2
The Failure of Economics

Taxation is, as will be argued in the following chapters of this work, a primal cause of both inflation and unemployment. The development of Keynes' general theory of employment leads to the conclusion that an open trading economy is likely to be most competitive, and therefore most prosperous, only when all taxation is abolished. Taxation raises the value of Z for all values of N (p.20), thus in a free market a prerequisite for efficiency and competition working together to reduce an economy's aggregate supply price to a minimum is the abolition of taxation. Regardless of this, the freely elected governments of contemporary trading economies — with the acquiescence of their electorates — persist in raising the major part, if not all, of their revenues by means of taxation. The immediate cause of such action by governments, and for the acquiesence of their electorates, is ignorance of any acceptable alternative method of raising sufficient public revenue. Ignorance of any alternative has led, without any further questioning, to taxation being accepted as the necessary source of public revenue. As a consequence economic debate on public revenue has become limited to considerations of appropriate methods of raising that taxation and of the amount that might be raised. Any discussion on the possibility of an alternative source of public revenue other than taxation has vanished from orthodox economic literature. The underlying cause is, however, a failure by economists to perceive the special nature of a developed trading economy. Econo-

mists must, as a first step, re-investigate the basic economic processes common to all developed trading economies.

The Primary Division

In any productive process, a process by which the natural world is modified so that the human race may live and live more fully, human labour is a necessary factor. 'No work — no product' is a fundamental law of the universe. Individuals may violate this law but collectively the human race cannot. Justice works. When justice is ignored at the individual level then it works on the mass and is often described as injustice. In addition to human labour every productive process needs also one or more non-human factors. Some writers on economics lump all non-human factors together and call them 'capital'. Other writers distinguish between non-human factors in their natural state unmodified by labour, which they often call 'land', and reserve the term 'capital' for those non-human factors which have been already modified to some extent by labour. When this latter distinction is made then both land and labour are necessary factors of production and for some productive processes may be, in particular combinations, sufficient. For certain analytical purposes even finer distinctions may be useful but such distinctions do not alter the basic requirement that in any productive process a human factor plus one or more non-human factors are necessary. This holds for the most primitive productive process in a self-sufficient household as well as for the most technologically advanced process in a highly developed trading economy. There are, however, fundamental differences in the nature of a non-trading economy and a trading economy.

In a non-trading economy a productive unit such as a self-sufficient household produces an output in its entirety solely for the enjoyment and consumption of its own members. What matters to the members is the quantity and quality of

the output they have laboured to produce. A bumper harvest means a year of good living whereas a poor harvest may mean death through starvation. Although such extremes of self-sufficiency may be rare today, there are many examples of communities in which individual households are the productive unit producing an output primarily for their own enjoyment and consumption, trading at most only what happens to be surplus to their needs. For them the quality and quantity of the output is of major importance and relative prices hardly matter. On the other hand in a trading economy an output is produced primarily for sale. In this fundamentally different circumstance what matters to a productive enterprise is not only the quality and quantity of the output but also the per unit market prices of that output. For example, if a bumper harvest leads to depressed market prices, then farmers may suffer, while the enhanced prices following upon a poor harvest may work to their benefit. Thus in a trading economy the emphasis is on income rather than output, and an important factor determining the nominal income of a productive enterprise is market prices.

For a non-trading economy comprising self-sufficient productive units Ricardo's theory of rent is directly applicable. The same capital and labour applied to the least fertile land in use will produce less output than when applied to the most fertile land in use. In Ricardian terms this difference in output is 'rent' and it arises solely from the differences in the fertility of the soil in use at a particular location over that at the margin of cultivation. Given private ownership of land the primary division of the output is between rent, the share of the output accruing to the landowners, and wages, the share of the output accruing to those who supplied the labour. The return to capital is a secondary claim on wages. In the case of a trading economy Ricardo's theory of rent is not directly applicable. In general differences in the fertility of the soil are of no matter. Even in the case of farming while fertility may be a factor determining the kind of farming

undertaken it is of far less importance than the location relative to customers and suppliers. A farm in a good location but with poor fertility will provide the opportunity for a better living than one with more fertile soil in a bad location. In a trading economy what matters in the general case is not the fertility of the soil but the advantages (externalities) available to a productive enterprise at a particular site. These advantages cannot give rise to a Ricardian rent for, as will be argued, they are produced by a combination of human and non-human factors. The essence of the Ricardian theory is that rent arises from a non-producible fixed factor.

The return to the factors of production in a trading economy is not, as is the case in a non-trading economy, a share of the output produced but a share of the income received from the sale of that output. There is a primary division of income rather than a primary division of output or wealth. The return to the human factor of production may be described as a *labour income* as it accrues to those who supply the necessary labour to the productive trading enterprise. The return to the non-human factors of production may be described as a *property income* because it accrues to those persons or corporate bodies who for the time being enjoy property rights over the non-human factors. The incomes commonly referred to as rent, interest or profit are sub-divisions of property income. However, what these factor incomes, or product shares, represent in real terms, will depend upon the relative market prices of the assortment of goods and services purchased out of those nominal incomes. For example, what labour income represents in real terms will depend on the price of what Pigou called 'wage goods' — the assortment of goods and services purchased out of labour incomes. Thus, assuming no change in nominal labour income, the share of the product accruing to those who supply labour will increase when the market price of wage goods falls and contract when the market price of

wage goods rises. Market prices are of no significance in a non-trading economy but their influence permeates a trading economy.

Property Rights

The division of the net receipts from the sale of output between labour income and property income is the means by which a trading economy, through bargaining and market mechanisms, provides returns to the different factors of production. This primary division of income arises from the very nature of a trading economy. It follows that, to argue this division and the mechanisms by which it is achieved are the primal cause of the extremes of wealth and the other social diseases that appear endemic in contemporary trading economies, is to argue that these undesirable results also are in the nature of a free market trading economy. The argument accepts implicitly that in the nature of a trading economy 'the poor', in more senses than one, 'will always be with you'. The logical conclusion is that either the free market trading economy must be got rid of or attempts must be made to mitigate the undesirable results.

This conclusion has some apparent validity in certain circumstances. A free market allows property rights over the non-human factors of production to be accumulated in perpetuity into single holdings without limit. The same does not apply to the human factor, labour; the human effort any one person can make is strictly limited both in time and amount. Thus there arises the possibility of a concentration of property rights in the hands of a minority who, in order to produce an output, must become buyers of labour. The result is a society comprising a comparative few who are for ever growing richer and more powerful alongside the many who, having nothing to sell but their labour, are relatively poor. Some part of this majority is rendered poverty stricken when it is unable to sell its labour. This sequence of events is

commonplace in contemporary trading economies and a matter of widespread concern, but so long as the cause remains, the result is unavoidable. The cause, however, does not lie in the nature of a trading economy: it is rooted in human failure, the failure of communities to conform to the principle of private property.

Except by fortunate accident, the primary division of income in a trading economy cannot result in what justice demands so long as the principle of private property is being flouted. John Stuart Mill in his *Principles of Political Economy* wrote, 'The laws of property have never yet conformed to the principles on which the justification of private property rests.'[1] This criticism continues to apply some 150 years later. The essential element of these principles, he wrote, 'consists in the recognition, in each person, of a right to the exclusive disposal of what he or she may have produced by their own exertions, or received by gift or fair agreement, without force or fraud, from those who produced it.'[2] Mill emphasised some of the consequences when members of trading economies fail to conform to this principle by custom, usage and law. Most of his remarks ring true today. Yet Mill's nineteenth century arguments couched in the Ricardian mode may mislead if applied directly to the present circumstances. Today landowners as a special class of persons are not, as Mill and many of his contemporaries implied they were in their day, the active culprits. Over the years the ownership of a title to land has become widespread and the majority of these landowners are more the passive acceptors of that to which by law they are entitled to receive and which the law allows them to keep in the most part for their own purposes. As Mill acknowledged it is governments who persistently fail in their duty to uphold the principle of private property and by their failure allow a few to exploit the economy for personal or corporate gain. Inflation, unemployment and the apparent general lack of justice which corrodes contemporary trading economies flow

directly from the repetitive flouting by governments of the principle of private property.

Tax Revenue

In a trading economy both labour income and property income in the first instance accrue naturally as private income. Unless government has property rights over some or all of the non-human factors of production the primary division of income does not automatically provide a public revenue for financing necessary public expenditure. The common first reaction of governments to a lack of public revenue is to seek relief through the imposition of taxation. By whatever names taxes are called, or by whatever methods governments may use to raise tax revenue, taxation is in effect an arbitrary levy imposed by force or the threat of force (p.39) upon those in receipt of a private income. In their effective incidence all taxes are income taxes. By force of statutory law taxation denies to the individual taxpayer the right to the exclusive disposal of that individual's private income. Taxes either appropriate directly nominal private income, or erode real private income through rising prices, or, most often, both at once. Thus all taxation flouts the principle of private property. To describe taxes as customary duties, insurance, or (as happens in the preamble to the Annual Finance Act of the United Kingdom) 'gifts', is to use constitutional fiction in an attempt to obscure the nature of the act.

Governments, politicians and others put forward a wide variety of arguments in an attempt to justify the imposition of taxation. It is argued, for example, that progressive taxation offers the means for redistributing income from the rich to the poor. This argument may be sufficient to add morality to the medieval romance of Robin Hood but it does not add morality to the actions of twentieth century governments. In any event the evidence suggests that progressive

taxation is ineffective for this purpose and that any redistribution achieved by governments flows from the expenditure side of the budget. In most cases taxation does little more than rob Peter to pay Paul what Paul could have better provided for himself had he also not been robbed in the first place. The various arguments put forward in an attempt to justify taxation may well be accepted by a majority of the electorate, a majority of the electorate may even appear to favour higher taxes for certain purposes, as the statistical wizards of some opinion polls claim, but none of this changes the nature of the act. With the imposition of taxation governments fail to conform to the principle of private property. Politicians may pay lip service to a 'property owning democracy', but when in power they misuse the force of statutory law and do not recognise in each person a right which is an essential element for the institution of private property. Trade is a matter of exchange, and fair exchange requires that each party to the exchange has and respects the valid title to whatever is exchanged. Any flouting of the principle of private property undermines the very foundations of a trading economy. Governments persistently flout this principle by the imposition of taxation.

The Road to a Mixed Economy

When governments become reliant upon tax revenue for the financing of public expenditure they cease to be subject to the discipline of having to adjust spending to income, a discipline that continues to apply to the private sector. The reverse discipline of adjusting income, that is tax revenue, to spending decisions has today become the accepted principle of public finance. United Kingdom governments, for example, take their spending decisions during the winter and to raise the necessary moneys present their budget the following spring.[3] This now unquestioned principle of public finance when allied to universal suffrage creates political

pressures which work towards public profligacy. As the government's failure to uphold the principle of private property leads to extremes of wealth, this in turn sets up stresses and strains within the community and it appears to politicians they are faced with a choice. They may promise to do little or nothing and suffer the electoral consequences or they may offer some form of mitigating action. Mostly the freely elected governments of the developed trading economies have opted for mitigating action. At the outset this took the form of limited social and welfare schemes intended to relieve the worst excesses of social deprivation. However, the political pressures generated in these economies by universal suffrage are such that this road has led, step by step and with the best of intentions, to the very expensive welfare state. In today's circumstances the need for some state welfare is all too apparent but to meet this need governments know of no alternative other than raising taxes. In other words governments, driven by political pressures and good intentions, attempt in their ignorance to spend their way out of trouble and to finance this spending by multiplying their tax take. The United Kingdom provides an example; tax revenue as a share of the net national product (NNP) at market prices has multiplied five fold during this century. A major part of this increase in tax has gone to finance the ever rising cost of establishing and attempting to sustain a welfare state. Yet the very circumstances that create the apparent need for extensive state welfare arise in the first place from the imposition of taxation.

As tax is an arbitrary levy on private income it cannot, regardless of political intentions, take fully into account an individual taxpayer's ability to pay. In the long run an ever increasing tax take tends in aggregate to squeeze disposable property income rather than disposable labour income. Again the United Kingdom provides an example. During this century the U.K. tax take has increased from between 8 to 9 per cent of net national product at market prices to over

40 per cent. Over the same period, while the share accruing as disposable labour income has fluctuated around a constant secular trend, the share accruing as disposable net property income has fallen from around 45 per cent of net national product at market prices to around 14 per cent. As property income is squeezed by taxation the firms in marginal industries sooner or later find themselves in a precarious financial position. Out of their disposable net income (all that is left out of income after meeting tax demands) they cannot pay an acceptable take-home pay to their employees, provide an acceptable return to those enjoying property rights over the firm itself and at the same time fund the investment necessary to remain competitive. As these threatened firms tend to be in industries basic to the well-being of the economy as a whole — agriculture, mining, railways and the like — in combination the firms have the power to demand and get some measure of protection (tariffs and the like) and financial support from government. By inhibiting trade, protection damages the whole of a trading economy while government financial support requires an increased tax take. Thus a course is set along a road upon which with every succeeding step economic and social difficulties are intensified and multiplied.

Along this road political pressures and the immediate needs of the economy eventually force governments into either taking over existing firms in a failing industry or allowing firms to go to the wall, setting up in their stead new state corporations. When this happens there is brought into existence what is called a 'mixed economy'. In a mixed economy some property rights over non-human factors of production are vested in the state and thus any property income that may accrue is a public income available to help fund public expenditure. However, the industries brought into the public sector in this way are mostly loss making firms who have failed, or who were in danger of failing, in the private sector. Governments find, therefore, that instead

of being in receipt of a property income they are forced to increase public spending to pay an acceptable take-home pay to the new public employees and to provide funds for long overdue new investment. More public spending means an increased tax take and an increased tax take puts even more firms at risk. Once established, the public sector of mixed economies, like Topsy, 'just growed and growed'. As the public sector grows so also does the tax take.

The Reaction

For the quarter of a century following the end of World War II the elected governments of developed trading economies sought to mitigate social and economic afflictions by big government with extensive welfare schemes and a large public sector. Taxation was accepted not only as the means of raising the required public revenue, but also as an essential fiscal instrument for managing the economy. In general their approach was consistent with the policy prescriptions of the then dominant demand-side school of economic thought. When it became a fact of experience that this approach was failing and creating more troubles than it mitigated there came a reaction both in politics and in economic thought. The reactionary approach, consistent with the now dominant supply-side school of economic thought, requires the slimming down of government, the so-called 'targeting' of welfare schemes, a significant contraction of the public sector and a cut in the tax take. Unfortunately there is no evidence that any government has met the latter requirement to any significant extent. In any event the latest approach must fail, as did the earlier, so long as government remain ignorant of any acceptable alternative to persistently flouting the principle of private property by imposing taxation as the means of raising public revenue. Neither the old nor the new economic orthodoxy can offer enlightenment to government on this fundamental issue. As Ricardians note

the primary division of wealth as between rent and wages, the later schools note the primary division of income as between labour income and property income, but fail to perceive further the special nature of a free market trading economy and, as a consequence, accept without question that public revenue means tax revenue. Worse, they accept also without question that the amount of tax revenue is to be determined by government spending decisions.

1. John S. Mill, *Principles of Political Economy*, Bk. II Ch. I para. 3.
2. *Ibid.* Bk. II Ch. II para. 1.
3. The present government (1993) are considering proposals for changing this order.