

Afterthought

Democratising the People's Finances

Ron Banks

AFTER a century of grand experiments based on social engineering, the democratic process has exhausted itself. The West is at a political crossroads. Our hard-won personal liberties are best protected if we now turn our attention to reform of the public's finances.

The democracies inherited their tax policies and philosophy from the aristocracies of Europe and the patricians of colonial America. Now, to demonstrate their maturity, they need to reconstruct the public's finances so that they synchronise with the politics of democracy. Otherwise, the direction of change will be backwards. The alarm bells are already ringing in the United States.

The richest nation on earth, in GDP per capita terms, is guided by a dream that has the appearance of being bankrupt. According to Paul Krugman, a professor of economics at Princeton University: "Income inequality in America has now returned to the levels of the 1920s . . . given time . . . we will grow ourselves a hereditary elite . . . And the new elite, like the old, will have enormous political power".¹

Krugman chronicles the return of the Gilded Age. The mansions being built by today's super-rich would leave *The Great Gatsby* awestruck. The New Deal years of the middle of the 20th century, when social policy was supposed to narrow the gap in incomes and reduce the vulnerable state of people at the bottom of the pile, might as well not have happened. A Congressional

¹ Paul Krugman, "For Richer", *New York Times*, October 20, 2002.

Budget Office study discovered that between 1979 and 1997, the after-tax incomes of the top 1% of families rose by 157%, compared with a 10% gain for families near the middle of the income distribution. The condition of those on the lowest incomes does not bear thinking about.

The right-wing guardians of official orthodoxy work assiduously to legitimise this reversal of the middle-American family's dream. The hard facts, however, are not controversial. The facts relevant to the study by Dr Miller concern life expectancy. Krugman reports that "life expectancy in the US is well below that in Canada, Japan and every major nation in Western Europe. On average, we can expect lives a bit shorter than those of Greeks, a bit longer than those of Portuguese. Male life expectancy is lower in the US than it is in Costa Rica".

The highest GDP per capita, it seems, has not translated into length of life expectations. The reason is to be found in the widening gap between the rich and the poor, a gap disguised by reliance on average income data. The comparison with Sweden – whose social policies are denounced with vitriol by the American Right – dramatises the point.

GDP per capita is lower in Sweden, but that is largely because Swedish workers choose to work fewer hours; *they choose to enjoy more of their lives while on holiday*. The American family's average income has risen, but that is largely because wives have been driven to wage-work in order to make ends meet. Outcome: life expectancy in Sweden is about three years longer than that of the US. No matter how many dollars an American citizen may have, these cannot – yet – buy those extra three years of sweet life.

But the solution to the American crisis is not to emulate Sweden's high tax regime. Historically, Japan and Taiwan demonstrated that economic progress and years added onto people's lives are consistent with a low tax regime. But in those two cases – during the formative years of their transition to the industrial economy – governments relied relatively heavily on the rent of land to defray public expenses. As a result, they could hold down the levels of taxes that damage economic incentives. That is the lesson that the Blair Administration needs to translate into policy reform in Britain.

As a nation, it is agreed that we need to devote more resources to improving people's health; which, in turn, would add a significant number of years onto many people's lives. Dr Miller has outlined the general strategy for fiscal reform. The transition needs to be phased in – we do not want the “shock therapy” tactics that I observed first-hand being applied by the West in Russia during the 1990s. But we need a glimpse of the benefits that would be enjoyed at the end of that change. So I would like to illustrate how we could radically reduce selected taxes to deliver the Health Dividend: higher incomes for *everyone*, and longer lives for those who are dying needlessly.

I suggest that the Treasury should target Income Tax for immediate reduction, starting with a cut of 5p in the pound off the standard rate. This would cost the Treasury about £15bn each year. If we compensated for this loss by raising an equivalent sum from the rent of land and natural resources, two crucial things would happen.

First, by reducing the excess burden of that tax, we can anticipate an increase in the nation's income of something like £47.5 billion. This would take some time to work its way through the economy, but sustainable economic growth would establish itself above the present ceiling. This extra sum in economic growth would, in per capita terms, be equivalent to £790 a year for every man, woman and child in Britain, or £3,160 for a family of four. This sum would be additional to the advantages obtained from the reduction in income tax of 5p, which is a sizeable sum in itself!

- If the government were to take, say, 35% of that *additional* income as public revenue, the kind of percentage that it takes at present, it would have in its coffers additional revenue of £16.6bn *each year*. This figure is much higher than the Wanless Report estimate of what was needed to bring the NHS up to average European standards.

The second consequence of this tax conversion would be a smoothing of the business cycle: instead of the booms and slumps that are provoked by land speculation (many of us are engaged in this process through the housing market), we would achieve

sustainable growth. The land and property market is a huge sector of the financial market, involving banks, insurance companies, the stock market, property companies and developers. The effort, energy and financing of this sector, mostly a speculative one, would be transferred to more productive investments.

As a consequence, productivity rates would rise, and the impact on our collective psychology is not quantifiable. Communities would flourish, neighbourhoods would experience organic renewal, and rural areas would experience a renaissance that is beyond the dreams of those who lobby for the miserable subsidies from the Ministry of Agriculture.

But is there sufficient land value to accommodate this tax conversion? The figures from *Double-cross* support this contention.² If the highest percentage is taken (£190bn), there is obviously more than enough. The £15bn I am suggesting for tax conversion is only 8% of the value available. But if we take the lowest percentage, £109bn, it is still only just below 14%.

This suggests that we could continue to convert the tax system on a regular basis, allowing time for the first conversion phase to settle down and show the benefits: perhaps another 5p reduction in income tax, which would double the benefits above; or perhaps a reduction of Corporation Tax of 25%, a loss to the Treasury of some £8.45bn, and another reduction of excess burden, delivering increased national income of £26.75bn.

We could then tackle Capital Gains Tax. Total abolition would cost the Treasury £3.4bn and deliver increased income of £10.75bn. Abolition of Stamp Duty (£7.2bn) would deliver an increase of £22.8bn.

Last but not least, Inheritance Tax should be abolished (£2.3bn) delivering an increase of £3.7bn. The increase delivered from the abolition of this tax is lower than the others because much of Inheritance Tax is property and land related, which value would be lower due to the tax conversion to rental values.

Facilitating all of the above tax conversions would still be below the figure for land value at the lowest estimated figure, £109bn. The increased national income delivered by all the above would amount to £111bn. The Treasury incurs no loss of revenue

² Ronald Banks, *Double-cross*, Centre for Land Policy Studies, London, 2002, p. 22.

from this tax conversion *and* it receives this massive increase in national income. Again, if the Treasury receives some 35% of this increase in tax revenue, £39bn, *each year*, expenditure on public services can be increased, and the health dividend can be assured.