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The Politics of Split Personalities

THE POPULAR VIEW that politicians are self-serving rascals and liars is not fair. As *private citizens*, the majority of them are sincere in wanting to help others. So why would I accuse those who serve in Her Majesty's Treasury as either myopic, or ignorant or dissemblers of the truth?

The gentleman whom I shall spotlight is not singled out because he is the worst of the bunch. He just happened to be the incumbent of that Whitehall bureaucracy –

which exercises the power of death over tens of thousands of people in Britain every year – when I challenged him over his claim to be a fair-minded spender of other people's money.

As I sat through a speech by Alistair Darling, I asked myself: what would a fair-minded citizen think, listening to the Chancellor of the Exchequer?

"I came into politics because of my sense of fairness," he insisted. Repeatedly. He wanted a "fair and more open society".[1] Don't we all? The difference is that, as Chancellor, Darling could contribute more to the fairness agenda that most citizens. As I listened to him, I recalled the testimony of the late Dr. George Miller. He was a member of Britain's prestigious Medical Research Council's Senior Clinical Scientific Staff, and Professor of Epidemiology at one of London University's colleges. At my request, he wrote a report explaining why about 50,000 people in England and Wales alone died prematurely every year – losing up to nine years of life – from causes that could be traced to the social and

1 Darling (2008).

economic havoc wreaked by the government's archaic way of collecting taxes.[2] Where was the fairness for them?

So after Darling had proclaimed his commitment to fairness, I asked him a question.

How could the Treasury possibly know if it was meeting his test of fairness?

I pointed out to him that the Treasury did not measure the "deadweight losses" which it inflicted on people with its taxes. So if the Treasury did not know – or disclose to the public – how much damage it was doing, through the way it raised revenue, how could he be sure that his spending policies delivered a *net gain* for society?

Darling avoided my question. If one of the goals of a democratic government is openness, *why doesn't the Treasury calculate and publish estimates of the damage its policies inflict on us?*

Darling wanted to discuss his alternative test: "Fairness is something you know when you see it ... it's about making sure that everybody has the opportunity to do

2 Miller (2003).

the best they can, not being held back because they can't get to work or get decent housing; it's about giving people opportunity, making sure they have all the chances you and I might take for granted." That *sounds* reasonable, but when you turn the spotlight on this Sensory Test, you realise that there is something deadly wrong with it.

The Sensory Test works well from the grandstand of a football stadium. When a soccer player kicks his opponent – that is popularly perceived as not fair play. If you saw a child walking down the street with holes in the soles of his shoes, emaciated from hunger, while the filthy rich ride by in their smart carriages – there is something self-evidently offensive to a normal person's sense of fairness about a community that tolerates this.

But the Sensory Test *does not work* when we are dealing with a government that spends billions of taxpayers' money on capital intensive infrastructure projects. In the complex economy, the winners and losers are not standing in street queues waiting to be counted. They are scattered far and wide, and hidden behind layers of laws and practices that were concocted to hide the effects on them. The only way to discover whether government is favouring one section of society against another is to follow the money trail. That is possible only if objective measures are employed to calculate the economic impact of tax policies. But the state does not encourage such policies. Therefore, it is not possible to audit the outcomes of its alternative policies.

Alistair Darling is the archetype of an honest person who is institutionalised into a political straightjacket. He does not intend to seriously mislead the public when he flies the Flag of Fairness. Sentimentally, politicians like him would like to be fair; but as stewards of a system that actively discourages such sentiments, they are compromised. It takes a man of the strength of character of a Winston S. Churchill to buck the system.[3]

3 For Churchill's speeches advocating the policy that is elaborated in the final chapter, see Churchill (1970).

A Princely Ransom

FAIRNESS IS NOT what our society is about. The laws are dedicated to delivering an unfair outcome.

The tear-jerking statistics on poverty and inequality are piled up high on the shelves of government agencies. That poverty is *not* the result of human nature (indolence of the poor, for example). But no-one knows what to do about the persistence of incomes so inadequate that millions of families could not exist without the subsidies transferred from other people's pockets. The people who are called the "core poor" live lives which are "income poor, materially deprived and subjectively poor". This contrasts with the 6% (in Britain) who are classed as "exclusively wealthy" – a category defined as people with "sufficient wealth to exclude themselves from the norms of society".[4]

But what is the mechanism that delivers this outcome? Politicians and social scientists have a tick-box list of descriptions of

4 Thomas and Dorling (2007: 290).

poverty, but not one satisfactory explanation for its persistence. The story of Britain's two princes, William and Harry, tells us all we need to know about the dynamics of poverty and inequality.

Charles, Prince of Wales, is a major land owner. He decided to raise £5m from the sale of 10 acres. This fund would provide the income needed to finance the passions of his two sons – playing polo and travelling the world. The money would come from families who purchased homes on land sold by the Duchy of Cornwall, the estate that built the king-in-waiting's favourite village of Poundbury in Dorsetshire.[5] Out of those funds would flow the income for Princes William and Harry, to secure their standing in society.

It was the trick that the aristocracy learnt long ago: privatise the land of the kingdom, lock it into the permanent ownership of the family, and secure freedom from having to work for a living. Instead, it was polo and politics all the way!

What is fair about that arrangement, when the majority of people of Britain

5 Hellen (2002).

cannot inherit any part of the land of their birth?

A fair deal is one in which people can earn their living without barriers that obstruct them in the marketplace for labour. And what they do not need is their elected government burdening them with tax policies that destroy jobs. And yet, that is exactly what does happen. The overwhelming obstruction to a "level playing field" is the tax regime cooked up by a Parliament in the days when it was controlled by landed patricians.

And who can we hold responsible for the persistence of this arrangement? Politicians elected on popular mandates to represent the interests of the people. People like Alistair Darling.

Finance ministers use the word "fairness" as their first line of defence, when they change the tax rules. The last thing they want anyone to think is that their raid on people's incomes is anything other than grounded in the rules of equity.

So we shall consider two examples of policy initiatives under Darling to determine whether, by his own test, government policy is designed to liberate people.

Seeing is Believing?

I WILL EXAMINE Darling's claim to be the champion of fairness in terms of the example that he specified, in his answer to me during that Q&A session at the Royal Society of Arts. He illustrated his commitment to fairness by citing the investment of taxpayers' money in the transport system. This was his evidence of how government pursued its funding policies for the greater good. "If you don't spend money on infrastructure," he said gravely, "you can see the results." There was that Sensory Test again: we can *see* the traffic congestion with our own eyes, right? So we need to spend money on railways, right?

Maybe. But my question was: how do we know that government expenditure yields a *net gain* (rather than an absolute loss of welfare). And how do we know that the benefits of investment in railways are *fairly distributed*? Without an estimate of the negative impact of taxes, those questions cannot be answered. And without that information, it is spurious to claim that government is dedicate to the open society.

I published a study in 2001 that reported the results of a survey by a London property owner, Don Riley. He owns buildings close to two of the stations being constructed for the extension of the London Jubilee underground line. He found that, because of the taxpayers' investments in that railway, he was being enriched without lifting a finger. By assessing the rise in properties around all the stations along the route south of the Thames, he discovered that land owners were enriched to the tune of about £13bn. This was *three times more than the underground railway cost to build.*[6] These findings were confirmed by an expensive follow-up study sponsored by Transport for London.

This outcome was neither fair, to the taxpayers of Britain, nor efficient, as a way of raising revenue to pay for transport. But when it comes to appraising social problems, we need to realise that the state is not an objective judge of the facts. Furthermore, even if its agents *did* understand why community-wide problems – such as poverty – persist, the state cannot act

6 Riley (2001).

Box 6:I

A Taxing Round with Mohammed Ali

Lord Forsyth believes that private enterprise would benefit if the tax burden was reduced all round. As a Member of Parliament in Margaret Thatcher's era, he learnt the economics of public finance from the inside. And once elevated to the House of Lords, he could speak his mind on the way government distorts the economy through taxation.

A career in the City as a banker also gave him insight into the way taxes prejudice people's entrepreneurial instincts. And as Chairman of a Tax Reform Commission, he spelt out the way in which Britain's Conservative Party could slash taxes to boost incomes. But the peer had a strange view on the notion of fairness. When asked about the benefits of abolishing taxes that distort incentives, and raising additional revenue from rental income, he replied: "My view is that the tax system should be neutral as regards people's activities. I don't think you should use the tax system to encourage any particular economic activity".* ➤

Box 6:1 (contd)

In brushing that particular tax reform aside, his Lordship was defining fairness in a way that preserved the fundamental distortion in the economy. Retaining existing taxes, and merely reducing the tax rates, is like saying that a match between Mohammed Ali and a bantam weight boxer is fair, providing the rules in the ring applied equally to both men.

In the present society, the starting point – the initial endowments – are rigged to favour existing land owners. The best illustration is the one Lord Forsyth held up as an exemplar of low taxation. He cited Ireland, the Celtic tiger whose "miracle was home grown". Unfortunately, the EU subsidies that made it possible to slash the corporation tax to 12.5% also fuelled the housing market. Prices rose faster than in any other OECD country. The outcome was a crippling indebtedness that rendered Ireland's banks more vulnerable to the 2007/8 credit crunch than any other country in Europe. This was the inevitable outcome of the tax policies admired by Lord Forsyth.

* Lord Forsyth "Taxation Policy for the Long-term: The Importance of Sound Tax Policy for the Health of Britain's Economy", The State of the Economy Conference, London: Institute of Directors, February 26, 2008.

impartially. The state is locked into the philosophy of property rights (and the complementary tax policies) inherited from an antediluvian past, which put in place the arrangement that privileges land owners.

Today, the rationale for this tax regime is nourished by the Right (see box above), but retained by the socialist Left.

Railroaded by the State

MY SECOND EXAMPLE of government fairness relates to funding under the Public Finance Initiatives (PFIs). These were audacious vehicles for transferring the rent of real estate from the public domain to private pockets. To understand how this scam works, we need a brief excursion into the way the pricing mechanism works in the markets. We will illustrate the theory by again referring to the policies employed to fund Britain's railway network.

The privatisation of British Rail, the national rail system, proved a failure because taxpayers still had to underwrite a large part of the costs of operating the network. Politicians had failed to apply a pricing mechanism that was fair to everyone. I described the economics of this fiasco in *Wheels of Fortune*.[7] Am I too harsh in branding the PFI funding model as a racket? Judge for yourself.

Politicians claim that by involving private enterprise, taxpayers are relieved of the burden of funding social amenities. Private investors partner a public agency and raise the money to pay for the construction of a school or hospital. In return, they pocket the profits over 30 years. But the Treasury also gains an advantage: the capital cost is not shown on the nation's books. But National Audit Office investigations have shown that the liability on taxpayers is frequently far greater than if those amenities had been funded by cash borrowed from the money markets by government.

The racket, however, goes even deeper than that, as illustrated by the increase in train fares introduced on January 1, 2008.

Fares were increased by up to 11% – three times the rate of inflation. The railway operating companies said they needed the money to fund investment in the rail

7 Harrison (2006a).

infrastructure (new lines and stations). According to the government, it was fair to place the cost on travellers, because this reduced the burden on taxpayers (many of whom did not travel on trains).

The first issue to bear in mind is that the net economic gains from the improvements in productivity from these investments are not captured by the travellers whose higher fares pay for the capital improvements. The economic value that flows from such capital investments is transferred to the owners of land whose assets are within the catchment areas of the stations serviced by the trains. You would think that, in a society that is supposed to be based on the principles of justice (such as: *getting your just deserts*), the capital costs of improvements to the rail network would be defrayed out of those land values. *Not a bit of it!*

Landowners, of course, want to keep the windfall gains well away from the public gaze. And governments conspire with them, by remaining silent on the question of who gets what, and how much, as a result of investments in infrastructure. Examine the books supplied by the

Treasury to Parliament once a year, on budget day, and you will not find any clue as to how the capital gains are reserved for land owners.

The Treasury champions a pricing policy that confines the burden to the incomes of railway passengers. Thus, commuters who bought tickets to travel to work after the New Year break in January 2008 were forced to carry a burden that further enriched the owners of land. The higher fares they paid would, indeed, fund improvements to the transport system. But the net gains would still trickle down to land. But now the pain, instead of being shared among all of the nation's taxpayers, was borne by a smaller group of people. The fares not only covered the operating costs of the seats occupied by the travellers, but also the capital costs of the infrastructure.

The financial consequences affect the character of our communities in profound ways. For under the tax regime approved by Parliament, each new generation finds itself unable to afford homes near the centres of towns where they work. So they are displaced further and further out to locations of lower land value. They are consequently forced to commute long distances by road or rail to places of employment. They are the people who can least afford to pay taxes, including the levies on the train fares to fund the infrastructure. And yet, they are targeted for milking by the private rail companies in league with the Treasury. And this is deemed to be wise statecraft by democratically elected representatives of the people!

The Pathology of Taxation

THE GOVERNMENT'S pricing mechanism – taxation – is a pathologically insane way to fund services such as military defence and law and order. That this perverse revenue system originated long ago is not an excuse for governments today, which conspire to deprive their citizens of their due rewards.

For a display of gross political offensiveness to the spirit of democracy, and people's personal rights, it would be difficult to trump the financial dealings of Britain's Treasury. It is quartered in a newly refurbished building that stretches from Whitehall to St. James's Park, the other side of which is Buckingham Palace. Tony Blair's government brought in private capital to refurbish that building and now pays rent to the corporation that undertook the work. You would think that those rental payments (by taxpayers) were liable to a tax that would return to the public purse. In fact, the corporation that undertook the refurbishment relocated itself offshore to avoid paying tax on its profits.

More than 50 PFI schemes were buried in portfolios held in the Channel Islands tax haven by three PFI investment companies. They were lawful. But why, therefore, should we be indignant when wage earners try to conceal their overtime earnings from the taxman?

Bad taxes corrode public morals. This inter-connection between public morality and law and order is highlighted by the economics of the Home Office, the state department responsible for Britain's police force. *The Guardian* exposed the economics of the Home Office's headquarters in Marsham Street, Westminster. A £311m PFI deal was struck with HSBC bank in 2005. This deal was supposed to save taxpayers money. Did it? The bank created a UK company with a 175-year lease on the building. A year later, when the building was ready to be occupied, 80% of the company’s ownership was transferred offshore to the Guernsey-based HSBC Infrastructure Company Ltd. This meant a large slice of tax revenue from the rents paid by taxpayers for the occupation of the building would not end up in the public purse.[8]

If Britain’s biggest bank can employ such schemes, can we really blame people for evading their fiscal obligations?

Economists who man state treasuries know that conventional tax policies do not make sense. They undermine the productive capacity of the economy. Taxes on wages and savings distort incentives to work and invest. The result: we produce much less income than we are capable of generating.

TONY BLAIR’S government went all-out to equalise the population’s life chances. Result after 12 years? Lives of the lowest income earners are cut short by

8 Hencke (2008).

an average of 7 years. And healthy living is cut short by 17 years, according to *Fair Society, Healthy Lives*.[9] No-one blames "progressive" taxation, even though the poor pay 38% of their income in taxes compared with 35% for the rich. Politicians like Alistair Darling seek refuge in the doctrine of dependency: tax-funded cash transfers to support children living at the margin where the state of their housing circumstances disadvantage them for the rest of their lives. On February 11, 2010, Housing Minister John Healy declared that having their homes repossessed might be the best option for families who could not fund their mortgages. Mr. Healy banked over £129,000 in expenses on his second home since 2001. Fair?

Meanwhile, Chancellor Darling is censured by Parliament for keeping secret his plan to hand £18bn to banks to keep afloat a bankrupted system that manufactures poverty. Treating politicians as sincere in their aspirations is tough in the face of the evidence. *Something* is wrong … but no-one is asking the radical questions.

9 Marmot (2010).