

RE-EMPLOYMENT WITHOUT INFLATION

BY NEUTRALISING the land-route-to-riches, direct saving out of income will be more desirable than in the past, and borrowing less desirable. This would raise the savings ratios, and pull down interest rates.

The permanent removal of the escalator will involve tax changes which will also provide supply-side benefits for the economy. The switch from the poll tax to the council tax is the first such change. The cash outgoing will encourage some homeowners to economize on space, and make the occupancy of the housing stock more fluid.

But in terms of the supply side, this is a very small step. Both the council tax, and the tax on commercial property, need to be improved. Their supply-side benefits would be vastly increased by exempting buildings from the tax base, and extending its coverage to all land, whether occupied or not.

The supplementary tax on all land rents to prevent land prices rising would allow tax reductions elsewhere. These should be chosen for their contribution to the assault on inflation. The greater the incentives for production, the less chance will there be for rising aggregate demand to run up against domestic production constraints.

Tax reductions cannot be chosen on efficiency grounds alone, however. Profits and employment levels would benefit by reducing employers' national insurance contributions and corporation tax. But taxes on business make good politics, as businesses as such do not have votes. (VAT changes are likely to be circumscribed by the European Community.)

Tax reductions for those who will bear the tax burden on land rents (the owners of equity in land) may be a political necessity. For although their net worth would not be eroded, their net incomes would be reduced (the cash flow of mortgagors, of course, would be protected by lower interest rates). To moderate the effect on land owners, income tax and employees' national insurance contributions should be cut.

Having chosen these taxes on equity grounds, the way they are reduced may be decided on efficiency grounds. Both equity and efficiency are, in fact, promoted by concentrating the cuts at the bottom end of the income scale. That would have the effect of diminishing the poverty and unemployment "traps". It would increase the take-up of lower paid jobs, reduce unemployment and extend the margins of production.

Making significant inroads into these traps is expensive. And there are efficiency trade-offs. Increasing the proportions of additions to earned income that may be kept as disposable income (i.e., reducing marginal tax rates) at the bottom end of the scale raises marginal tax rates (reducing incentives) further up the scale.

The Labour Party in its shadow budget this year devoted a billion pounds to raising the income tax threshold by 10% instead of the statutory inflation-determined 4.5%. That would have taken 740,000 taxpayers out of income

tax. But the political impact appeared to be outweighed by the fact that the reform was financed by higher income tax on the top 10% of incomes.

Such a reform could instead be funded by a tax spread out over perhaps 16m landowners, many of whom would simultaneously benefit from lower debt service costs.

Assume that the council tax is in place, but land rents are rising at 3% per annum. The land price stabilisation tax would be set to prevent those changes feeding through into land prices. Before the changes, the tax capitalisation equation with zero land price change built into expectations would look like this:

$$\text{Land price} = \frac{\text{annual land rent}}{\text{interest rate} + \text{tax rate on price}}$$

[That is, using approximate aggregate data (in billions of pounds)]

$$500 = \frac{40}{.052 + .028}$$

The council tax would be at an effective rate of 2.8% on land prices. To keep the changes in check, the equation would have to look like this:

$$500 = \frac{41.2}{.052 + .028 + .0024}$$

That is, a supplementary one-quarter of 1% (0.0024) on land prices, equivalent to 2.9% (1.2/41.2) on land rents, would have to be added to the taxation of housing land. This alone would raise £1.2bn, more than enough to fund a proposal like that from Labour's shadow budget. Commercial and industrial land would also be subject to the supplementary tax.

The land stabilisation tax, like the council tax, should enable interest rates to be lowered, because it would lower the risk of inflation in the long term. Assume that interest rates are shading down, at a rate of 3% per annum, but land rents are not rising. The previous equation becomes:

$$500 = \frac{40}{.05044 + .028 + .00156}$$

The supplementary tax needed in this case is 0.00156, raising £780m., equivalent to a 1.95% tax on housing land rents.

In practice, both these influences would be present. If they were as in the examples, housing land alone would raise £2bn., to be used to raise the thresholds of income tax and national insurance contributions. The object of this, of course, is to make more attractive the lower paid jobs, which at present are avoided by people receiving the dole.