Simplifying the tax and welfare systems in the UK

Tax revenues in 2009-10

- Income tax, National Insurance £234.2 bn
- Corporation tax - £35.8 bn (exp. to fall to £30 bn)
- VAT - £70.1 bn (expected to rise to £90 bn)
- Council Tax, Business Rates £49.3 bn
- Fuel duties, car licences £32.8 bn
- Tobacco, alcohol and gambling duties £22.5 bn
- Stamp Duty, Inheritance Tax, Capital gains Tax, Insurance Premium Tax etc. £18.7 bn
- 'Other taxes and royalties' £16.3 bn

Income tax/National Insurance

- Income tax and National Insurance are relatively ‘flat’. The marginal rate is 43.8% of gross salary for a basic rate taxpayer; 53.8% for a higher rate taxpayer and 63.8% for those with salaries over £150,000 per annum.
- Most tax breaks, in particular tax breaks for pension saving, are given to higher earners, which makes the system flatter.
- According to HMRC Tables 1.5 and 1.6, the total ‘cost’ of all the pensions tax reliefs is enough to scrap higher rate income and increase the personal allowance to £10,000.

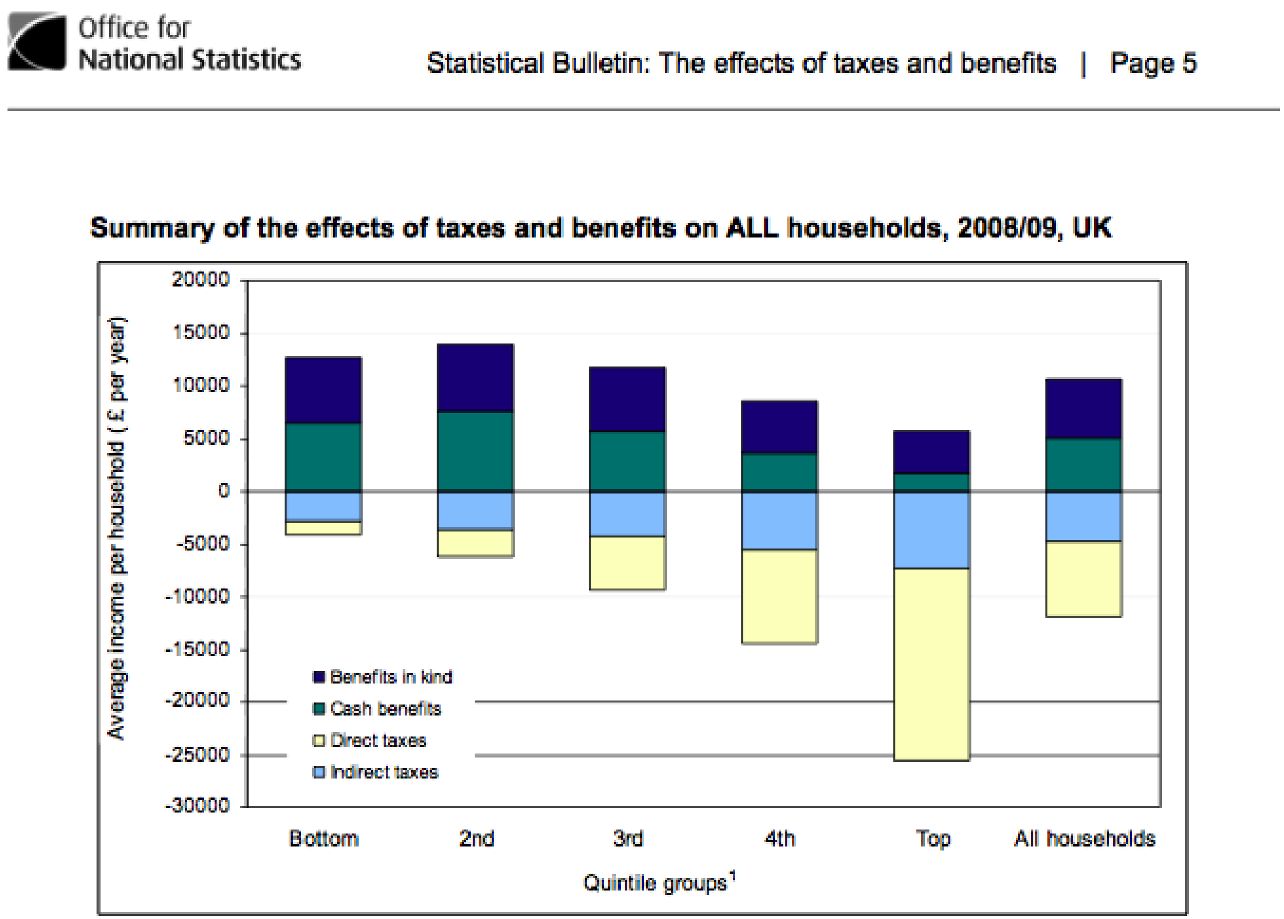
Corporation tax

- Corporation tax rises from 21% for small companies to 28% for large companies.
- If we assume that VAT is borne by the supplier, the true rate is far higher for VAT-registered businesses (total VAT revenues are three times as much as total corporation tax revenues).
- Higher rate taxpayers have to pay 25% of cash dividends received in income tax, and those earning above £150,000 have to pay 36.11%, which brings the overall tax rate to 46% and 54%.

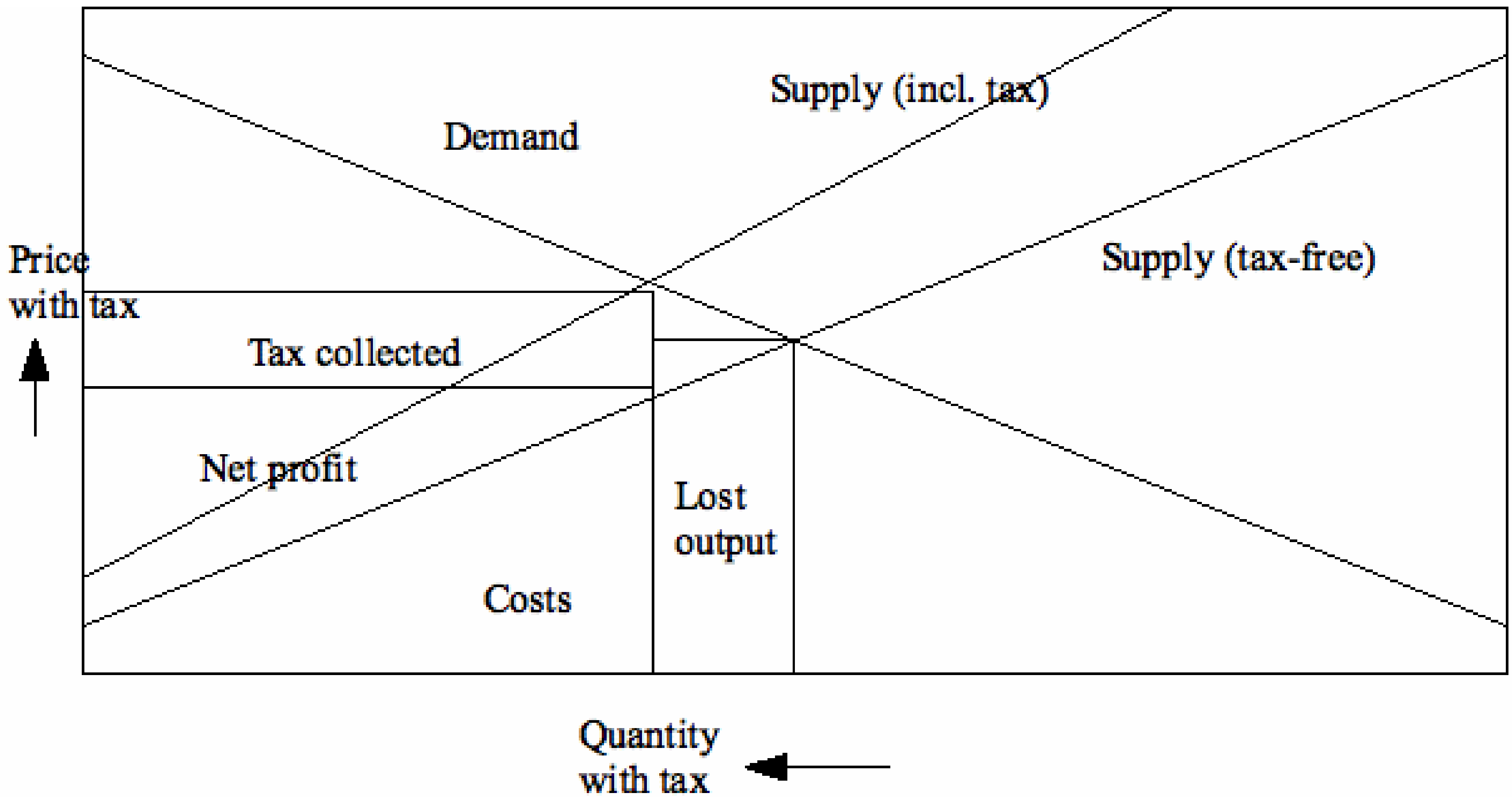
VAT

- From the consumer’s point of view, VAT is regressive to incomes (see following chart, taken from here), but if VAT on tobacco and alcohol were excluded, it would be more or less a fixed share of household income.
- Because VAT is a tax on transactions or economic output, it has the highest deadweight costs of any tax.
- VAT also discriminates massively against activities deemed to be VAT-able and acts as a barrier to entry.
- Corporation tax is on the return on capital, but not the productive capital itself –VAT can actually eat into capital as it is payable even if a business is making losses (usually in the start up period).

VAT (aka 'indirect tax')



VAT and deadweight costs



Other taxes

- Business Rates is a fairly flat tax on the total rental value of commercial premises.
- Then we have all manner of smaller taxes, which can be broadly classified into:
- Poll taxes – such as Council Tax, the TV licence fee, and
- Jealousy surcharges – such as Inheritance Tax, Stamp Duty Land Tax, Capital Gains Tax etc.
- While each of these taxes is ‘unfair’ taken in isolation, by and large, the ‘unfairness’ evens out.

Average marginal tax rates

- There are nigh infinite marginal tax rates, depending on how much your income is and what type of income it is (whether it is earned net of VAT or National Insurance), if you have Student Loan deductions, if you cross an income threshold and have the personal allowance withdrawn etc.
- Suffice to say, the average marginal income tax rate is nearly fifty per cent. It is much higher than this for people who are paying tax and having benefits withdrawn based on their income.

Welfare (1)

- The welfare system in the UK is incredibly complicated and expensive to administer (DWP administration costs nearly £10 billion a year).
- It is riddled with fraud, error, over- and underpayments (official figure for fraud is over £5 billion).
- It discriminates hugely against marriage and stable families, especially because of the way it overlaps with the tax system.
- High marginal withdrawal rates discourage people from working.

Welfare (2)

- It would be very easy – conceptually or administratively - to replace the entire welfare system with a non-taxable, non-contributory, flat rate ‘Citizen’s Income’. The current jargon for this is ‘Universal Credit/Single Unified Taper’.
- This would be cheap to administer, difficult to defraud, would not discourage marriage and stable families or working, studying etc.
- A fiscally neutral Citizen’s Income would be approximately equal to current Income Support or Pensions Credit rates.
- There would be relatively few winners or losers from this, assuming no changes in behaviour. Most behavioural changes would positive. The main winners would be single-earner married couples with children.

Three types of private property

- Your own particular skills and abilities, willingness to work hard, pure blind luck. These change over your lifetime and go or die with you.
- Things you own because you have traded the product of your skills and abilities with those of others.
- ‘Private’ land is clearly private in the sense of ‘not being open to the public’, but it only remains private because society largely respects the right to exclusive possession. So ‘private’ land is a social contract between the land ‘owner’ and society in general, or ‘the state’ in particular. When you buy or rent land, you are paying for the benefits that arise under a contract with ‘the state’ and not for the output of the vendor’s skills and abilities (that would only apply to the buildings).

Publicly vs privately collected taxes (1)

- Things like income tax or VAT are publicly collected taxes. The proceeds go to the government.
- There is quite a disparity in average incomes across different regions of the UK, so people in high wage areas pay more publicly collected tax than people in low wage areas.
- But the differences in household net incomes, once actual or notional housing costs are taken into account, are much lower.
- Why?

Publicly vs privately collected taxes (2)

- People are – legally - free to move around within the UK. So people gravitate towards higher wage areas.
- If there were no practical barriers to moving, we might expect wage differentials to be competed away, but there are practical barriers, namely the shortage of housing in high wage areas.
- Building more housing in high wage areas would have the equal and opposite effect of increasing wage differentials between regions (the more people you can trade with, the greater the degree of specialisation, so incomes are higher where there are more people etc).
- As a result, people have to pay extra to live in a high wage area – this 'extra' manifests itself as higher rents and house prices in high wage areas.

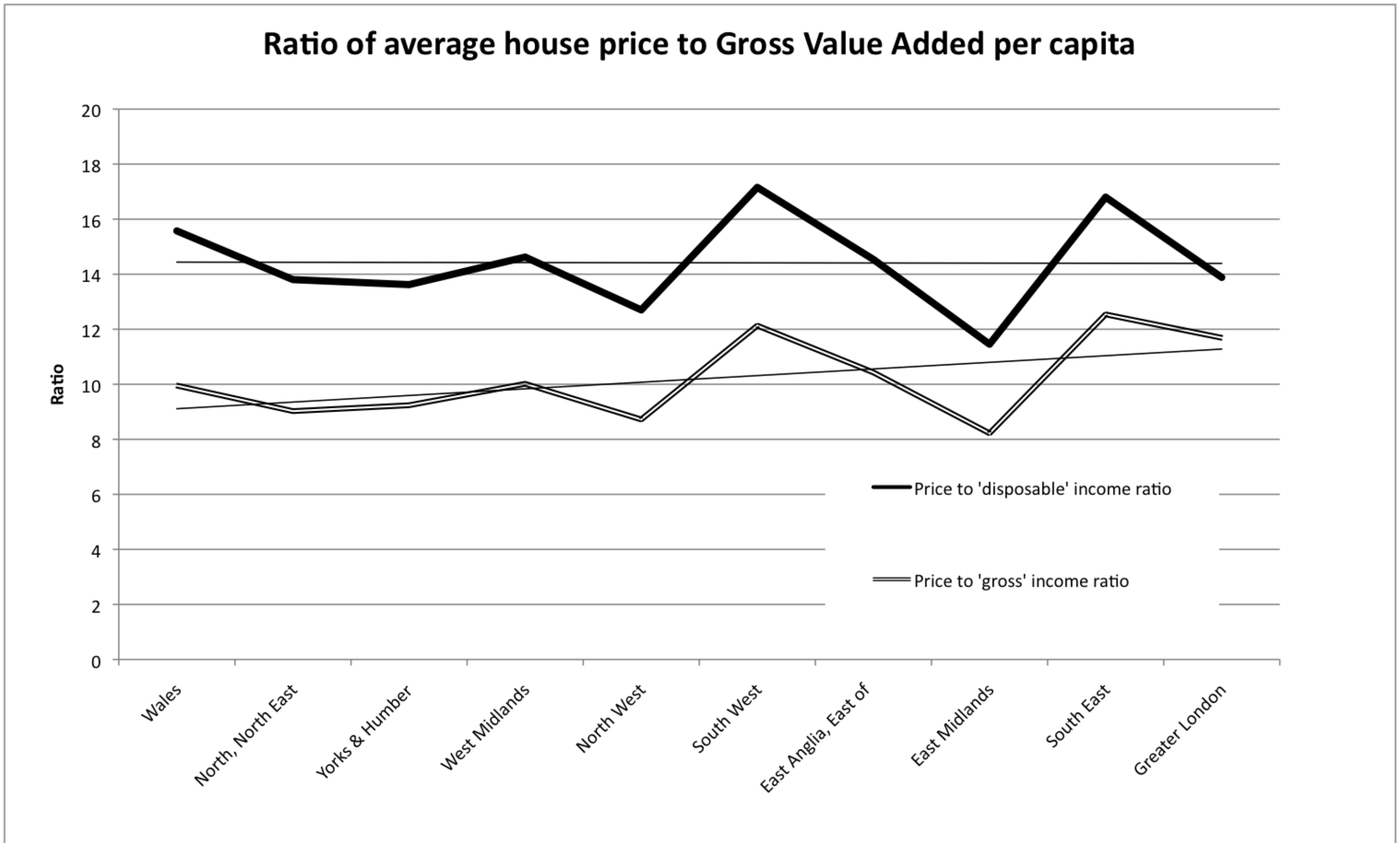
Publicly vs privately collected taxes (3)

- Thus prices and rents are a ‘balancing figure’ which soak up the difference in net wages (after income tax etc.) between high and low wage areas.
- The extra income tax you pay if you live in a high wage area is a ‘publicly collected tax’ and the extra rent or mortgage you pay is a ‘privately collected tax’.
- It would be conceptually easy to scrap publicly collected taxes on income, but all that would happen is that privately collected taxes would then absorb most of the income tax saved.
- Think about it – where are rents and house prices higher – in a high tax country or in a tax haven?

House price to income ratios (1)

- The chart on the next slide is based on regional gross value added per capita (from here) and regional house prices (from here).
- The upper bold line is based on gross value added minus £5,500 per person per year to arrive at 'disposable income'.
- To summarise, both publicly and privately collected taxes are a fairly fixed share of gross incomes. They are more or less interchangeable from the point of view of the person paying them.

House price to income ratios (2)



The UK is not an agricultural economy

- Although the UK could be just about self-sufficient in food if it wanted, the agricultural sector is barely 2% of the economy, measured by the number of farmers and the total value of food they produce
- The other 98% of the economy takes place on about 10% of the UK, by surface area.
- The total rental value of all the developed land (excluding buildings thereon) is a hundred times as much as the total rental value of all the agricultural land (ignoring taxes and subsidies).

So why not tax the rental value of developed land? (1)

- The amount of tax currently paid by a household is broadly proportional to its income; so is the value of the home it occupies. A similar relationship holds for businesses.
- Replacing the entire tax system with a tax on the rental value of developed land (agricultural land could be exempted without disturbing the logic of this) would thus not be particularly radical, and for most people, the tax burden would not go up or down dramatically.
- Taxes on income, profits or turnover depress economic activity, also known as ‘dead weight costs’. Incomes are under-declared, businesses go bankrupt or move abroad. By taxing these things you get less of them.

So why not tax the rental value of developed land? (2)

- The owner of any site can do very, very little to increase or decrease the rental value of the site, apart from obtaining planning permission or entering into a restrictive covenant (both of which are ‘social contracts’).
- Unlike taxes on income, profits or turnover, taxes on the rental value of land have no deadweight costs. Land cannot be moved abroad and the tax cannot be evaded or avoided, so this benefits honest taxpayers.
- The other main advantage of taxing the rental value of land is that the tax would act like a higher interest rate, thus keeping house prices low and stable; it would encourage efficient use of land and existing buildings and it makes it easier to measure which types of government spending ‘add value’.

The Poor Widow Bogey

- The standard counter-argument to the taxation of residential land is that elderly pensioners with small cash incomes (i.e. the state pension) would be ‘forced to leave their homes’.
- As pensioners’ main residences are only about one-sixth of all UK land and buildings by value, they could simply be exempted.
- This would have much the same effect as taxing them in full and paying out a more generous state pension. This would be far better economically, but not so good politically.

Measuring the rental value of land (1)

- Another standard argument against taxing rental values is that they are difficult to work out – you have to deduct the rent that relates to the buildings and improvements and just tax the location rent.
- To get the ball rolling, it is quite sufficient to work out a tax in £ per square yard for each smaller area (such as a postcode sector which is between two and three thousand addresses).
- The registered holder of each plot is then liable to an annual tax bill of the size of the plot x the rate in £ per square yard for that area.

Measuring the rental value of land (2)

- HM Land Registry has all the necessary information to work out average total property values, as it has recorded and published selling prices for the last ten years (and about half of all homes were bought and sold at least once in that period) and it knows exactly how big plot sizes are (what it doesn't know is held by the Rural Payments Agency and the registers for Council Tax or Business Rates).
- It is not actually necessary – or even particularly desirable – to try and be more scientific and to deduct the capital or rental value of buildings and improvements.
- Total property values are broadly proportional to incomes, so a tax on total property values would be a close replacement for the current tax system. Whether we take a smaller percentage of capital selling values or a larger percentage of rental values is neither here nor there as the result would be the same.

Measuring the rental value of land (3)

- This is where the concept of a 'Citizen's Income' – which would be the cornerstone of any sensible welfare reform - makes a second appearance.
- Provided the total Citizen's Income received by most households is more than any tax that relates to the rental value of the buildings (together with utilities etc), the net tax bill payable would, by definition, relate purely to the location rent.
- The tax burden on uninhabited residential buildings (including second homes and holiday homes) would not be subsidised by the Citizen's Income, so they are more likely to be brought back into full use.

Measuring the rental value of land (4)

- Once the tax system had 'bedded in', the rates in each area would be increased or decreased so that the selling prices of land and buildings never fell below the rebuild cost or insurance value of the buildings, and so that selling prices tended to even out across the country.
- Commercial buildings would not receive a subsidy via the Citizen's Income either, so this could be compensated for by applying slightly lower rates to commercially used land.
- Even if this didn't happen, it would not have a particularly terrible outcome. At present, commercial premises are liable to Business Rates, which are about ten times as much as the Council Tax would be if they were re-zoned as residential – and this differential would be very much reduced.

Small government (1)

- A government can be small either in terms of total taxes raised and redistributed, or in terms of the services it provides.
- Once a government does anything more than providing ‘core functions’ (law and order, defence, immigration control, roads, planning or zoning, fire service and refuse collection) it is hugely inefficient, even though it has massive purchasing power.
- For most things – even merit goods such as health or education - it would be far better to give people cash vouchers to be paid to competing private providers.

Small government (2)

- Most other things that the government does are simply not worth doing (EU membership, ‘Green’ subsidies, foreign aid, Identity database, wars in Iraq, Afghanistan etc).
- The total tax that could be raised on the rental value of land (in the absence of most existing taxes) would far exceed the cost of core functions of the state, and the cost of health or education vouchers.
- So why collect a tax that the government does not need to spend? What happens to this money? Why not just collect less to start off with?

Small government (3)

- To reply with another question: is the machinery of government primarily there to channel income from the productive economy towards landowners and homeowners (remembering that most homeowners are also workers), or is it there to defend the productive economy against rent seeking, and distortions?
- All in all, it is better for rental values to be collected and dished out as a Citizen's Pension or Citizen's Income than it is for them to be collected privately. The entire financial crisis that started in 2007-08 was based on the notion that people could become wealthier by buying up these streams of privately collected taxes (i.e. land rents) for ever higher prices.

Citizen’s Income & Citizen’s Pension (1)

- To sum up, the Citizen’s Income has at least four separate purposes;
- It can replace the entire welfare and state pension system and personal tax allowances for low earners;
- It ensures that the rental value of buildings and improvements is not taxed; only location rents would be taxed;
- It helps keep government small by putting money back into people’s hands.
- It would effectively make everybody a landlord (as well as being a tenant), so people would be able to concentrate more effort on creating new wealth rather than competing to buy up streams of privately collected tax (i.e. ‘land’).

Citizen's Income & Citizen's Pension (2)

- On a philosophical note, as everybody contributes towards land values (apart from a few burglars or particularly noisy neighbours, who can be punished or fined), why shouldn't that rental value be dished out again to everybody? Of course high earners and hard workers contribute more than others, but they will have benefitted most from income tax, VAT etc. being scrapped.

Putting some numbers on it (1)

- The Citizen's Income/Pension would be set at the following rates:
- Children up to 18: £35/week
- Young adults 18 – 24: £52.50/week
- Adults 25 – 64: £70/week
- Pensioners 65 and over: £140/week
- Severe disability payments would be unaffected
- This would cost around [£45 billion per annum less]() than the current welfare system and poverty alleviation measures inherent in the tax system.

Putting some numbers on it (2)

- Land Value Tax would be set at approximately 8% of total property values.
- This would be averaged out to give a £ per square yard rate between £30 (Burnley) and £150 (Outer London).
- The rates for Central London and other town centres would be about £1,000 per square yard. This affects mainly commercial premises (which are currently subject to Business Rates) and people who live in flats (who get an automatic reduction as the tax would divided by the number of storeys).

Winners and losers (1)

- Most people would break even after the transition, and there will also be plenty of ‘winners’.
- The ‘losers’ would be those whose home is currently worth more than seven times their total current household income.
- Broadly speaking, with an average current income tax rate of (say) 48% and a Land Value Tax of 8% on current property, the break even point is six (48% divided by 8%).
- An average working age household would receive a Citizen’s Income of around £8,000, which would effectively exempt the first £100,000 in the value of their home, pushing the break even point above seven.

Winners and losers (2)

- Most of those who lose out would not be ‘forced’ to sell their home. They could also:
- Try to increase their earnings.
- Sub-let a room or invite adult children or heirs to contribute.
- Cut back other discretionary expenditure, such as taking an annual holiday abroad or buying second hand cars rather than new ones.
- Pay off the mortgage more slowly (so the debt burden would be shifted from the public sector back to homeowners).