is difficult to see this happening. While it is easy to see the good hunters being excused gathering duties in exchange for equivalent hunting effort, or indeed the good gatherers being excused from hunting duties to give them more time for gathering, (since the community as a whole would benefit from such an arrangement), can one really imagine a situation where the exceptionally gifted were to be made to work harder? It seems much more likely that they would be allowed a few privileges by way of more time off!

Given this, how can we account for the widespread belief that taxes “ought” to be progressive? If this is not simply selfish hypocrisy, then it must relate in some way to issues like equality of benefit or ability to pay. Clearly, if for some reason taxes have to be high, (e.g. in wartime), then it is indeed possible that the “poor” would experience real difficulty in paying them. However, in more normal times, how can it be that the “benefit” that they receive from these taxes does not compensate for their ability to pay them? If the poor do not get good value for money, then who does? As we have already argued, if those who actually pay for these services really wanted them, then they would not have to be taxed. They would purchase them where possible on the open market.

In our supposed primitive society it is likely that all members of it would be allowed to take the same amount out of the common pot - regardless of their actual contribution in volume terms, (a clear example of equality of benefit). In a more advanced, money based society this is equivalent to universal non-means-tested benefits, (though not necessarily cash benefits). In fact, if we were to combine a flat rate of income tax with universal non-means-tested cash benefits we would end up with a **progressive** tax and benefits system, even though the tax portion of that system would **not** be progressive.

Whilst it is easy to see why the poor should **sometimes** pay less, (on grounds of affordability), it is not obvious why the rich should **always** pay more. Is there no limit to how much they should contribute? Any practical implementation of the rather meaningless slogan that “the rich should pay more” needs to answer questions like: more than what; more than whom; how much more, and, most importantly, **why**. If there is such a thing as a “right” level, then, if we happen to be above it, shifting the burden from the rich to the poor would actually be the right thing to do! Of course if we are below the “right” level we would do the opposite.

Given that, in general, it is people on the lower incomes who tend to argue that taxes should be more progressive and those on larger incomes who tend to argue that they should be less progressive, it would seem that most such arguments are little more than selfish hypocrisy.

5.4 What is ability to pay?

The ability to pay approach to taxation bases people’s tax bills on the **resources** they possess. To take a simple intuitive example, suppose a group of people want to work together to construct a small river dam. The benefit approach would share out the work in relation to how the benefits of the construction of the dam - in terms of flood protection and irrigation etc. - were distributed among the group. In contrast, the ability to pay approach would suggest that the stronger and fitter members of the group should do relatively more of the work, as each unit of work will be easier for them. - although this does not mean that they would be expected to spend more **time** on it.

The equality of sacrifice approach to taxation is often called the ability to pay approach. This is rather misleading. Only in times of extreme national emergency, (such as total war), would every citizen ever be taxed right up to the limit of his ability to pay.

When most people use the phrase “ability to pay” they usually mean that actual payment would not cause “undue hardship”. This is quite separate from “fairness”. It is perfectly possible to have a “fair” tax that causes hardship. Indeed, sometimes it is inevitable, (e.g. in time of war). What would be totally intolerable though is unnecessary hardship caused by an “unfair” tax.

Different people’s perceptions of undue hardship differ, but most people would regard the **absence** of a mere subsistence level of means as an unduly harsh criterion when judging “ability to pay”. It would seem to me that the popular, informal, “gut feeling” definition of hardship is when somebody is unable to procure **most**, (but not all), of the sorts of things that **most**, (but not all), “ordinary” people can enjoy. This definition is obviously closely related to some fraction of **median** (or modal) income, (though not necessarily the 60% of median income that many statisticians and government bodies, both in the UK and overseas, use as an indicator of **relative** poverty).

In practice, incomes are frequently used as a measure of people's ability to pay, although it is not a perfect measure. To illustrate one way in which income may be a poor measure, suppose a person likes a lot of leisure and only works 3 days a week to get an income of £20,000 a year; does this person have only the same ability to pay as someone who works five days a week to earn the same income? Most people would probably argue that the more leisured person has a greater ability to pay. After all, would it not be unreasonable to require him to give up some of his leisure time on community related activities?

It would appear that many people regard income as the **sole** determinant of ability to pay. Clearly it is an important one. However, it is worth remarking that many people's incomes, even those which are relatively high, are often close to being fully committed, (on mortgages, school fees and the like). This provides a good argument against any **sudden** or **large upward changes** in taxes on income. More gradual increases can probably be accommodated.

In the final analysis there are only three ways in which people can pay monetary taxes: they can pay them out of their **incomes**; they can pay them out of their **wealth** / savings; or they can pay them out of **credit** / borrowings. Since a person's credit-worthiness is largely determined by their incomes, (or, to be more accurate, their expectation of future income), and / or their assets, payment of taxes out of borrowings is more of a **mechanism** for payment rather than a determinant of actual ability to pay.

Once a person has met their minimum subsistence needs, it could reasonably be argued that they are **capable** of paying taxes at any rate up to 100% on any further income, wealth or credit that they may have. Since, (I believe), the overwhelming majority of the electorate would object to anything like this actually happening in practice, it is clear that pure "ability to pay" should **never** be the main reason, (or excuse), for imposing any particular tax whatever. On the other hand perhaps, genuine "inability to pay" should always be a valid excuse for **not** being required to pay particular taxes. It follows that it is only valid to use "ability to pay" as an argument in favour of a particular taxation regime when the amount of tax that needs to be raised is so high that serious questions about other people's ability or inability to pay them would be raised. Unless this situation applies, then, logically, the common view that: "the rich should pay more" needs to be justified on completely different grounds.

The main **practical** problem of any wealth tax lies in the questions of **liquidity** and **divisibility**. Not all forms of wealth are easily converted into money, (at least rapidly and cheaply), and not all wealth is easily divisible - real estate being an obvious example in both cases. However, this does not preclude the use of **credit** or deferred taxation as a way of implementing a tax on wealth. Once again, whether it would be sensible or "fair" to force people to take out loans in order to pay their taxes is a different question altogether.

The argument that I have heard most often against basing any taxation on wealth is that the wealth concerned has already been taxed as income. This has nothing to do with “affordability” and, indeed, it is not always true. From the standpoint of “affordability”, it would seem that people who draw down their savings to support whatever lifestyle they may have are in much the same position as people who are drawing an income of an equivalent amount. Indeed, on **average**, they would enjoy much the same income if they were to use their savings to purchase an annuity. There seems to be no case in terms of either “fairness” or “affordability” to treat savings any differently from income in this respect. However, the situation is somewhat different for those who are still building up savings for their old age. Can such people really “afford” to pay taxes on these savings? In immediate terms they obviously can, but does it make sense to, in effect, tax them in advance on a basis that, when the time comes, they would no longer be able to afford?

Apart from this particular exception, (which could always, at least in **principle**, be dealt with by making wealth held in pension funds exempt), one can always “afford” to pay taxes out of one’s wealth. Whether or not this is “fair” and whether or not governments would be **wise** to impose wealth taxes are completely different issues

6. GENERAL DISCUSSION ON PROPERTY TAXES

The main reason why real estate has been used so often and for so long as a basis on which to raise **local** taxation is that it is one of the very few tax bases that is truly **local**. However, if the rate at which real estate taxes are to be levied is set **nationally**, (as in Northern Ireland), and if the proceeds are, in effect, redistributed between one area and another, (through Resource Equalisation, differential Central Government grants or whatever), then it ceases to be a local tax. It becomes a national tax masquerading as a local one.

There are good reasons for basing local taxation on real estate. The main one of which is that its **location** is clear and so it is obvious which Local Authority should receive any benefit from taxing it. This is not the case with Income Tax, (who should receive the benefits - the Authority in which the income was earned or the Authority in which the earner resides?) or VAT, (where did the transaction take place - especially if it was done over the Internet?). Unlike Income Tax or VAT, real estate taxes are also very difficult to avoid or evade. Real estate is easily visible and it cannot be moved elsewhere! Its location is beyond dispute.

Those who argue for a national property tax, whether or not it is disguised as a local one, usually do so on the grounds that the wealth tied up in property has been, at least in part, created by “the community”. Whilst it is undoubtedly true that national rises in the value of property have national causes, (like inflation, favourable tax treatment for owner occupation and so on), it is difficult to argue that **differences** in values between one area and another have anything much to do with **national** causes. Broadly speaking we would expect **national** factors to have **uniform** effects.

Local differences are almost certainly down to local effects - so that if one argues that “the community” should benefit from an increase in local values the “community” in this case should be the local community and not the nation as a whole.

It is true that some places do get more in the way of national taxpayer funded investments than others. If this leads to an increase in the value of properties there, then indeed there is some case for returning some of the extra value created to the nation as a whole. However, even the most cursory examination of where these investments actually do take place demonstrates that the vast majority take place in the poorer areas with lower property prices. (This is self evidently the case insofar as Local Government expenditure is concerned. Central Government grants are largest to those places with the lowest property prices / property bands as a result of Resource Equalisation.) These are the very areas that would benefit even further if a **national** property tax were to be imposed!

The value of any piece of real estate depends very much on **where** it is situated. (As the estate agents say - location, location, location). Much of this depends upon its proximity to services, (including those like shops, mains water, electricity and sewerage that are **not** provided by the public sector). Clearly one can only have a **proximity** to **local** services - even if some of those are managed and financed, in whole or in part, out of **national** taxation. This raises the issue of who actually provides the lion’s share of the funds that are collected through national taxation. This is “obviously” the “rich”. It is also the “rich” who tend to live in the more expensive houses and in the more expensive areas. Does it really make sense to tax any further those who have already paid for the services that they enjoy - especially as they have also paid for these same services to be enjoyed by others? If it does, then would it not be better to tax them **directly** - through income tax or VAT, for example?

There is no doubt that proximity to a good school does indeed tend to raise the value of properties in its catchment area. However it is not the amount of public national funding that determines whether a school is a good one or a bad one. It is largely the quality of the teachers, (especially the head teacher), the parents, the children, the governors and possibly the Local Education Authority that makes the difference. All of these people would normally live fairly **locally**. Why should they pay taxes to **other** parts of the country for their **own** hard work? Similar remarks apply to services that have been financed and managed locally. It is the **locals**, both rich and poor, who have provided and paid for these services. Does it make sense that they should pay taxes to **others** in such circumstances?

The value of a property in a particular location also depends to a considerable extent upon the sort of neighbours that the property enjoys, (or suffers from). For example, many streets are noted for having undergone a process of “gentrification”. It is probably true that if your neighbours increase the value of their properties through various improvements, then this will also have the knock-on effect of increasing the value of your own property - and *vice versa*. It is obvious that the “community” in this particular context is very local. It is difficult to see how improvements to properties in, say, Wyre, (in Lancashire), could affect the value of properties in Wyre Forest, (in Worcestershire)!

It would seem to me that the only “community” with any claim on the increased value of any property caused by “community action” are those who would also, at the same time, be paying increased taxes to the residents of that property because their property had also gone up in value as well! This looks like a zero sum game with a great deal of unnecessary bureaucracy on top. National property taxes coupled with “Resource Equalisation” to reward the “community” would actually mainly result in rewarding those who have done nothing!

This is not to deny that the “rich” do indeed benefit from the activities of some of the lower paid **within their own vicinity**, (from dustmen and hospital porters for example), but it is difficult to see how they benefit from the activities of the lower paid who operate in **other** geographical areas. This would suggest that any redistribution on the grounds of “community” contribution ought to be purely **local**

There are, of course, a few exceptions to this general rule:

- People don’t always live in the same location all their lives. Some (small) redistribution between where they have lived, where they currently live, and where they are about to live may therefore be justified - although it is far from obvious which locations should benefit and which ones should pay!
- Without a “community” or state there would be no laws - and hence no work for any lawyers. Lawyers in particular earn **all** their money from the “community”. Maybe a special tax on lawyers **might** be justified - but probably not!
- Active and former members of the armed services, however lowly paid, defend the **whole** country - not just the region they happen to come from. Some sort of “community return” is not unreasonable in their case.
 - However, as with all arguments about redistribution of wealth or income, it is important to remember that people **chose** to do the jobs that they do and for the pay rates that they actually get. Also, in the private sector, (but not in the public sector), people get whatever money they earn from people who have “voted” in the most responsible and honest way possible - with their wallets! Is it really logically consistent to vote differently in the ballot box?
 - Few people would have any objection to devoting part of their income to helping those who have suffered **genuine** misfortune. Such redistribution is obviously worthy. What most of those who actually make a **net** contribution **do** object to is helping those who don’t really **need** it but who are only “poor” because of improvidence, idleness, or some other sin - “deadly” or otherwise

- The only reason why young people in this country “earn” more than similar young people do in places like India is because they are benefiting from the systems, institutions, investments and the physical and cultural infrastructure created by earlier generations. Most of these past contributors are now dead, but it is obvious that the surviving age group that has contributed most must be the pensioners - they have worked longest and the compound interest effect has had longer to work its magic. A redistribution between pensioners and the working population designed to provide a “decent” pension would seem to be a moral imperative, (even though the majority of pensioners have probably not made a net contribution through their lives taken as a whole - very few people have!).

Apart from these exceptions, there seems to be no “obvious” justification for returning anybody’s earnings or wealth to the community. There may, of course, be other grounds to justify some form of wealth or income redistribution, but it is difficult to justify the redistribution of **property** based wealth as a special case. Indeed it is impossible to do so literally. One cannot take 10% of a house and move it elsewhere - and even if one could, the value of the bit so moved would depend upon its **new** location more than anything else!

Property Taxes and Wealth Taxes

Council Tax is often described as a wealth tax. Sometimes this is used as an argument in its favour and sometimes it is used as an argument against it. Whether wealth taxes are indeed a “good thing” or a “bad thing”, I remain unconvinced that any property based tax is a true wealth tax for two main reasons:

- Council Tax, the Rates and the Northern Ireland property tax are all levied on the **gross** value of a property. However the wealth tied up in two identical, neighbouring properties can be, and often is, very different. One property may well be subject to something like a 100% mortgage, whereas the other could well be owned outright. The owner occupier of the first property has much less property wealth than the owner occupier of the second.
 - It is also worth noting that Council Tax is payable, (usually by the occupier), on **rented** property. It would be difficult to argue that Council Tax was any sort of wealth tax in this situation.
 - It might be argued that, were it not for property taxes the rent chargeable on a property would be higher, so that, although the tax is formally paid by the tenant, in reality it is paid by the landlord as a result of his decreased rental income. I would tend to reject this argument because, unless the revenue raised by the Council Tax were to be foregone, then the net income of the tenant, (or the landlord), out of which the replacement tax had to be paid would remain much the same. Since housing is virtually a basic necessity, the price elasticity of demand for it is very low. As a result, true rents would remain virtually unaffected by any change of this sort. (This argument would not apply to business property).

- Clearly in the case of any **new**, or increased, tax the rent on any property is unlikely to be affected at least until the property is re-let. In this case the tax is obviously paid by the tenant and not the landlord.
- Council Tax, (and other forms of property tax), is a tax on only one particular form of wealth - i.e. real estate. There seems to be no obvious reason why one sort of wealth should be taxed whereas others should escape scot free. Any property based taxes are best defended on other grounds, (such as the convenience of real estate as a **local** tax base).

Arguments Against Wealth Taxes

Most of those who have argued against any form of wealth tax regard it as “unfair” to tax wealth since it has been built up out of income “that has already been taxed”. However this is not true of all wealth:

- Most property was originally bought on a mortgage - and, until recently, mortgage interest was tax deductible. Moreover rapid inflation, (a “community” effect), enabled those mortgages to be repaid with devalued pounds. Far from property wealth having been built up out of taxed income, it has, in effect, been created by subsidies from other taxpayers (and savers)!
- Some wealth has been inherited - where there are separate and more generous tax free allowances than there are on incomes.
 - Some people might counter that inheritances themselves come out of income or capital that has already been taxed and so should not be taxed further. It would seem that this is only really true in a minority of cases. Most of the really significant inheritances come from wealth created before there was any capital gains tax, and, in some cases before there was any income tax or at least when income taxes were much lower than they are today. However, the biggest source of the more modest inheritances are property, (which, as we have already discussed, often received very favourable tax treatment), and the tax free vehicles described below

Even with these exceptions, not all wealth is accumulated out of savings from taxed income. Some wealth has been accrued from gambling, (gambling winnings are tax free), some has been accrued from so-called capital gains, (where there are separate and more generous allowances before any tax becomes due), and some is the result of gifts. Some wealth / savings are also the result of investing in tax-free vehicles like PEPs, ISAs or TESSAs. At one time endowment life assurance, (another way in which wealth was accumulated), also received favourable tax treatment.

However, none of the above dismissal of the case **against** wealth taxes constitutes any form of argument in their **favour**. They might, on the other hand, provide some sort of argument against the use of the various tax-free vehicles out of which wealth has been built up.

As I have already remarked above, the main **practical** problem of any wealth tax lies in the questions of **liquidity** and **divisibility**. Not all forms of wealth are easily converted into money, (at least rapidly and cheaply), and not all wealth is easily divisible - real estate being an obvious example in both cases. Many of the older generation are now living in property that they could no longer afford to purchase out of their current incomes. It tends to be argued on their behalf that any tax based on the value of such property is likely to be “unaffordable”. In addition, it is also argued that, in any case, people living in a property do not receive any benefit from any increase in the value of that property until they move elsewhere. Both of these arguments are used to oppose the imposition of **all** types of property tax.

Actually, neither of these arguments really hold much water. People **do** receive a benefit from the occupation property that they own outright when compared with those people who do not. Their benefit is the imputed rent or mortgage interest that they are not paying, (remember the old Schedule D?!?). Once again, this is **not** an argument in favour of taxing such wealth. Equally, the fact that some older people now have property (or other) wealth that is out of line with their current incomes does not mean that any tax on that wealth is unaffordable. Whilst it might be difficult for them to pay such taxes with “cash on the nail”, this does not preclude the use of credit or deferred taxation as a means of making any such taxes “affordable”. Whether or not it would be **wise** to impose such taxes is a different matter altogether.

Many people who are still working regard their current houses as part of their pension pot, (unwisely in my view - but that is a different matter). Does it make sense to tax this form of “pension pot” any differently from other forms of “pension pot”? In fact, given the moral imperative described above to allow people a “decent” pension - especially if they have funded it themselves - does it not make sense to leave all “pension pot” wealth untaxed? The taxation, if any, could be deferred until they realised the value of their properties, (why is owner occupied housing exempt from Capital Gains Tax?), or started to live on their savings - although it is unclear how such a wealth tax could be implemented. Perhaps income received from annuities should be tax free (?!). This would, at least, put people who chose to purchase annuities on a par with those who preferred to manage their “pension” themselves by drawing down their savings. It is worth noting that most annuities are, in reality, little more than a return of capital - since the real interest on bonds is, after tax and inflation, virtually zero!

Inheritance tax / capital transfer tax / death duties

The ultimate form of deferred taxation on wealth is tax payable on it after death. As property prices rise, and as more people are thereby feeling that they are likely to be drawn into the Inheritance Tax net, Inheritance Tax is beginning to become more unpopular, (it was OK when only a few **other** people paid it!). Nevertheless if people were to be given the choice between paying taxes when they are alive or paying taxes when they are dead, which would they be likely to choose? To me it is a “no brainer”!

Apart from those who have worked in the family business or on the family farm, (and similar people - who are they?), people who inherit wealth have generally done little to create or “deserve” it. Inheritance taxes and the like are clearly "fair". Indeed, inheritance is itself somewhat "unfair" and difficult to reconcile with a classless society in which there is equality of opportunity. For example, is it fair that some people can inherit thousands of acres, whole streets of attractive parts of London, and seats in the House of Lords or on boards of directors when others struggle to afford any sort of home or find a decent job? Inheritance Tax at rates close to 100% on all but the tiniest estates would seem to be a "fair" tax. It would help to achieve equality of opportunity and would not involve rewarding the idle and spendthrift at the expense of the hard working and provident.

A high rate of Inheritance Tax would also enable us, at no extra cost, to remove the "unfairness" whereby the elderly with sufficient assets are required to sell those assets in order to fund their places in care homes while the less wealthy elderly do not. Those with assets would simply be deferring their tax liability. In practice making the "wealthy" elderly pay for their care is simply punishing the prudent and rewarding the imprudent.

6.2 What are local taxes?

Before proposing the imposition of any “local” taxation system, it is important to be clear what actually constitutes **true local** taxation. I would suggest that true local taxation has to fulfil the following criteria:

- The **amount** of any “local” tax that an individual taxpayer has to pay is decided purely locally - that is by the Local Authority raising the tax.
- The entire **yield** from any “local” tax is spent locally on things that are decided locally - again by the Local Authority imposing the tax
- There is a **direct** relationship between the local tax imposed by any Local Authority and the money that it has available to spend on its own priorities. If Central Government grants are used to “equalise resources” so that Local Authorities have to spend “local” taxes on things decided by Central Government then we really have a **national** tax masquerading as a local tax
 - The Council Tax, which was originally more of a true local tax, has, in effect become a national tax because some Local Authorities are required to spend some of the Council Tax yield on things decided by Central Government and not by themselves. It is also possible that others receive grants from Central Government part of which they can spend as they themselves think fit - although this is more debatable.