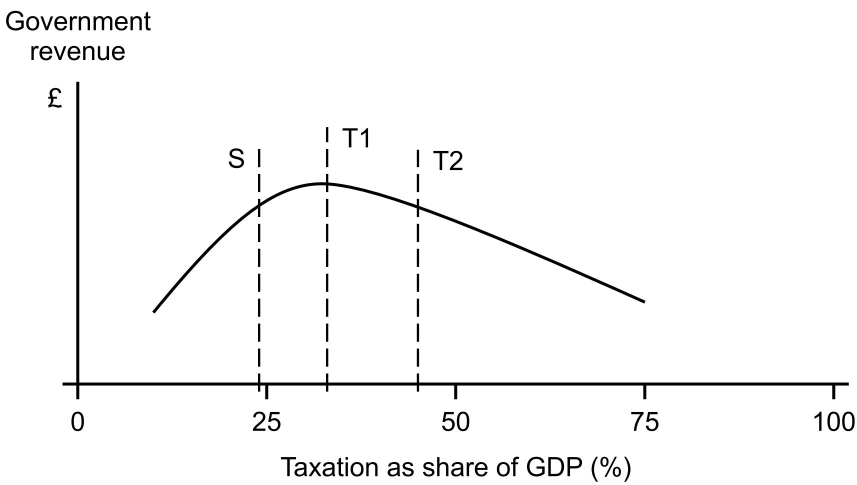
LEVELLING UP

The upper limit of taxation

When taxation as a share of GDP is increased above the economic upper limit, shown as T1 in the chart below, to a higher level T2, the economy contracts. Government income declines in real terms.

Reducing the level of taxation from T2 back towards T1 allows the economy to expand. At this point, however, government income is unstable. A further reduction from T1 towards S provides the same government income as at T2, but with greater economic stability.

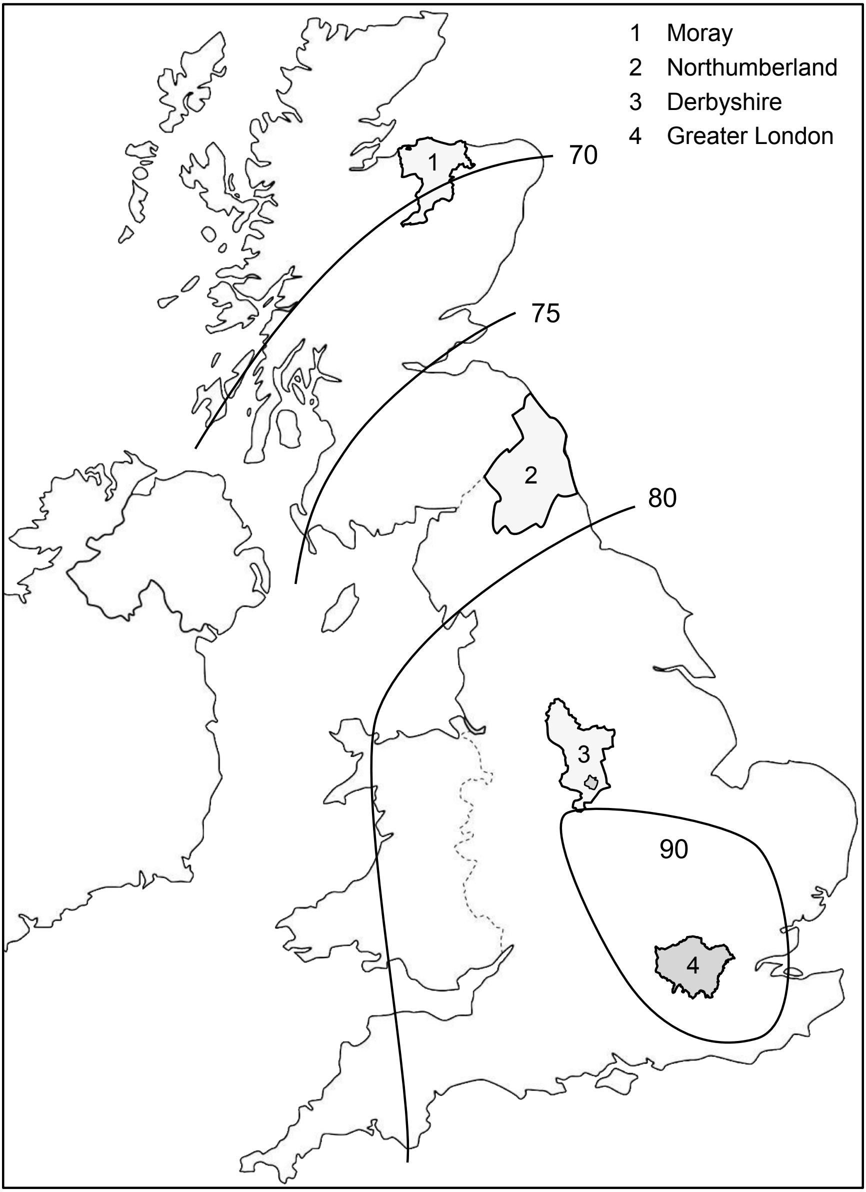


Economic potential

For a firm in a foot-loose industry, economic potential is the total effective demand that can be addressed from any given location. It takes into account the purchasing power of all potential customers after making due allowance for the effect of distance-related costs.

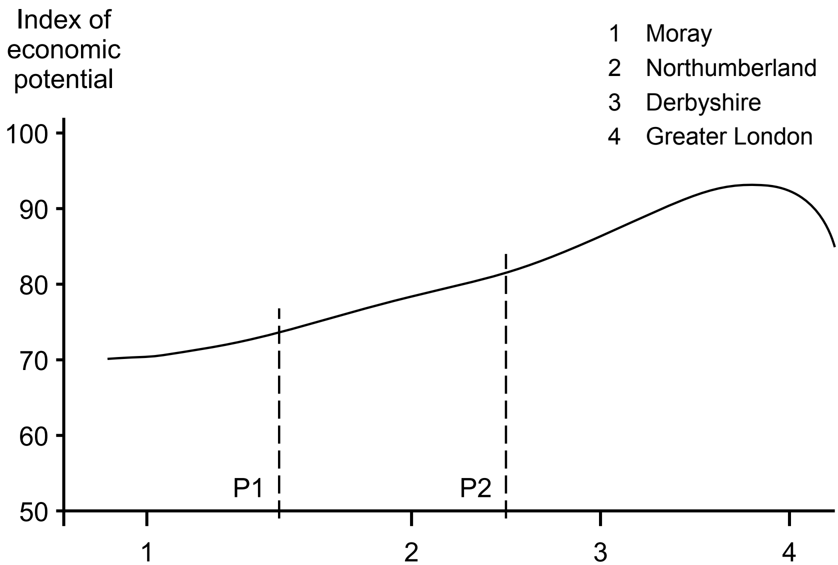
In the UK, the gradient of economic potential is aligned from north to south and can be illustrated by using an index of up to 100 units.

Moray, Northumberland, Derbyshire and the Greater London area are positioned along the gradient of economic potential with index numbers from less than 70 units, up to the maximum of 100 units.



The gradient of economic potential is the result of geographical factors and historical development. It has been made more intense by a rising level of taxation, the continental customs union, and the concentration of new public infrastructure in the south-east region.

The gradient of economic potential is shown in the chart below.



Taxable capacity

The index of economic potential provides a broad indication of the taxable capacity of firms having similar characteristics at different positions along the gradient of economic potential.

The taxable capacity of a firm is the total amount of tax collected and forwarded to government, plus any residual profit after tax. It includes payroll taxes, national insurance contributions, VAT, local business rates, and taxes applied directly to the profits of the firm.

The distribution of the taxable capacity of firms follows the pattern of economic potential, and is broadly aligned from north to south.

High taxation

In the diagram shown above, P1 and P2 represent two alternative locations with different levels of economic potential. At high levels of taxation, only those firms in areas where the economic potential is greater than P2 are able to remain profitable in the longer term.

Under these conditions, firms in foot-loose industries will tend to move towards areas of higher economic potential. Firms which are unable to do so may increase their prices, reduce costs, or cease to operate as independent units. Economic activity will be reduced as the gradient of economic potential becomes more pronounced.

High taxation is one of the causes of geographical inequality.

Levelling up

Tax reductions which increase both take-home pay and the profits of firms increase the prosperity of areas of low economic potential and may contribute significantly towards the aim of levelling up.

When taxation as a share of GDP is reduced then, in this example, firms located in areas where the economic potential is greater than P1 are once more profitable. The economy expands, and there is a dispersal of economic activity away from Greater London and the south-east. The gradient of economic potential is reduced.

After the removal of taxation, firms move towards those locations where the public goods and services available best suit their needs.

Under these conditions, local areas are able to provide those public goods and services which are specific to their requirements.

Conclusion

It is not possible to eliminate the gradient of economic potential, nor is it necessary. An optimum condition is reached when taxation has been fully removed and public goods and services are paid for by a system of public revenue.

