

A New Framework for Public Finance

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Summary

The trading economy is based on specialisation and exchange, and is dependent upon the supply of public goods and services. Public finance is the method of payment for public goods and services.

It is not sufficient to define taxation as the method of payment for the activities of government. Taxation is the confiscation of private property for unspecified purposes. Public revenue, however, arises naturally from the work carried out by a specific public authority.

In the fully developed trading economy, public revenue is defined as the market price of the public goods and services supplied at any given location, and is based on the cost of supply. In this kind of economy, taxation is not used as a method of public finance.

The use of taxation restricts the trading economy to a sub-normal condition. This policy proposal describes the transition away from taxation and towards the normal condition of the trading economy.

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Preface

In 1993 a small book was published with the unconventional title *Public Revenue Without Taxation*. Embodied in that short phrase is the distinction between the valuation of public goods and services in the trading economy and the medieval concept of taxation as the method of payment for the activities of a centralised state.

Drawing upon a long tradition of economic analysis, from the early Physiocrats to the works of Alfred Marshall, J. M. Keynes, Colin Clark and many others, the author Ronald Burgess described a new approach to the central question of public finance.

More recently, an effort has been made to apply those principles and insights to the prevailing economic conditions of today, and to communicate the results to a wider audience as a policy proposal.

The outcome of this effort, as presented here, has both strengths and weaknesses, and some of the steps in the argument are clearly open to challenge and further consideration. If, however, there is at least one path leading to a different kind of economy that is free of all taxation, then perhaps there may be others yet to be discovered.

The intention, therefore, of this small book is to set out some of the characteristics of a new framework for public finance in which taxation is no longer employed, and to examine the possible way forward to a different kind of fully developed trading economy.

The editors wish to acknowledge the contributions of past and present members of the Association and the many conversations and debates which have led to this present publication. It is hoped that the reader will find it both accessible and relevant.

1

Introduction

The trading economy

Specialisation and trade are the basis of the sophisticated economy of today and are the principal source of prosperity of the developed western world. The central purpose of the system of public finance is to ensure the supply of those public goods and services on which the modern trading economy depends.

The use of taxation as the method of payment for public goods and services restricts the development of the trading economy to a sub-normal condition and, by its very nature, does not provide any method of determining which public goods and services should be provided, or of regulating the total amount of public expenditure.

In a fully developed trading economy, public revenue is derived from the value placed on the output of any given public authority by the electorate within its area of responsibility. With all taxation removed, dependence on the public revenue creates a very strong incentive for the efficient supply of public goods and services.

The policy proposals set out here consist of the removal of all forms of confiscatory taxation and the adoption of a new system of public finance based instead upon the principle of public revenue.

The vision which makes this objective worth pursuing is that of a civilised and democratic society supported by a fully developed open trading economy, with high quality public goods and services funded without the use of any form of confiscatory taxation. It is a vision of greater economic freedom, a reduction of inequality, and a higher standard of living for all sectors of the trading economy.

Public revenue

To describe this proposal in more detail it is necessary to define certain terms with greater precision than is usually observed. It is also important to note that some of the definitions used here are not the same as those in common usage in economic literature.

In this proposal, for example, public revenue is the market price of the public goods and services available at a given location. It is the outcome of work carried out by a public authority and reflects only the public component of location value. Taxation, on the other hand, is the confiscation by the state of private property. These and other terms will be discussed more fully in later chapters.

The change from taxation to public revenue is a transition to a different kind of trading economy. Before setting this change in motion, however, it is first necessary to reduce the current level of taxation below the economic upper limit. This step will ensure that firms and households are able to take advantage of new conditions and that the economy is resilient to unexpected external events.

The reduction of taxation below the economic upper limit leads to an expansion of economic activity and increases both the private and the public components of location value. Only then, and after a period of adjustment, does it become possible to introduce the new system of public finance based on the principle of public revenue, and to remove all remaining forms of confiscatory taxation.

Once this transition is complete, all levels of government must accept financial responsibility for their decisions, and adjust their expenditure to the income actually received from their own area of jurisdiction. This precludes the use of government borrowing as a means of funding additional public expenditure. (1)

Without taxation, monetary policy continues to be an important responsibility of central government, but fiscal policy is no longer available. There is no longer the possibility of continual additions to long-term central government debt, or transfers of funds raised by taxation between different public authorities. (2)

The removal of taxation

Today, taxation is incorporated at every stage in the production of goods and services in the trading economy. High taxation becomes a major component of the cost of living for ordinary households; it also tends to produce an excessive concentration of prosperity in a small number of geographical regions, and impoverishes others. In addition, interest due on central government debt is ultimately paid by households through higher taxation, or by inflation, or both.

The reduction of taxation, and its eventual removal, changes the geographical distribution of economic activity and reduces the cost of living. In the longer term, the elimination of central government debt removes a significant cost and is beneficial to households.

The fully developed trading economy, based upon specialisation and trade and with public goods and services paid for by the public revenue, is more conducive to individual opportunity and personal development than centralised state control paid for by taxation. (3)

Extension of the principle of public revenue to natural resources creates the possibility of a sovereign wealth fund, derived not from additional government borrowing, but from the income received.

Scope of the proposals

There are many other pressing issues which could be addressed, in particular those which relate to transfer payments and subsidies, or other forms of re-distribution. Topical examples include health and unemployment insurance, pensions and other benefits provided by the state, and the payment of interest due on the national debt.

With the exception of interest due on the national debt, it is not the aim of this policy paper to address these other issues in detail.

The case for re-distribution under the sub-normal conditions of today may not be directly applicable to the fully developed trading economy without taxation, and is not the main focus of the policy recommendations presented here.

Policy recommendations

The three main policy recommendations of this proposal are stated below, and some of the more important policy outcomes which can be anticipated after a period of adjustment are listed overleaf.

1. Reduce taxation below the economic upper limit.
2. Replace taxation by a system of public revenue.
3. Remove all other remaining forms of taxation.

The concept of public revenue is developed in the next chapter, which provides further definitions, sets out some general principles of the proposal, and explores a compatible theory of the purpose of the state. This is followed by a chapter on the practical application of those concepts and principles to the economy of the UK.

Later chapters set out a brief outline of the underlying economic theory of public revenue, its relationship to the national accounts, the significance of the economic upper limit to taxation, and the sequence of steps necessary to complete the transition process.

The main body of the work concludes with some examples of invoices for government services based on the market price of the public goods and services supplied. Invoices such as these would be issued after the removal of all forms of confiscatory taxation.

For simplicity, it is assumed that health and education services provided by the state, and certain other public sector activities, fall within the category of public goods and continue to be supplied in their current form. It is also assumed, however, that the larger part of these activities is transferred from central to local government.

Some comparisons are included to illustrate the general effect of the transition from taxation to public revenue for households, firms and other organisations, and also for the public sector.

The appendices provide an outline of an economic model of the transition and comments on other topics, such as monetary reform.

Sources and references are listed in the bibliography.

Policy outcomes

The private and public sectors both work under the same economic principle. Everyone pays for what they receive, and is paid for the work they have done according to the value placed on it by others.

Firms and households receive the public goods and services which they most value, and for which they are willing and able to pay. No public goods are given away free of charge.

Government receives a secure source of public revenue and is less subject to external constraint arising from an accumulation of debt.

The scope and function of each public authority is determined by a consistent set of principles and its activities are funded exclusively by the electorate within its own area of responsibility.

There is an increase of both electoral responsibility and democratic accountability at all levels. Much greater attention is paid to public expenditure, whilst government no longer needs information about the financial resources of firms, households or other organisations.

Economic distortions caused by taxation are removed and replaced by a common incentive of growth and prosperity. The 'pay bargain tax wedge' between employer and employee is eliminated.

Natural resources are used more efficiently and there is an increase in geographical mobility across all sectors of the economy.

International free trade is eased by the removal of internal taxation and the progressive reduction of the majority of external tariffs.

In the particular case of the UK, the long-standing central control of the Treasury over all significant taxation and spending decisions is very much reduced as the reliance upon taxation diminishes.

If followed through to its logical conclusion, this proposal leads to a significant shift of resources from central to local government and a progressive reduction in the size and activities of the state.

Notes

1. Traditionally, large capital infrastructure projects in the public sector were financed by borrowing from the private sector, on the assumption that there would be some future income arising from taxation to support the loan and its eventual repayment.

This has not been the case for many years. Today, government borrows first for all expenditure of any kind. The total amount of outstanding government debt may or may not be reduced by the actual amount of taxation subsequently received.

Under the reforms described in these policy recommendations, the implication of a 'balanced budget policy' is that an item of proposed expenditure does not proceed unless the value of the output produced is greater than the cost, and the expenditure is supported by the amount of public revenue already received.

There is thus a built-in cost-benefit analysis of all expenditure proposals that is not possible under a system of taxation.

A balanced budget can only be achieved when the full market price is charged for all the public goods and services supplied.

2. An important aim of monetary policy is to maintain the value of the currency and avoid the gradual debasement of the means of exchange. This is easier to achieve when the expenditure of government does not exceed its income.
3. The removal of all taxation facilitates a geographical dispersal of economic activity and greater specialisation. The possibility then arises of all individuals developing their skills and talents, and each becoming a master of their trade or profession. This is an important aspect of the fully developed trading economy.

In the longer term, the removal of taxation ultimately implies the elimination of all tariffs on international trade that are not required for reasons of foreign policy.

2

General principles

Britain's economy today

Britain is a prosperous country. Nevertheless, its economy is in a relatively poor condition. Output is below the potential offered by the available resources, and the human effort required to achieve a good standard of living is, for many households, more than would reasonably be expected in a modern well-developed economy.

The size of the central state in proportion to the total amount of productive economic activity has grown steadily over the last fifty years. Taxation, borrowing, and government debt have also risen.

Government is increasingly involved in the details of everyday life and is highly centralised. Local government is correspondingly very weak. The quality of many public services is unsatisfactory.

Productivity per person employed has shown little or no growth and economic output per head of population has begun to decline.

There are many contributory factors and many different ways in which improvement could be sought, but approaches which retain the use of taxation as the central feature of public finance limit the trading economy to its present sub-normal condition.

The focus in this policy proposal is the development of a new framework for public finance in which public goods and services are paid for on the basis of their market price, and not by taxation. This is described as the normal condition of the trading economy.

In the normal condition, there is a consistent set of assumptions about the purpose of government and of economic activity, so that the political and economic aspects share the same policy objective.

The purpose of government

There are many different theories seeking to explain the nature and origin of the state. These can be interpreted as explanations of the purpose and characteristics of different forms of government.

At one extreme, it is assumed that the state is more important, or more real, than the individual and that it has its own objectives, which may not be the same as those of the general population and may be in opposition to them. At the other extreme is the complete absence of any form of organised central government.

The theory of the state compatible with the full development of the trading economy has the following essential characteristics:

- (a) The state, or polity, is an institutional arrangement established for the protection of the lives and property of the citizens. It has no independent existence and does not pursue an agenda of its own.
- (b) Government consists of ordinary citizens employed in specific roles or functions. All citizens are equal before the law and all are subject to the same set of laws and constitutional arrangements.
- (c) The economic function of the polity, or of any public authority, is to serve the trading community by means of the supply of public goods and services within its area of responsibility.

Thus, in the context of the fully developed trading economy, the purpose of government is to protect the community from internal disorder and external aggression; to uphold the law; and to supply those public goods and services which are an essential input to the processes of specialisation, production, trade and exchange.

Government, or the polity, then becomes an integral part of the trading economy and is no longer external to it. It is not above the law, but must itself comply with the laws it has been established to uphold. This principle precludes the confiscation of either property or incomes by means of taxation, and requires payment of the full market price for all the public goods and services supplied.

In the fully developed trading economy, government is a special type of firm which, like other firms, receives payment according to the value of the work it has carried out. Payment must certainly be made, but this requirement does not convert the payment made for public goods and services into a form of confiscatory taxation.

This theory of the state and of the purpose and characteristics of government is consistent with the normal condition of the trading economy. It is also compatible with the institutional arrangements of the UK, which necessarily provide the starting point for change.

The definition of taxation

It is not sufficient to define taxation as any method of payment for the activities of government and of the public sector, other than the income derived from commercial trading by government bodies.

In economic terms, a gift is a voluntary one-way transaction for which nothing is required in return. Donations to charitable bodies are gifts, and benefits paid out by the state are of a similar nature.

The essence of taxation is the one-way nature of the transaction and its enforcement by the full powers of the state. It is similar to a gift, but is compulsory; the economic effect is identical to theft. (1)

For the purposes of this policy proposal *taxation* is defined as:

An arbitrary and compulsory contribution imposed by a public authority irrespective of the exact amount of service rendered to the tax-payer in return, backed up by the use or the threat of force, and not imposed as a penalty for any legal offence.

In practice, taxation is the confiscation of private property and incomes by a public authority for unspecified purposes. It is not an inherent feature of the fully developed trading economy, and is not compatible with the characteristics of the state set out above. (2)

Gifts and thefts may both be found in the trading economy, but whereas gifts and charitable donations are lawful, theft is not. The use of confiscatory taxation is not a feature of a civilised society.

Through the use of force, taxation may be collected at any point in the trading economy where a monetary value can be identified or estimated. The general effect of a tax is always to diminish the subject of taxation, so that taxes based on contracts of employment will tend to reduce employment, whilst taxes levied on exchange and on capital formation reduce output, productivity and growth.

Furthermore, taxation by force offers no economic incentive for government and the public authorities to provide the public goods and services required by the trading economy. In this way, the use of taxation limits the trading economy to a sub-normal condition.

Public goods and services

It is not sufficient to define a public good as any product or service typically provided by government and paid for by taxation, as this leads to circular definitions of taxation and public goods.

In the fully developed trading economy without taxation, firms produce an output for sale. Private transactions take place between individual buyers and sellers at an agreed price. Whilst there may be unintended effects on others, known as *externalities*, these are not the purpose of the activity and may be constrained by law.

By contrast, the supply of public goods by a public authority is intended to benefit a defined group of people within its jurisdiction in return for payment, not to confer an individual benefit, and not as a gift. Any unintended effects may again be constrained by law.

Thus, the definition of *public goods and services* is as follows:

Public goods and services are the intentional outcome of work carried out by a public authority, for the benefit of a specified group of people within its area of jurisdiction, in exchange for payment, and are indivisible at the given level of aggregation.

According to the theory of the state set out earlier, it is not the purpose of government to supply individual needs that can be met by private transactions and free exchange in the trading economy.

This definition is different from the conventional understanding that a public good is identified whenever its consumption by one individual does not preclude consumption by another, or whenever an individual cannot easily be excluded from its use. (3)

Household waste, for example, may be removed directly by the householder as a private activity. Alternatively, it may be removed by a public authority to prevent the spread of disease. The removal is then supplied as a public good for the protection of others, and is not consumed by the individual householder. At the national level, defence is supplied for the protection of the citizens as a whole and is not consumed by individual persons as a private benefit. (4)

The supply of public goods and services raises public location value in a specific area. According to this definition, most public goods and services are supplied locally. Only a limited number of government activities meet this requirement at the national level.

Private and public value at a location

Productive economic activity in the trading economy takes place at a location within the catchment area of a public authority. Location value at any given site may then arise in three different ways:

- (a) Work done directly on a freehold site creates private value and yields a private income. It also produces a combination of positive and negative externalities, which are regulated by legal constraints.
- (b) Work done by a public authority is not carried out directly on a freehold site, but modifies the public value at the site in question, which in turn gives rise to a public revenue. This work consists of the supply of public goods and services, and includes the issue of licences for the extraction of natural resources and waste disposal.
- (c) Lawful positive or negative externalities are not the intended result of work done by any public authority and do not increase the cost of supply of public goods and services. Externalities do not give rise to an increase of public location value, or public revenue.

This analysis of the components of location value is similar to that of Alfred Marshall, who allocated all externalities in the third category to private value. Other economists, however, have treated all aspects other than the first category as public value. (5)

Externalities in the third category may increase private value, and thus increase the price an occupier is willing to pay for public goods and services. Over time, however, this increment would be reduced by competition between the public authorities. A negative externality would apply downward pressure to private value and to the available public revenue. It follows that the third category does not give rise to a stable and reliable source of public revenue.

A public authority is treated as a special type of firm supplying public goods and services within the trading economy. The market price of the public goods and services supplied regulates both the income and the subsequent expenditure of the public authority.

It is not entitled to receive an additional revenue drawn from the work and efforts of other participants in the trading community, in the form of the confiscatory taxation of private location value.

The determination of public revenue

The function of a public authority is to provide public goods and services, and not to provide private goods and services which, by definition, are not indivisible in their supply. Its aim is to ensure that its costs do not exceed the public revenue which it receives.

To achieve this aim, it is required to charge the full market price of the public goods and services which it supplies. The concept of a market price implies specific conditions, such as many buyers and sellers, a tradeable commodity, ease of market entry and exit, and a degree of open competition between both buyers and sellers.

Competition between public authorities increases the incentive for efficiency and restrains the total amount of public expenditure; over time, it will tend to reduce the market price of public goods and services supplied towards the actual cost of provision.

The definition of *public revenue* used here builds on the concept of public goods and services set out earlier, and is as follows:

Public revenue consists of the sum received as payment of the full market price for the public goods and services available to the catchment area of a public authority, excluding the effects of any work carried out directly on or within any given site.

This definition excludes any payment from private revenue or in respect of externalities, and assumes competition for the supply of public goods and services. It is different from either the method of determination of site value used by Alfred Marshall and others (the estimated market price of the bare unimproved site, assuming full permitted development on all other sites), or the traditional ‘method of residuals’ (estimation of the full market price, less the cost of buildings and improvements already on the site). Methods such as these typically seek to identify the private component of location value for the purposes of taxation. The valuation required here, however, is not the value of the site itself, but the value of the public goods and services made available by the public authority to its catchment area and expressed as a market price.

The state is also the custodian of public property, which may include certain categories of natural resources. The definition does not include income from the issue of licences for the use of natural resources, other than the cost of the work done to issue the licence.

The market price of public goods

From the point of view of a public authority, the public goods and services it supplies are indivisible at a given level of aggregation.

The viewpoint of the firm is very different. Normally, there will be many alternative locations on offer, and many other potential users competing to occupy those locations. Each firm will have a different valuation of the individual sites available according to its line of commercial activity and its particular circumstances. (6)

The removal of taxation allows firms and households to make a fresh evaluation of the alternative locations available to them.

When a firm evaluates a new location, it first estimates the sales revenue it expects to receive at that location, and deducts the cost of buying in goods and services from other firms. It also expects to pay out wages and salaries to its employees, and must achieve the normal rate of profit for its industry, which is similar to a cost, if it wishes to continue as an independent commercial operation.

The resulting estimate of sales revenue and costs determines the maximum annual amount the firm is willing and able to pay for the specific combination of public goods and services available at each of the alternative locations under consideration.

Finally, depending on the options available at its preferred site, the firm will consider whether it is more advantageous to purchase the site, or make payments to a third party for a long-term lease.

Firms which are closely tied to their natural resources will have a more limited choice of sites, but some alternatives will normally be available, as well as other competing uses for suitable locations.

Thus, from the point of view of the firm, the amount payable for the specific combination of public goods and services on offer at its preferred location is in the nature of a market price, and is similar to its other costs of production. This combination of public goods and services then becomes an input to the overall process of production, and the cost is fully passed on to the final consumer.

Similar considerations will apply to households, and a process of adjustment will take place as firms, households and other bodies move towards those locations better suited to their needs, and the public authorities respond by bringing forward improved offerings of public goods and services in their respective catchment areas.

In all cases, the public authorities receive the full market price of the public goods and services supplied and no public goods and services are given away free of charge. All positive and negative externalities are taken into account and the need for the taxation of sales, wages, profits, incomes or savings does not arise.

Capital projects

There are many examples of large scale capital projects undertaken by the public authorities which take several years to complete and then continue to provide a long-term public good or service.

In the absence of taxation, a public authority is able to act as a specialised firm supplying public goods and services. It operates in a similar manner to any other firm within the trading community.

When setting its prices, a firm makes an appropriate allowance for the depreciation of its existing capital assets, such as buildings and machinery which will eventually require replacement, and also to meet the need for fresh investment in new capital assets through a process of capital formation. Both of these are treated as ordinary charges against the total sales income received by the firm. Even in a competitive market, provision for these charges can be achieved.

In the absence of any tax on sales, wages or profits, a successful firm will accumulate reserves and commit its funds to investment, including for example research, development and innovation.

With all taxation removed, a public authority is able to operate in the same way as any other firm in the trading economy. Within its area of responsibility, it will first identify the optimum locations for each of its various activities, and then set appropriate prices for the public goods and services it supplies. If successful, it will be able to allocate to its reserves an amount drawn from its income to cover the depreciation of existing capital assets and the acquisition or development of new investments in facilities and equipment.

The requirement for government to balance its budget without additional long term borrowing ensures that public expenditure is fully constrained within the bounds of public revenue and does not lead to either an increase of central government debt or inflation of the money supply. This requirement would not preclude the use of short term overdraft arrangements or three-month Treasury bills to support new capital projects, provided that government does not become beholden to the financial markets in the longer term.

Natural resources

In addition to the functions of government described earlier, the state is also the custodian of the public property which it holds on behalf of the citizens on an indivisible basis. This includes certain minerals, such as coal, oil and gas, and all the surrounding oceans up to a distance of 200 miles or the boundary of another nation.

The free goods of nature are the natural elements of the planet and its environment prior to any human intervention. They become natural resources only as a result of the human effort of discovery, and only when there is an effective demand for that resource.

In the UK, natural resources are generally private property, with the exception of the onshore and offshore reserves of coal, oil and gas. These are deemed to be a national asset, and are subject to the issue of government licences for both exploration and extraction.

A licensing system is also in place for other activities such as the extraction of minerals and the disposal of environmental waste, the exercise of fishing rights within the 200 mile limit, and the use of the radio spectrum for broadcasting and communications.

According to the definitions set out earlier, a payment made for the administrative work of issuing a licence is part of the market price of public goods and services supplied by the relevant public authority, and is considered to be a part of the public revenue.

The natural resource obtained or exploited under the terms of a licence is not, however, the result of work carried out by a public authority. This part of the payment made is not part of the public revenue as defined earlier and is therefore not available for general public expenditure or the repayment of central government debt.

The state is required to charge the full market price of the rights granted under licence. The payment made for the economic value of the natural resource obtained accrues to a capital fund, held as previously on behalf of the citizens on an indivisible basis. This is typically referred to as a sovereign wealth fund, and may be used for a variety of purposes, other than routine public expenditure.

Notes

1. The description of the one-way nature of tax payments and the comparison to gifts follows the approach of Sir John Hicks.

J. R. Hicks, *The Social Framework*, Ch. XIII and pp.233-234.

2. The definition of taxation is based on the formulation of Hugh Dalton (Chancellor of the Exchequer, 1945-47). It includes all direct and indirect taxes and national insurance payments, but does not include the income arising from the public ownership of nationalised industries, or the income a monetary authority may derive from the issue of legal tender. An advantage of this definition is that it can be used to identify the total amount of tax revenue received within the published national accounts.

Hugh Dalton, *Principles of Public Finance*, Chapter V, §1.

3. An example of the conventional definition of a public good is Paul Samuelson's concept of 'collective consumption goods':

"which all enjoy in common in the sense that each individual's consumption of such a good leads to no subtractions from any other individual's consumption of that good."

Samuelson's definition of collective consumption goods does not take into account the application of location theory, which offers a fundamentally different approach based on the take-up of public goods and services by firms and households, and the valuation of the public goods and services actually supplied. It does, however, exclude any consideration of natural resources, as these are typically depleted by individual consumption.

In practice, the concept used by Samuelson is not sufficiently precise to support the theory of public revenue as developed in these policy recommendations.

P. A. Samuelson, *The Pure Theory of Public Expenditure*, 1954 in *Review of Economics and Statistics*, Vol. 36 (4), pp. 387-89.

4. The definition makes clear that public goods are not consumed by individuals, but are supplied to meet an effective aggregate demand within a specific catchment area. There will normally be more than one level of aggregation, as will be shown later.

The protection of the population from the spread of infectious diseases is one of the functions of government. An individual with an infectious disease may be taken into quarantine not for his own benefit, but solely for the protection of others. Even if the infected individual does not survive, an effective demand for the protection of the population has then been satisfied.

Similarly, in the example of a fire brigade, there is an effective demand within the area served by the fire station, even under the most favourable circumstances in which no fires take place and the service is not used for a prolonged period of time.

5. A discussion of this subject can be found in Alfred Marshall, *Principles of Economics*, 8th ed. Bk. V, Ch. X-XI, pp.425-454.
6. According to the economist Colin Clark, a firm may be market oriented, materials oriented (constrained by natural resources), or foot-loose (highly mobile).

For a firm in a foot-loose industry, the choice of location will take into account the concept of economic potential. This is a quantitative measure of the relative attraction of alternative sites based primarily on proximity to markets and distance-related transport costs. It uses the analogy of gravitational attraction, and gave rise to the subsequent development of gravity models in which tariffs and non-tariff barriers to trade are evaluated.

Within any given economic region, economic potential is also related to the concept of taxable capacity. Typically, systems of taxation take no account of location theory or taxable capacity.

C. G. Clark, *Regional and Urban Location*. St. Martin's Press, New York, p.90. First published in 1982.

3

Practical application

The catchment areas of public authorities

This chapter considers the practical implications of the principle of public revenue when applied to the trading economy of the UK.

In a fully developed trading economy, firms produce outputs to satisfy the needs of households in conjunction with a government, whose function is to supply the required public goods and services.

Government, sometimes described as the polity, or as the public authorities, may operate at many different levels of organisation. In all cases, however, its aim is to supply public goods and services to its own area of responsibility, referred to here as a catchment area.

In an economy without taxation, the supply of public goods and services by a public authority gives rise to an increase of public location value within its catchment area. This in turn is the basis of the payment of public revenue to that particular public authority.

In the UK, the unit of occupation of an individual site within the catchment area of any one public authority is traditionally known as a *hereditament*. This is the primary concept used in the relevant legislation, and provides the basis for a system of public revenue.

This term includes all freehold and leasehold property, such as uncultivated wasteland, forests, farmland, residential households, business premises, places of worship, government buildings, parks, beaches, and public open spaces, all of which may be referred to more simply as sites. The catchment area of a public authority is a collection, or aggregation, of many such sites, and any given site may lie within more than one catchment area.

A single site in a catchment area

Figure 1 shows the simplest case of a single site, Site A, within the catchment area of one public authority. All work done within the boundary of the site gives rise to private value and, in this type of economy, is not subject to taxation. Any unintended consequences arising externally to the site are regulated by legal constraints only.



Figure 1: The catchment area of a public authority

The public revenue consists of payments made by the occupier of Site A, and by the occupiers of other similar sites, to the public authority for the work it carries out in providing public goods and services to the catchment area as a whole. This work is not carried out within the boundary of any of the individual sites in question.

Sites in multiple catchment areas

The more general case is that of many sites in the catchment areas of several public authorities, some of which overlap.

In Figure 2, the occupiers of three different sites, A, B and C are supplied with the same public goods and services at the national level. Typical examples of these public services include defence, the administration of justice and the courts, and the maintenance of the national transport infrastructure, such as the major road and rail networks, coastal shipping lanes and air traffic control. All of these activities are indivisible at the national level of aggregation.

Similarly, Sites B and C receive the same combination of public goods and services from a local public authority, shown here as the County. These may include the local road network, the police, fire and rescue services, public libraries, household waste collection, primary and secondary education facilities, and the maintenance of public open spaces, rural footpaths and local watercourses.

Site A, however, is presumed to lie within the catchment area of a different local public authority, where a different combination of public goods and services is available from those at Sites B and C.

Finally, the occupier of Site C receives additional public goods and services at its location within the City that are not available to Sites A and B. These may include a subsidised bus service or light rail system, street lighting, or highly specialised medical facilities.

In the absence of taxation, it is assumed that the occupiers of the three sites will place different values on the public goods and services available according to their own needs and preferences, and will make their choice of preferred location accordingly.

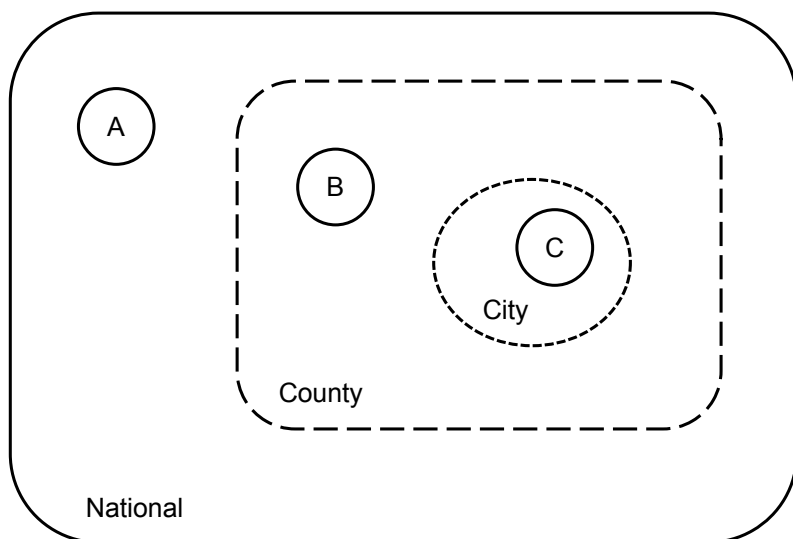


Figure 2: Sites in multiple catchment areas

The charges adopted by each of the public authorities shown in Figure 2 will reflect the cost of supply of the different public goods and services they provide, taking into account the size of the area served, the number and size of hereditaments, the local population and its density, and competition from other public authorities.

By considering these aspects, each public authority determines its prices for the supply of public goods and services using its own expertise and judgment, and not by reference to any fixed formula.

Public infrastructure

The construction of public infrastructure has a significant effect on location value and, if correctly executed, increases public revenue.

Figure 3 illustrates an example of transport infrastructure, such as a new highway, railway or aviation route, constructed within the catchment area of a single public authority. It is laid out between two terminal points at positions 1 and 2. The cost of construction will reflect, amongst other things, the total length of the route and the size of the proposed service area adjacent to each terminal.

The public authority intends to provide a service to sites within a certain distance of the terminals, but it is also likely that negative externalities will arise at many locations along the proposed route.

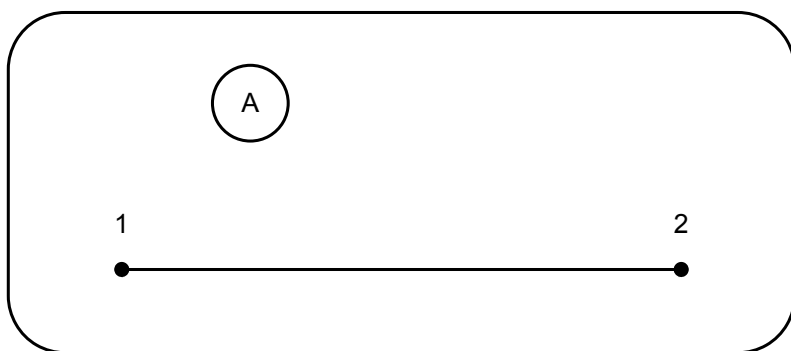


Figure 3: The effect of public infrastructure

For sites close to the terminal points with an urgent requirement for transport services, there will be a significant increase of public location value. This increase will be reflected in the market price of the public goods and services provided by the public authority, and public revenue will rise as a result of the new infrastructure.

Site A, however, may not use the transport services, and may be too far away from the route to be affected by negative externalities.

Nevertheless, a firm at Site A may experience either more or less competition for its own output, and the market price of public goods and services at Site A may either rise or fall as a result of the construction of the public infrastructure, even if the firm at Site A does not directly make use of the transport services offered. (1)

The treatment of externalities

Figure 4 illustrates the method of treatment of externalities arising when two adjacent sites, A and B, lie within the catchment areas of the same national and local public authorities.

The polity, consisting of the relevant public authorities, has a duty to preserve private value at A and B, and to charge the market price of the public goods and services it makes available. To secure this aim, it exercises control over the permitted use of sites.

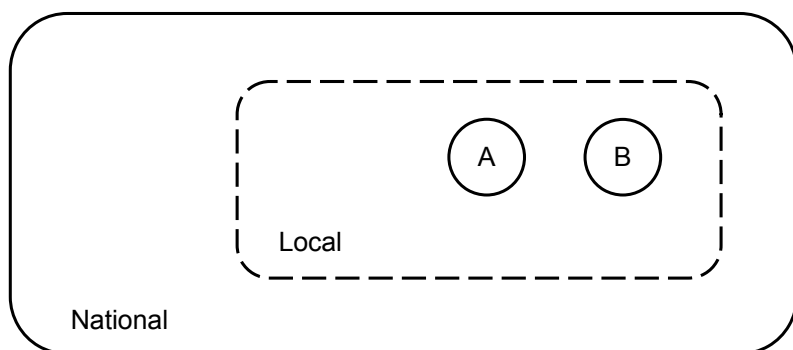


Figure 4: Externalities between adjacent sites

Lawful externalities affecting private location value at Site B, and arising from work carried out on or within the boundaries of Site A, do not give rise to any change in the public revenue.

When a request is made for a change of use at Site A, the polity may require the occupier of A to enter directly into a compensation agreement with B in advance of the request being considered.

This procedure avoids the transfer of private value from B to A, and encourages further development on sites where compensation costs are likely to be lower, instead of undeveloped sites, where the expected cost of construction may be lower.

Alternatively, a reduction of the private value at Site B caused by a decision of the polity in favour of A could justify the payment of compensation by the polity to B, or a significant reduction in the market price of public goods and services that B is able to pay. (2)

To discourage speculative requests, the full market price of the public goods and services available at Site A is payable from the time that a decision is made for the change of permitted use. (3)

In carrying out its responsibility for control over the use of sites the polity does not gain or lose from changes in private value. It is paid for the work it has carried out in the provision of an effective service for the control of permitted use and for any expansion of public goods and services on the basis of the actual costs incurred.

The procedure set out above for the treatment of externalities is equally applicable to the construction of new public infrastructure and the issue of licences by the relevant public authorities.

The offshore domain

Licences for the extraction of natural resources or for the disposal of waste are issued to individual sites where the resource or facility is located, or is accessible. This includes sites located offshore.

With all taxation removed, it is necessary to apply the principles of public revenue to the offshore domain, which forms part of the national catchment area administered by central government. (4)

Electoral responsibility

So far as possible, the electoral group which makes the decision to incur additional costs for the supply of public goods and services is also the group which pays the higher market price arising from that expenditure decision. This aspect of the policy proposals provides a safeguard against the risk of expenditure decisions being used to transfer costs to a different electoral group or, by increasing long term government borrowing, to transfer those costs not covered by the available public revenue to future generations of citizens.

Given electoral approval, a public authority may sub-divide its catchment area into a number of smaller zones, in each of which a different combination of public goods and services is offered in response to the specialised needs of certain areas. Similarly, there may be an economic advantage in combining some existing zones for the supply of particular public goods and services. (5)

Invoice for government services

In order to collect the public revenue in the manner described, it is necessary to issue an invoice to the occupier of each hereditament and to collect payment. As will be shown later, the administrative arrangements are already in place, such that a single invoice can be issued without the requirement for a new central authority. These arrangements can be extended to include offshore activities and the issue of licences, such as for the extraction of coal, oil and gas.

The single invoice for government services itemises all of the public goods and services made available in the relevant catchment areas. The simplest approach is to allocate the annual cost incurred by central government in proportion to the local public goods and services supplied, with adjustments in respect of government debt, licence fees, and the value of any natural resources obtained.

Invoices can be issued to all firms and households, and there is no requirement for a centrally administered system of taxation.

Notes

1. In the first instance, the effect of the infrastructure on the value of the public goods and services available to Site A is known only to the occupier of the site. It may be positive or negative.

Initially, for example, the occupier of Site A may prefer a rural location to urban infrastructure and will experience a reduction of both private and public location value. In the longer term, however, there will be a period of adjustment, and a different market price may emerge for the public goods available at A.

Where new public infrastructure is constructed, the increase in public revenue reflects the availability of the new service and its costs of construction and maintenance. Individual journeys or freight movements using the new route are private benefits, and can easily be purchased as individual transactions without the need to make a financial contribution to public revenue.

2. There is an advantage in establishing the system of incentives, such that changes in the public and private location value at any given site tend to increase rather than to reduce each other, and the need for a compensation procedure is minimised.
3. It is assumed that the public authority will incur costs within one year of the decision being made. An alternative approach would be for the decision to lapse after a period of one year.
4. For the UK, the national catchment area covers 250,000km² of dry land, about 500,000km² of ocean and sea bed, and airspace to a height of approximately 20km. The policy proposals could be extended to such areas as aviation and spectrum licensing, but most of the benefit can be realised by addressing onshore activity and licence fees for the extraction of natural resources.
5. Over time, the process of sub-division of catchment areas may lead to the development of a zoning system: as circumstances change, specialised zones are created, merged or eliminated.

4

Economic theory

Background

This chapter outlines some of the main points of economic theory which lie behind the policy proposals and highlights those areas where there is a departure from conventional economic analysis.

It begins with a consideration of the different types of economy, from self-sufficient agriculture to the fully developed open trading economy with sophisticated public goods and services, both with and without the use of taxation. The aim of this initial discussion is to show that there are different types of economy, and that further development using different general principles is possible.

Before setting in motion the transition from taxation to public revenue, it is first necessary to restore the economy to health and to bring the level of taxation below the economic upper limit. This requires a brief discussion of the system of national accounts, the upper limit to taxation, and some of the main economic statistics.

The effect of the transition to public revenue on the distribution of household incomes is briefly discussed. As noted earlier, some services provided by the state in such areas as housing, health and education do not satisfy the definition of public goods previously set out; it is assumed that these services continue unchanged, other than a transfer of responsibility from central to local government.

An outline of an economic model can be found in Appendix 1, which highlights the possible changes in economic statistics during the transition. Other appendices consider the effects of taxation on inequality and the need for re-distribution, on the level of wages, the housing market, and proposals for monetary reform.

Self-sufficient agriculture

Centuries ago, the economy of Britain may have been an example of self-sufficient agriculture. In this type of economy, most rural communities were self-sufficient economic units; they produced an output primarily for their own consumption. If, for any reason, the harvest failed, there could be famine and starvation, but changes in market prices did not much affect the prosperity of the community.

In good years, a small surplus from production could be traded by merchants over long distances, sometimes at considerable risk.

The merchants would return with specialised high-value goods from other communities further afield, and were the only group of people who handled money to any great extent. Taxes were often low, and were not necessarily in the form of money payments.

In a hierarchical society most of the population had little or no dealings with the state during times of peace. The population was relatively small, and not all of the available land was cultivated.

Figure 5 below illustrates a self-sufficient rural economy. Most of annual production is used up directly in consumption, but some part of any surplus may be sold as outbound trade, and a small part of consumption is obtained from inbound trade. Public goods, such as transport networks, are at a very limited stage of development.

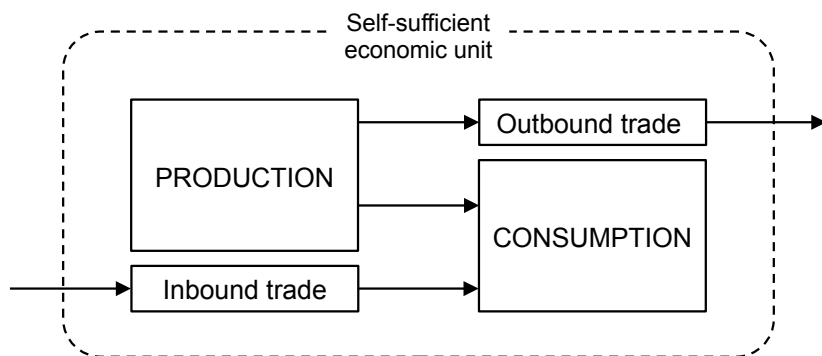


Figure 5: A self-sufficient economy with limited trade

In earlier times, this kind of economy may have been typical of rural settlements, villages and smaller towns, where specialisation and exchange were almost entirely internal. Examples can still be found today in isolated countries with poor transport links that do not trade very much. Britain today, however, is a very open trading economy with a relatively large public sector paid for by taxation.

The nature and origin of taxation

In comparison to the hunter-gatherer way of life, settled agriculture produced an economic surplus. As it developed, some arrangement was required to ensure the defence of the settlement from external aggression, and observance of the law within the community. The increased output of settled agriculture made this change possible.

Some part of annual production was therefore allocated to the consumption of those who provided protection, both internally and externally. This stage of development is shown in Figure 6. In due course, monetary taxation arose as a payment made for protection.

Thereafter, taxation was extensively used to raise the necessary material resources for warfare. After a major conflict, it could be imposed on the losing side as an alternative to captivity or death.

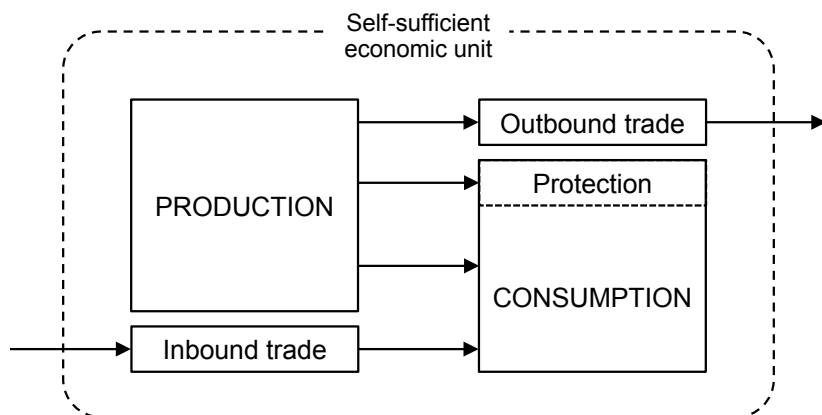


Figure 6: A self-sufficient community with protection

Improvements in agricultural methods may then have coincided with a rapid increase of population. In some cases, this required an extensive scheme for the relief of rural poverty and hardship.

In more recent times, as industrialisation progressed, it became necessary to allocate a much greater proportion of resources to the production of public goods and services. This was particularly the case for improvements in transportation and public hygiene.

In turn, this expansion of public goods and services supported the growth of an industrialised economy able to take advantage of individual specialisation and trade. Taxation rose steadily.

The trading economy with taxation

The purpose of all economic activity is to supply households with goods and services. In a trading economy, firms produce an output for sale. Households and individuals purchase the outputs of firms and earn their income by supplying factors of production, such as labour or capital, to firms. This is usually shown as a circular flow, with the outputs of firms and factors of production moving in one direction, and money flows in the other direction, as in Figure 7.

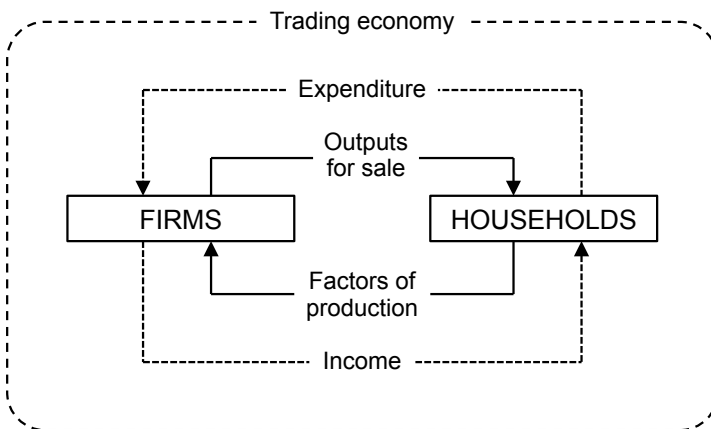


Figure 7: The trading economy as a circular flow

In this type of economy, money is the means of exchange, and the market price determines the success or failure of an enterprise.

The activities of government can then be added as shown below in Figure 8. Government provides public goods and services to the trading economy as a whole, and uses taxation as its main source of revenue for transfer payments and purchases. It then borrows in the financial markets to cover shortfalls of revenue in comparison to its expenditure. Money transfers between groups of households, funded from taxes, are a major component of public expenditure.

In reality, there are many more flows of outputs and payments, including exports, imports, savings, investments, and purchases by firms from other firms within the trading economy. The effective incidence of taxation is uncertain, but it may be assumed that all forms of public expenditure are ultimately borne by households.

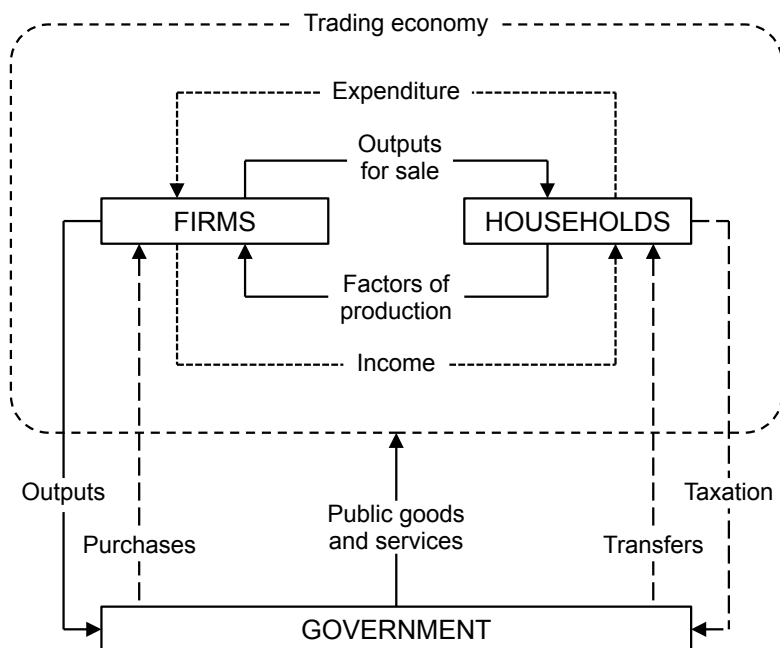


Figure 8: The trading economy with taxation

The banking system

The circulation of money within the trading economy takes place through the payment system operated by the commercial banks.

Firms, households, government departments and all other public authorities hold bank accounts at the commercial banks. Payment for all goods and services is made by the transfer of credit between accounts held at the commercial banks, as shown in Figure 9.

Each commercial bank maintains a bank account of its own at the central bank, in which it holds its reserves. These central bank reserve accounts are used for settlement between individual banks, and to ensure that the commercial banks have adequate resources.

The government also has its own account at the central bank, called the Consolidated Fund. At the national level, all tax revenue is received by a commercial bank acting on behalf of government; it is then paid into the Consolidated Fund, from which transfers are made to the commercial bank accounts of spending departments.

Within the payment system, commercial banks may issue credit to firms or households, for which they are able to charge interest.

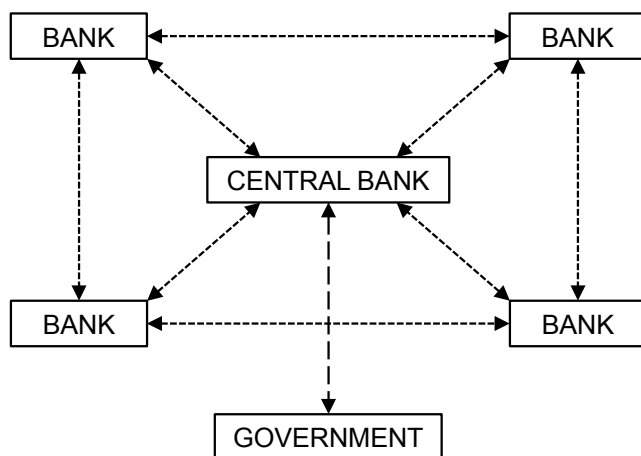


Figure 9: The banking system

Government spending departments and all public authorities use their bank accounts in the same way as firms and households, and these monetary transactions also pass through the banking system.

Commercial banks increase the money supply by issuing loans to borrowers and reduce it when loans are repaid. The central bank seeks to regulate the nation's money supply by changing the rate of interest, so that the demand for loans is increased or reduced.

The capital market

In addition to the circulation of payments in the trading economy, as described above, a large number of other transactions take place in the capital market. This is illustrated in Figure 10.

These transactions include purchases and sales of many types of existing financial assets, such as investments, government bonds, foreign currency, property, and many other financial instruments.

The central bank, operating through the capital market, makes loans to the financial institutions and, in times of crisis, acts as the lender of last resort. It may also conduct 'open market operations', in which it buys and sells government bonds and other classes of financial assets in order to influence short term interest rates.

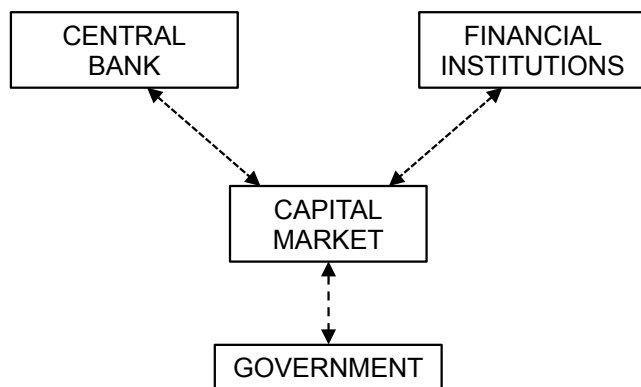


Figure 10: The capital market

Government borrows from the capital market by issuing long term bonds, known as gilts, which carry either a fixed or an index-linked rate of interest. Shorter-term Treasury Bills are sold in the market by government at a discount, and redeemed at face value.

All government borrowing is secured primarily by recourse to the Consolidated Fund, backed up by future tax revenues. The rate of interest payable on government debt is, however, susceptible to movements in the prices of gilts and Treasury Bills in the capital market, and in some cases is also affected by the rate of inflation.

The volume of transactions in the capital market far exceeds the amount of money circulating within the payment system.

The trading economy without taxation

Without taxation, firms again supply outputs to households, which provide factors of production to firms. Some firms supply a part of their output to government, and some households supply factors of production directly to government, such as their employed labour.

Government and the public authorities supply public goods and services to firms and households within their geographical areas of responsibility, and receive payments of public revenue in return.

As shown in Figure 11, the take-up of public goods and services is clearly differentiated between firms and households. In the case of firms, the supply of public goods and services is an intermediate good, and is not part of final production; in the case of households, the take-up of public goods and services is part of consumption.

This differentiation is not possible when all government activity is paid for through general taxation. It has significant implications for the preparation of the national accounts, as discussed later.

The flow of money payments is illustrated in Figure 12. There is a direct correspondence between the flow of goods and services and the flow of money payments. The banking system and capital market operate much as they did before, but there is no longer the possibility of long term government debt supported by taxation.

As previously, Figures 11 and 12 both show a closed economy and do not include other monetary flows and transactions, such as exports and imports, savings, investments and foreign exchange.

The removal of taxation is a further stage in the development of the modern trading economy, in which government and the public authorities operate as an integral part of the trading community.

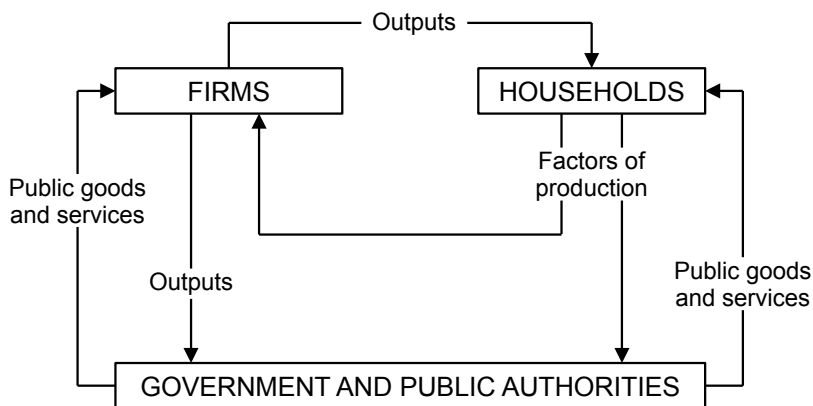


Figure 11: The flow of goods and services

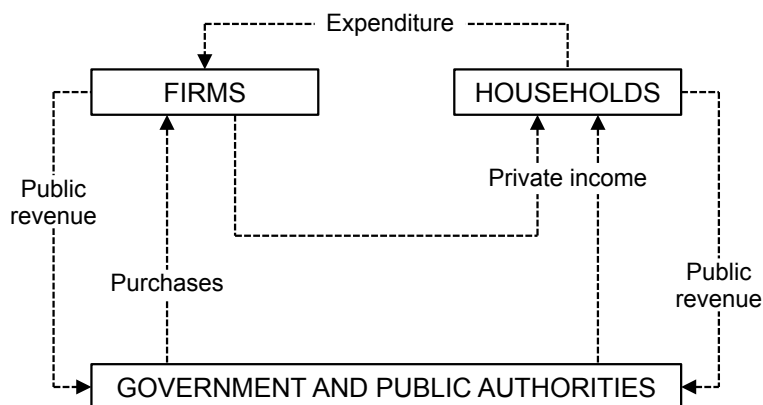


Figure 12: The flow of money payments

The national accounts

The national accounts seek to estimate the size of the economy as a single activity. Once this has been done, it is possible to judge whether the economy is expanding or contracting, and to give an indication of the amount of taxation as a share of the total national income. For simplicity, the following discussion assumes initially a closed economy with no international trade or overseas income.

The main quantity identified in the national accounts of the UK as a measure of output is the gross domestic product, or GDP. The calculation of GDP can be approached in three different ways. (1)

The first method is to add together all the outputs of goods and services produced in a given period, taking account of the prices at which they are sold. The second method is to calculate the total of all expenditures. After some adjustments, the figures should agree.

The third method is to find the total of all the incomes received. After allowing for a part of income being set aside as savings, this total should give the same result as the other two methods.

The current practice is to combine the final output of firms, at current market prices, with the output of government, valued at its cost of production, to calculate total economic output. In effect, it is assumed that all of the outputs of government are purchased by households as consumption, and have a positive economic value.

Changes in GDP give an indication of expansion or contraction of the economy, but do not allow for the inevitable depreciation of capital, such as buildings or equipment. Adjusting for depreciation leads to the lower figure of the net domestic product, or NDP.

For an open economy, further adjustment is needed to account for imports, exports and overseas income. These adjustments lead to the net national income, NNI. For the UK, net national income is no longer widely quoted, but is typically about 85% of GDP. As taxation is a liability of UK residents, tax as a share of net national income is the most useful measure of the level of taxation, but is more difficult to estimate than taxation as a share of GDP.

In a trading economy without taxation, one part of government output is incorporated in the final output of firms, and the balance is taken up by households. All outputs are valued at current market prices, and the national accounts can be prepared on a consistent basis. Figures 13 and 14 show the output of firms and government, and the corresponding flows of payments, under the two different sets of economic conditions. (2)

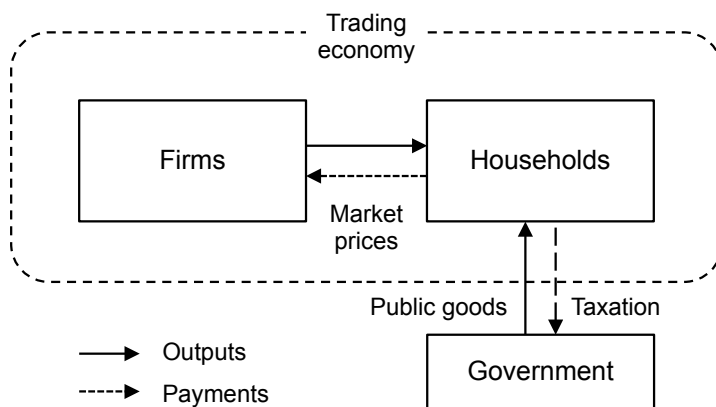


Figure 13: The national accounts with taxation

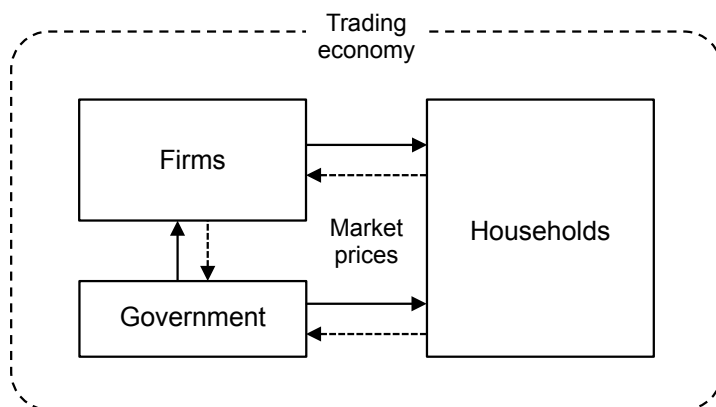


Figure 14: The national accounts with public revenue

The upper limit of taxation

The transition from taxation to the use of public revenue requires a significant period of adjustment on the part of firms, households, government, the banking system, and the financial markets. This is best attempted from a position of economic strength and stability.

When taxation is applied to a trading economy, the total amount of taxation represents the price paid for the outputs and activities of government. Short of total state control of the economy, a point is reached at which it is no longer possible to increase government revenue in real terms by increasing the level of taxation. An upper limit takes effect, and any further increases in taxation beyond this point lead to inflation and a contraction of economic activity.

Reducing the level of taxation below the economic upper limit minimises inflation and enables an expansion of economic activity.

The concept of an economic upper limit to taxation has a long and respectable history. In recent times, the groundwork was laid by the economist Colin Clark. For the post-war years, he showed that in many countries a level of taxation exceeding 25% of the net national income was associated with a high rate of inflation. (3)

Keynes endorsed this conclusion. Since then, other economists have shown a strong correlation, for both the United Kingdom and the United States, between taxation plus government borrowing as a share of the net national income and the annual rate of inflation.

Given fixed tax thresholds, inflation may increase nominal tax receipts and reduce the real value of government debt. Conversely, however, it reduces the purchasing power of government income in real terms and tends to increase the rate of interest payable on government debt. This is especially the case if the economy enters a period of contraction as a result of an increased level of taxation.

An upper limit or an optimum overall level of taxation can also be evaluated in terms of economic growth, employment, and social welfare. Studies such as these typically suggest a lower limit than those which examine levels of taxation and the rate of inflation.

In the 1970s the concept of an upper limit to taxation was given further prominence by the work of the American economist, Arthur Laffer. An example of the 'Laffer curve' is illustrated in Figure 15.

As the rate of taxation is raised from 0% to 100%, an optimum overall level is found at which, under a given set of conditions, the maximum possible amount of government revenue is obtained.

Similarly, for any given amount of government revenue other than the maximum, there are two possible rates of taxation leading to the same amount of revenue, indicated by the points E1 and E2.

In moving from E1 towards E2, economic output is reduced and taxation as a share of GDP will tend to be higher than expected. In moving from E2 towards E1, output is increased, and taxation as a share of GDP will tend to be less than expected.

The rate of taxation corresponding to the maximum government revenue is therefore difficult to determine, and the optimum level for economic stability is likely to be lower than the maximum.

Where government operates a balanced budget, the reduction of taxation from E2 towards E1 does not necessarily require reduced public expenditure, as the same revenue is available at both points.

The concept of the 'Laffer curve' can also be applied to specific taxes and is particularly relevant to taxation levied upon capital.



Figure 15: The upper limit of taxation

The trading economy depends upon a minimum level of public goods and services without which it cannot operate. This in turn requires at least a minimum level of government revenue. There is also a maximum level of government revenue as a share of GDP beyond which the concept of a trading economy no longer applies.

Within this range, total government expenditure may exceed the amount of revenue obtained from taxation, as shown in Figure 16.

When government expenditure persistently exceeds tax revenue for a prolonged period, the difference is made up by increasing the level of annual borrowing. This consists of the issue of additional government debt backed up by the expected receipts from taxation.

Once the economic limit of taxation is exceeded, however, the issue of new government debt in a contracting economy is likely to increase the rate of inflation and the rate of interest payable, and to reduce the supply of public goods and services in real terms.

These conditions would not provide the stability, resilience and confidence required prior to a fundamental change of the system of public finance. Taxation, borrowing and government debt must all be restored to a condition of stability before the transition begins.

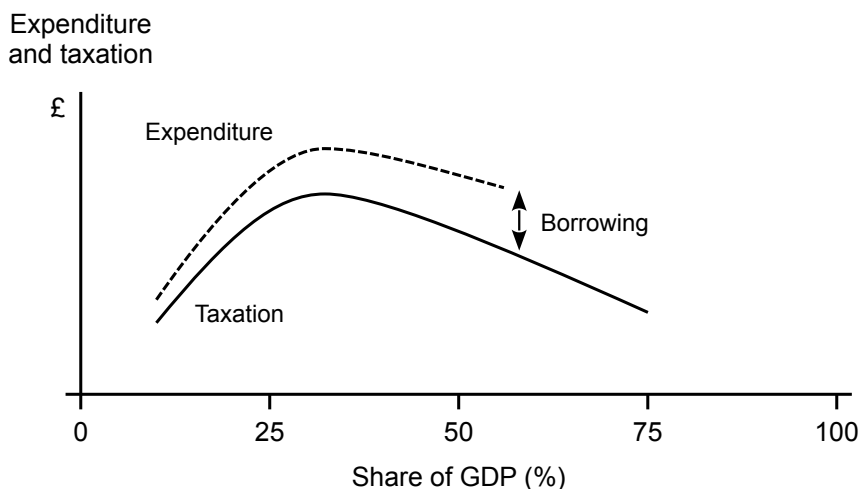


Figure 16: Government expenditure and taxation

Economic indicators

During the transition, firms will experience significant changes to their cost structures and business opportunities. Commercial banks and financial institutions may change their assessments of lending risks, and adjust their willingness to hold government debt. Public sector bodies will improve the public goods and services on offer, so that firms and households begin to evaluate alternative locations better suited to their specific requirements.

The national accounts offer several quantitative measures which can be used to monitor and evaluate the transition from taxation to public revenue. As part of the necessary preparations, however, it would be useful to publish several additional measures, including estimates of Net National Income at current market prices (NNI).

This would enable regular observation of the following:

- (a) General economic indicators:
 - Total amount of taxation received
 - Total amount of public revenue received
 - Total amount of employees' take-home pay
 - Annual rate of consumer price inflation (CPI)
 - Average rate of interest on long term government debt.
- (b) Indicators based on Gross Domestic Product (GDP):
 - Gross Domestic Product at current market prices
 - Central government taxation as a share of GDP
 - Taxation plus borrowing as a share of GDP
 - Government debt as a share of GDP.
- (c) Indicators based on Net National Income (NNI):
 - Net National Income at current market prices
 - Central government taxation as a share of NNI
 - Taxation plus borrowing as a share of NNI
 - Public revenue as a share of NNI.

Other estimates can then be derived as necessary. (4)

Household incomes

The distribution of household incomes can be expressed in terms of the purchasing power of net take-home pay. This is illustrated in Figure 17, where two distribution curves are compared. Each curve shows the number of households for any given level of income.

Before the transition, nearly all incomes are reduced by direct taxation, such as income taxes, and most household expenditure is subject to indirect taxation, such as VAT. This is represented by the distribution curve A, which shows annual household income after deducting all direct and indirect taxes, and before the addition of transfer payments or the imputed value of public goods.

In this example, the income of some households falls below an acceptable minimum level, and other households have no income, due to sickness or unemployment. The effect of the transition from taxation to public revenue is then shown by distribution curve B.

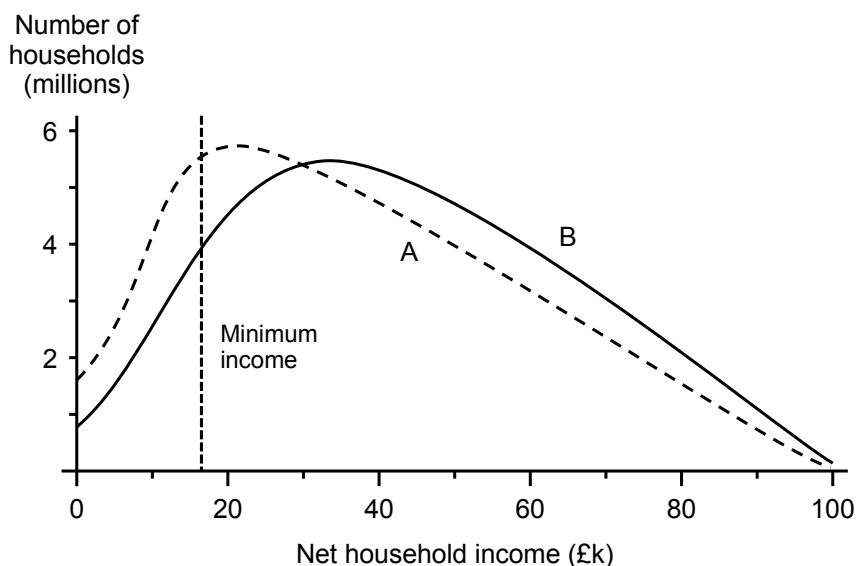


Figure 17: Distribution of household income

After the transition, all taxation is removed. Fewer households receive annual incomes below the minimum acceptable level. The distribution curve is shifted to the right and, for all households, the purchasing power of household income, in terms of the goods and services received in exchange, is significantly increased.

As the transition proceeds and taxation is reduced, it will still be necessary to make provision for households whose annual income falls below the minimum acceptable level. It is likely that the size of the provision required will be smaller than under the sub-normal economic conditions of today, and the need may be fully addressed by the voluntary and private sectors.

Alternatively, state intervention in this area could take the form of a fully-funded national insurance scheme. Contributions could be collected from private incomes, as at present, or included within the single invoice for government services described in Chapter 3.

This second option would assume that provision for low income households constitutes a public good at the national level. It would be consistent with the earlier assumption that health and education services provided by the state also fall entirely within the category of public goods. On this basis, the corresponding charges would be shown as itemised amounts on the single invoice for government services, and would be fully open to public scrutiny.

An exact equality of money incomes for all households is not a characteristic of a trading economy. The same is true of equality of outcomes. In the development of the trading economy, however, it is possible to expand opportunity by the removal of all taxation.

Notes

1. See for example *An introduction to the UK National Accounts*, issued by the Office for National Statistics, 31st October 2022, and other similar official publications.

A brief introductory explanation can also be found in Sir Roy Allen, *An Introduction to National Accounts Statistics*, 1980.

2. Since that part of the output of government that is taken up by firms is now treated as an intermediate good, it can no longer be counted as part of the total output measured by GDP. Like the output of any other firm, it is 'cancelled out' when the final step of aggregation is made at the national level. In principle, therefore, the transition to public revenue is expected to have some degree of deflationary effect on the total amount of GDP.
3. These results were first published by Colin Clark in a journal article, *Public Finance and Changes in the Value of Money*. *Economic Journal*, Vol. 55, No. 220, December 1945.
4. In an open economy, the removal of internal taxation is likely to bring about significant changes to international trade. This may take the form of an increase in the volume of exports and a reduction of domestic demand for imports.

After a period of adjustment, it may be possible to eliminate international tariffs that are not required for reasons of foreign policy. This in turn would set in motion further changes to the pattern of international trade. The overall effect would depend on many factors and is difficult to predict in advance.

Changes to the pattern of international trade are highlighted in the traditional statistical measures of the balance of payments and the rate of exchange of the national currency. International trade statistics for the UK are published at regular intervals by the Office for National Statistics.

5

The transition

Background

This chapter describes how the transition from taxation to a system of public finance based on public revenue can be carried out over a period of several years, in the specific case of the UK.

The approach taken is consistent with the general principles and analysis set out in previous chapters and with the three main policy proposals. The first step is to reduce the level of taxation below the economic upper limit. After a period of adjustment, the traditional rating system is then adapted to become the basis of a new system of public revenue. The former Council Tax and Business Rates are combined to become a new Local Rate, and a new National Rate is gradually introduced. These changes will require some legislation.

There is a further period of adjustment as the level of taxation is reduced and the Local and National Rate are increased until, in the longer term, all confiscatory taxation is fully removed. At the end of the transition there is an opportunity to transfer some aspects of housing, health and education from central to local government.

The principle of public revenue precludes any further increase of long-term central government borrowing, but provision is made for payment of the interest due on existing government debt. The reduction of central government debt over time is also possible.

As the transition proceeds, public revenue is collected by means of itemised invoices for government services showing the amounts due for the Local and National Rate, charges related to government debt, and any licence fees which may apply. Examples of invoices issued at the end of the transition are discussed in the next chapter.

Timescales

The transition is assumed to take ten years, or two parliamentary terms of about five years each. Initially, taxation is reduced from a high starting point of 45% of GDP to a level below the economic upper limit, assumed here to be around 33% of GDP. Both private and public location values begin to increase, and legislation for the development of the rating system is enacted during this time.

Taxation is then further reduced as the total amount of local and national public revenue rises. Additional legislation for the partial transfer of housing, health and education expenditure from central to local government is introduced in this later period. By the end of the transition, all taxation is removed and the total amount of local and national public revenue rises to about 20% of GDP.

A profile of the transition period is shown in Figure 18 below, and the underlying economic model is explored in Appendix 1.

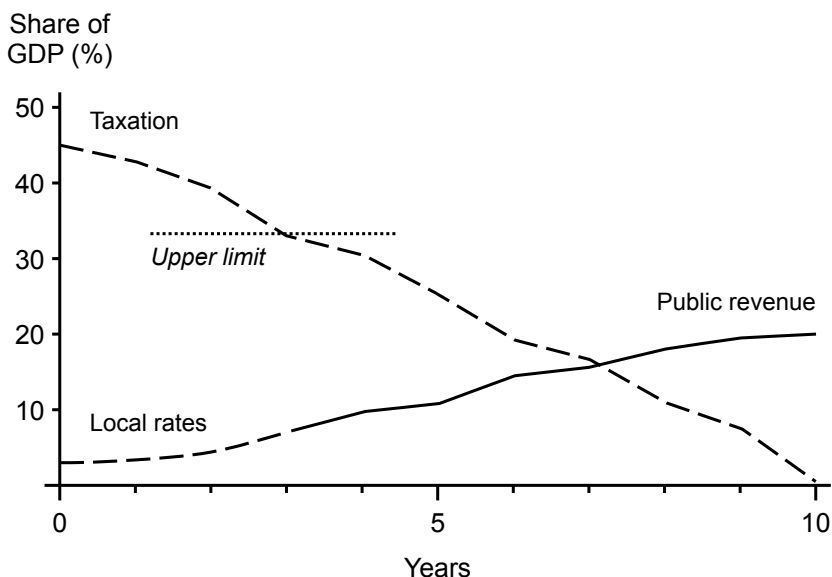


Figure 18: The transition to public revenue

The rating system

An advantage of using the rating system is that arrangements are already in place for local authorities to send invoices to firms and households within their areas, to receive payment, and to deal with cases of non-payment. These arrangements include forwarding part of the payment received to other public authorities, such as county councils, police and fire services, or a national park. According to current practice, all Council Tax payments are retained locally and distributed to other local bodies as necessary. These arrangements are suitable for the collection of the proposed new Local Rate. (1)

Payments received for Business Rates are currently forwarded to central government, but in some cases a proportion is retained locally. As part of the transition to public revenue, these payments become an integral part of the Local Rate, and are retained locally.

The existing arrangements are then extended for the collection of the new National Rate. Payments in this category are forwarded to central government, paid into the Consolidated Fund, and made available to the central government spending departments, such as those responsible for defence and security, justice and the courts.

The transition requires fresh legislation to change the definition of rateable value, to combine Council Tax and Business Rates into the new Local Rate, and to establish the National Rate. The Local and National Rate are then itemised on the same annual invoice.

Thus, after adapting the rating system, a single invoice is issued for all government services, both local and national, itemising the market price of all the public goods and services supplied.

The balanced budget principle is applied, and no additional long term government debt is issued. The total amount of expenditure on the provision of public goods and services is therefore limited to the public revenue received at both the local and national level.

Throughout the transition period, an additional item is added to each invoice to ensure that funds are collected, and held separately, to cover the interest due on existing central government debt. (2)

Once these arrangements are fully in place, further legislation is introduced to transfer responsibility for certain aspects of housing, health and education from the National Rate to the Local Rate.

Each of these steps relies upon the increase in both private and public location value that results from the reduction of taxation.

The development of the rating system, as the means of issuing a single invoice for government services, offers a further important advantage in its potential for the democratic control of expenditure decisions and electoral accountability. This is discussed later in the context of the annual budget cycle of the public authorities and the method by which the itemised invoice amounts are determined.

Licence fees

In cases where a licence fee is charged for waste disposal or for the extraction of natural resources, the fee reflects the market price of the facility or the resources obtained, and a charge is also made for the administration of the licence scheme. These amounts can both be shown as additional items on the single annual invoice, but only the administration charge is related to current expenditure.

That part of licence fee income corresponding to the depletion of a natural resource is properly treated as a capital receipt, which can be accumulated in a local or national sovereign wealth fund.

Licences for waste disposal and other rights are issued locally, and these payments are retained locally. In the UK, however, coal, oil and gas reserves are held by the state. Income received from the extraction of these resources is therefore transferred to a national capital fund, held separately from the Consolidated Fund.

In offshore waters where there is no other local authority to act as the billing authority, the Crown Estate is assumed to possess the ability to issue annual invoices, including licence fees, and forward payments to other public bodies as necessary. Invoices issued for these locations will include National Rate charges and an itemised amount for interest due on existing central government debt.

Legislation

The reduction of taxation does not require fresh legislation and is accomplished through the annual Finance Bill. New legislation is required in such areas as local government finance, planning and infrastructure, and the administration of licence fees.

The traditional rating system is based firstly on the concept of a hereditament, and secondly on its rateable value, which is held on a central valuation list. There is already a rateable value for every hereditament. For all domestic property, it is derived from the sale price, whereas for business premises, it reflects the annual rent that a commercial tenant would pay to the owner of the property.

The central valuation list is maintained by a central government body, and is currently used by the local authorities to determine the amount payable for Council Tax or Business Rates. Under the new policy proposals, a modified central valuation list is required. (3)

The concept of rateable value has been defined in consecutive Local Government Finance Acts and in other related legislation. It relies upon the definition of the legal term *hereditament*, meaning any inheritable real or imaginary property or possession.

According to Section 115(1) of the General Rate Act 1967:

... hereditament means property which is or may become liable to a rate, being a unit of such property which is, or would fall to be, shown as a separate item in the valuation list.

For business premises, the Local Government Finance Act 1988, in Schedule 6, defined rateable value as follows:

The rateable value of a non-domestic hereditament shall be taken to be an amount equal to the rent at which it is estimated the hereditament might reasonably be expected to let from year to year.

Changing the definition of rateable value enables a new system of public revenue to be introduced with the minimum of legislation.

For the purposes of these policy proposals, the legal definition of *rateable value* in all relevant legislation becomes the following:

The rateable value of a hereditament shall be taken to be an amount equal to the total market price of all the public goods and services made available to the hereditament by a public authority within a period of one year.

This definition is applicable to both domestic and non-domestic hereditaments. It enables the introduction of the National Rate and the Local Rate on a consistent legal basis, and there is no longer a 'poundage rate' that can be varied by any public authority. (4)

The rateable value of a hereditament is then identical to the total amount payable on the single invoice for government services.

Since the proposed new legislation will not introduce a form of taxation, its preamble would read as follows:

An Act to change the definition of rateable value, to provide for local authorities to collect a form of public revenue to be called the National Rate, to replace both Council Tax and Non-Domestic Rates jointly with a form of public revenue to be called the Local Rate, to make further provisions with respect to local government finance, and for connected purposes.

Provisions in the legislation will require that the total amount of each invoice is shown on the central valuation list and is open to public inspection, and that itemised invoices are also made public by the individual billing authorities and supported by the published accounts of income and expenditure for each catchment area. (5)

Other provisions in the legislation will establish a procedure to hear appeals and resolve disputes arising from discrepancies in the prices charged by different authorities for similar services and, as taxation is removed over time, to discontinue all existing statutory exemptions, exceptions, discounts and reliefs.

Some additional legislation may then be required to complete the implementation of the policy proposals, as discussed above. (6)

The annual budget cycle

During the first part of the transition, taxation is reduced below the upper economic limit and the necessary legislation is enacted.

Thereafter, for each year of the transition, a budget-setting cycle takes place at both the local and national level, by means of which central government taxation is progressively reduced. (7)

The decision as to which taxes to reduce, or to eliminate, at any given time will depend upon the circumstances. The priority may be to increase employment and productivity, or to reduce inflation; the action required may be to increase tax thresholds, or to reduce rates of taxation or, in some cases, to eliminate a tax completely.

For those public goods and services which are funded from the Local Rate, the annual budget cycle consists of the public authority responsible for each catchment area setting out the schedule of the charges it proposes to make for the year ahead for each service that it provides. The proposed schedule of charges is supported by the published costs for the previous period, and is then put before the local elected representatives for approval in open public forum.

Over a period of time, the charges applied to the Local Rate are brought into line with the new legal definition of rateable value.

As the transition proceeds, the costs incurred for the supply of public goods and services at the national level are transferred from general taxation to the National Rate. This transfer includes only those functions and costs which are indivisible at the national level without local or regional variation, and is accomplished by means of the presentation of the annual Finance Bill to Parliament.

The VOA (Valuation Office Agency) is the government body which maintains the central rating list. After the transition, the list will show the total annual charge applicable to each hereditament.

As part of the Finance Bill provisions, the VOA will determine the National Rate allocations for sites located offshore. It will then apportion the remaining balance of National Rate charges to other hereditaments in strict proportion to the amount of the Local Rate.

The same procedure is followed to allocate the total amount of expected government debt interest and repayment charges to each hereditament in proportion to the total amount of the Local Rate.

The annual Finance Bill is accompanied by the publication of an updated version of the central valuation list showing the effect of the proposed expenditure decisions on the amounts payable.

Approval by Parliament of the annual Finance Bill includes the approval of the updated central valuation list. In accordance with the new legislation, the list then shows the current market price of the public goods and services available at any location, and is used for the production of invoices by the local billing authorities.

After any necessary adjustments and appeals have taken place, the total amount shown on each invoice issued is the same as the corresponding entry on the central valuation list. No distinction is made between domestic or business usage of the hereditament, and no adjustments are made for positive or negative externalities.

As shown in the table below, each entry on the central valuation list shows the Local Rate, National Rate, central government debt charges, and any licence fees which may apply. Where the licence fee is for the extraction of natural resources, the list entry does not show that part of the fee transferred to the capital fund. A separate report is made to Parliament on the status of the capital fund.

Extract from the central valuation list

Reference number	Local Rate	National Rate	Debt charges	Licence fees	Total payable
1001	£6,400	£3,200	£2,000	—	£11,600
1002	£9,600	£4,800	£3,000	—	£17,400
1003	£6,400	£3,200	£2,000	£900	£12,500
1004	£32,000	£16,000	£10,000	—	£58,000
1005	£64,000	£32,000	£20,000	£2,000	£118,000
etc...					

Notes

1. There are approximately 300 local authorities with the power to raise invoices and to receive payments. These are known as billing authorities. In total, there are approximately 30 million hereditaments, so that a typical billing authority handles about 100,000 invoices each year. There are many thousands of other public bodies with powers to make a charge, called a precept, which may then appear on an invoice. All of these charges are currently based on the rateable value held on the valuation list.
2. The national debt is the total amount borrowed by government in the form of securities issued by the Treasury and by other government agencies. In March 2023, general UK government gross debt was £2,537bn or 100.5% of GDP. One third of this total amount is the result of quantitative easing and is owed to the Treasury, so that interest due on this part of the debt is paid by government to itself.

The remainder of the national debt is owed to investors, such as pension funds, and is traditionally regarded as risk-free. The elimination of all taxation will require a firm commitment to meet interest payments and to reduce debt, in order to avoid an increase in the perceived level of risk, which would otherwise lead to higher interest charges. Some part of the government's income must therefore be allocated to cover interest and debt repayment. It may then take 25 years or more to eliminate the total amount of central government debt in this way.

Since the adoption by the UK of the Maastricht Treaty in 1993, government is not permitted to borrow directly from the Bank of England. It has, however, established several other public bodies which are able to borrow in this way, or are dependent on government guarantees which assume the use of taxation.

In due course, these arrangements will need to be re-examined as government borrowing reduces and taxation is eliminated.

3. The practical arrangements are a little more complicated. A list of the rateable values of hereditaments is maintained centrally for each local authority area. The local lists are combined into a master list by the Valuation Office Agency (VOA), which is the central body responsible for determining rateable values.

Certain categories of commercial property that are currently subject to Business Rates are recorded on a central rating list maintained directly by the VOA. These properties would all be transferred to the appropriate local authority list and payments received would be retained locally as part of the Local Rate.

4. Under current legislation the 'poundage rate' is the proportion of the rateable value of a hereditament charged by each public authority, and can be varied over time. Similarly, there is also a 'multiplier' for the calculation of Business Rates. These would both be removed as part of the initial legislation.
5. The published version of the itemised invoice for government services must show the address of the hereditament, but it does not need to disclose any personal details of the occupier. This degree of disclosure is sufficient to support an open process of appeal. A reference number on the approved central valuation list also identifies each address to which an invoice is sent.
6. Examples of other legislation that would be affected include: the Local Government Finance Acts 1988, 1992 and 2012; the Town and Country Planning Act 1990; the Planning Act 2008 (which deals with large public infrastructure projects); and all those Statutory Instruments dealing with rating and valuation.
7. As noted in Chapter 1, the reduction of total public spending is not addressed in these policy proposals. A separate programme is required to deal with the total amount of public expenditure, and with the costs incurred for activities of government which do not satisfy the definition of public goods and services, and are therefore not transferred as a charge to the public revenue.

6

Conclusion

Invoices for government services

The six sample invoices which follow show the amount payable by the occupier of a hereditament after the removal of all taxation, such as income taxes, VAT and corporation tax, and the conversion of Council Tax and Business Rates to become the Local Rate. It is assumed that all international tariffs have also been removed, and that a period of geographical dispersal and increased specialisation has taken place. No allowance is made for inflation or deflation.

The total amount shown on each invoice is the market price of the public goods and services available to the hereditament under these conditions, with adjustments in respect of the national debt and any license fees for the extraction of natural resources, and is published as an individual entry on the central valuation list. (1)

Each itemised amount is the result of an exercise of judgment and is supported by publication of the itemised invoices and actual cost incurred for the relevant catchment area. The invoiced amount is also subject to a formal process of appeal in open hearing. (2)

The National Rate is allocated in strict proportion to the Local Rate, and the debt interest and repayment charge is proportional to the total annual amount of the Local and National Rate charges.

Payments are received and distributed by the billing authorities as discussed earlier. With all taxation removed, these arrangements constitute the complete system for the collection of public revenue; no other payments are necessary for the supply of the public goods and services required by the fully developed trading economy.

Transfer of local services

The first two examples show the invoices issued to a typical small firm or household before and after the transfer of responsibility for health, education and housing from central to local government.

As a result of this transfer, there is a significant change in the proportions of the local and national sections of the invoice. There is, however, no change to the annual amount charged for interest and repayment of the national debt, or to the total amount payable.

The market price of public goods

The third invoice illustrates a change in the invoice amount for the same hereditament after the reduction of costs in response to local electoral pressure. The national and local charges are reduced, and there is a corresponding change to the charge for the national debt.

The fourth invoice shows the higher market price for the public goods and services made available to a hereditament in a different catchment area, occupied by a different household or firm. (3)

The local and national sections of the invoice are in the same proportion as for all other hereditaments, and the invoice amounts, including the national debt charges, are adjusted accordingly.

The fifth invoice shows the addition of a waste disposal licence, which a larger firm may require in order to discharge pollution; the waste disposal charge would accrue to a local capital fund.

The offshore domain

Finally, the last invoice shows the extension of the principle to an offshore site. It is assumed that all of the public goods and services supplied are indivisible at the national level.

A suitable public body is appointed to collect and distribute the total annual charge, and the payment made for the extraction of the natural resource accrues to a capital fund at the national level.

Invoice 1

Local Rate charges	
Social services	£978
Local road network	£254
Waste collection and disposal	£117
Public planning service	£91
Parks and open spaces	£48
Other departments and budgets	<u>£512</u>
Annual charge payable	£2,000
National Rate charges	
National Health Service	£3,517
Education	£1,759
Defence and security	£793
Home Office	£379
Housing and local government	£379
Justice and the courts	£241
Foreign and Commonwealth	£172
Other departments and budgets	<u>£2,760</u>
Annual charge payable	£10,000
Debt interest and repayment	
Annual charge payable	£2,120
Total annual charge	£14,120

Notes:

1. Health, education and social services constitute 45% of the Local and National Rate charges. Other departments and budgets account for a further 23%, and the remaining categories approximately 32%.
2. National debt charges are 15% of the total amount payable.

Invoice 2

Local Rate charges	
Social services	£978
Local road network	£254
Waste collection and disposal	£117
Public planning service	£91
Parks and open spaces	£48
Other departments and budgets	£512
Local health services	£3,000
Primary and secondary education	£1,600
Housing, net of rental income	<u>£100</u>
Annual charge payable	£6,700
 National Rate charges	
National health services	£517
Tertiary and adult education	£159
Defence and security	£793
Home Office	£379
Housing and local government	£279
Justice and the courts	£241
Foreign and Commonwealth	£172
Other departments and budgets	<u>£2,760</u>
Annual charge payable	£5,300
 Debt interest and repayment	
Annual charge payable	£2,120
 Total annual charge	£14,120

Notes:

1. The proportion of Local Rate charges is increased from 20% to 56%, and the national debt charge is unchanged at 15% of the total amount.
2. In later years, the local health, education and housing charges will be replaced by the actual costs incurred in the relevant catchment area.

Invoice 3

Local Rate charges	
Social services	£978
Local road network	£254
Waste collection and disposal	£117
Public planning service	£91
Parks and open spaces	£48
Other departments and budgets	£212
Local health services	£3,000
Primary and secondary education	£1,600
Housing, net of rental income	£100
Annual charge payable	£6,400
National Rate charges	
National health services	£517
Tertiary and adult education	£159
Defence and security	£793
Home Office	£379
Housing and local government	£279
Justice and the courts	£241
Foreign and Commonwealth	£172
Other departments and budgets	£660
Annual charge payable	£3,200
Debt interest and repayment	
Annual charge payable	£2,000
Total annual charge	£11,600

Notes:

1. The Local Rate is reduced by about 4.5% and the National Rate by about 40%. The total annual charge payable is reduced by about 17%.
2. The monetary amount of the national debt charge is slightly reduced, and now constitutes just over 17% of the total amount payable.

Invoice 4

Local Rate charges	
Social services	£4,890
Local road network	£1,270
Waste collection and disposal	£585
Public planning service	£455
Parks and open spaces	£240
Other departments and budgets	£1,060
Local health services	£15,000
Primary and secondary education	£8,000
Housing, net of rental income	£500
Annual charge payable	<u>£32,000</u>
National Rate charges	
National health services	£2,585
Tertiary and adult education	£795
Defence and security	£3,965
Home Office	£1,895
Housing and local government	£1,395
Justice and the courts	£1,205
Foreign and Commonwealth	£860
Other departments and budgets	£3,300
Annual charge payable	<u>£16,000</u>
Debt interest and repayment	
Annual charge payable	£10,000
 Total annual charge	 £58,000

Notes:

1. The higher total annual charge reflects the different characteristics of the hereditament, and the catchment areas within which it is located.
2. The national debt charge is allocated in proportion to the total amount of the Local and National Rate, and is again about 17% of the total.

Invoice 5

Licence fees

Administration charge	£2,000
Environmental waste disposal	<u>£30,000</u>
Annual charge payable	£32,000

Local Rate charges

Social services	£9,780
Local road network	£2,540
Waste collection and disposal	£1,170
Public planning service	£910
Parks and open spaces	£480
Other departments and budgets	£2,120
Local health services	£30,000
Primary and secondary education	£16,000
Housing, net of rental income	<u>£1,000</u>
Annual charge payable	£64,000

National Rate charges

National health services	£5,170
Tertiary and adult education	£1,590
Defence and security	£7,930
Home Office	£3,790
Housing and local government	£2,790
Justice and the courts	£2,410
Foreign and Commonwealth	£1,720
Other departments and budgets	<u>£6,600</u>
Annual charge payable	£32,000

Debt interest and repayment

Annual charge payable	£20,000
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Total annual charge £148,000

Invoice 6

Offshore licence fees	
Administration charge	£480,000
Natural resource extraction	<u>£14,000,000</u>
Annual charge payable	£14,480,000
 National Rate charges	
National health services	£51,700
Tertiary and adult education	£15,900
Defence and security	£79,300
Home Office	£37,900
Housing and local government	£27,900
Justice and the courts	£24,100
Foreign and Commonwealth	£17,200
Other departments and budgets	<u>£66,000</u>
Annual charge payable	£320,000
 Debt interest and repayment	
Annual charge payable	£200,000
 Total annual charge	£15,000,000

Notes:

1. The Crown Estate acts as the offshore billing and collection authority.
2. The Marine Management Organisation issues the licence required for offshore activity and receives the administration charge.
3. Licence fee income from the extraction of natural resources accrues to a separately held capital fund and is not used to pay for short-term government expenditure or national debt interest and repayment.
4. The Crown Estate issues a lease for the occupation of the sea bed and receives a rental payment, which also accrues to the capital fund.
5. There may be other services, such as aids to navigation and offshore search and rescue facilities, which could be included in this example.

The public revenue

Figure 19 shows further examples of invoices issued at different locations. For Sites A to E, the amount payable includes the Local Rate and National Rate, together with debt interest and repayment charges. The local charges will typically include itemised amounts for more than one catchment area. Site F is assumed to be located offshore. In this example, however, it is assumed that a licence fee for the extraction of natural resources is not required. For each site, the annual charges reflect the cost of the public goods and services made available after the removal of all taxes and tariffs. The total amount of all such charges constitutes the public revenue. (4)

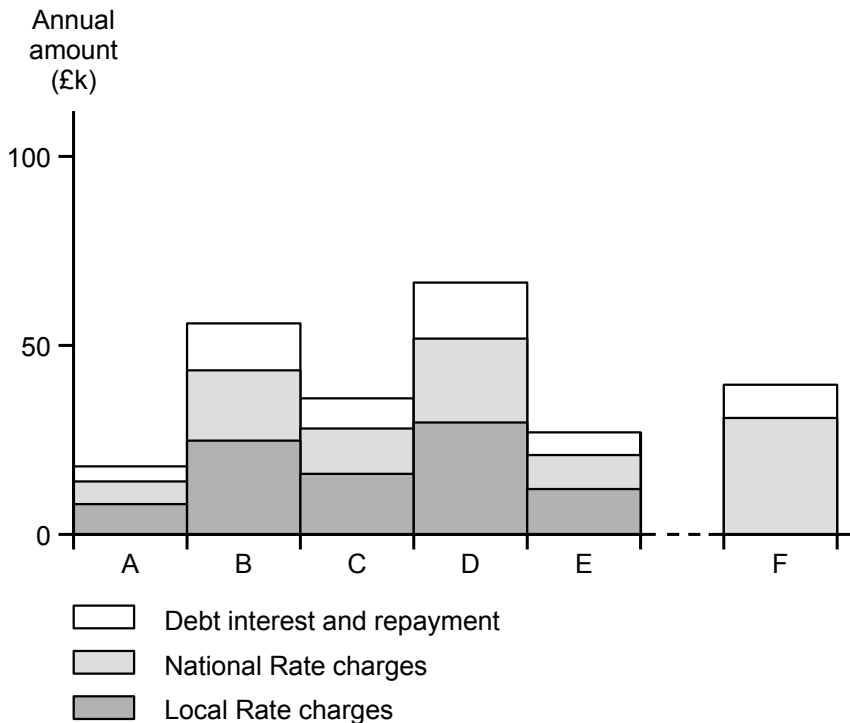


Figure 19: Annual charges at different locations

A smaller state

By the end of the transition, the burden of taxation is completely removed from all productive economic activity. Public expenditure is under direct electoral control at the local level, and the system of public finance becomes entirely transparent. (5)

There is a wider geographical distribution of economic activity, and of the provision of public goods and services. Essential public services are maintained or improved and provision is made for low income households. The changes are accompanied by more intense scrutiny of public expenditure and a much smaller central state. (6)

A civilised society

The replacement of all confiscatory taxation by a system of public revenue is a transition to a different kind of economy. The trading economy depends on public goods and services, but government is dependent on the ability and willingness of firms and households to produce those economic outputs necessary for its continuation.

The fully developed trading economy brings all of these factors together in harmony. A new framework of incentives is established to encourage the supply of public goods and services without any confiscation by the state of private property or incomes.

The removal of taxation releases the trading economy from its sub-normal condition and expands the scope for specialisation and trade in both the private and public sectors. It places all members of society under the same laws, and is conducive to the growth and development of the individual and the prosperity of communities.

This is a transition towards a society with fewer laws, and one in which government upholds the law. It is paid in full for the work it has done, and does not take from others; public revenue without taxation is possible, and may lead towards a more civilised society.

Notes

1. In the interests of simplicity, the monetary amounts used for the preparation of the invoices are slightly different from those shown in Appendix 1. In particular, a slightly higher allowance is made for national debt charges, and the relative proportions of the national and local rate components are emphasised.
2. The public authorities should ensure that there is no significant financial incentive to combine or subdivide hereditaments with a view to reducing the total amount payable.
3. Two apparently similar households may receive very different combinations of public goods and services. A rural property in north-west England may benefit from little more than poorly maintained local roads, but it would still receive all the public goods and services itemised under the National Rate. This may result in annual charges similar to those shown on Invoice 3.

The charges for a property in an urban London borough, with access to a highly developed transport network and the public infrastructure of a capital city, may correspond to Invoice 4.

The two properties may appear similar, but the market price of public goods and services is very different in the two cases.

4. Under these policy proposals, each firm or household has only one principal financial transaction with government. As shown in Figure 19, higher value locations contribute proportionately more towards the cost of supply of public goods and services.
5. This is similar to the viewpoint of classical liberalism, which held that economic problems are best solved by the operation of the free market and low taxation, and all political questions by representative government. In this case, however, there are the additional distinguishing characteristics of a fully funded and responsive public sector, the complete absence of taxation, and the development of a different kind of trading economy.

6. A smaller state is desirable in itself and leaves more scope for the increased value arising from voluntary exchange within the trading economy. This view was expressed by Antony Fisher:

“Compulsion must reduce the satisfaction individuals derive from their incomes. In other words, the vast amount of money spent on so-called public services, and on government itself, may be worth much less than the value on paper shown in terms of pounds. Yet ‘public expenditure’ is included in the national income as though it were worth as much as the values created by voluntary exchange. There could be no greater fallacy.”

Antony Fisher, *Must history repeat itself?* 1974, p.95-96.

The elimination of all forms of confiscatory taxation makes it possible to increase the scope for voluntary exchanges, and to minimise the degree of compulsion, in a trading economy fully equipped with modern and efficient public goods and services.

On the basis of the economic model outlined in Appendix 1, a reduction in the size of the state to no more than 25% of GDP would appear to be feasible.

7

Examples

Background

The examples set out in this chapter are intended to show the effect of the policy recommendations in particular circumstances.

Comparisons are made between the conditions of today and the conditions at the end of the transition, after the removal of all taxes and tariffs, for households, firms and the public sector. The main focus is on the payment made for public goods and services.

The operation of the system of taxation, allowances, subsidies, benefits and transfer payments to households currently in force is highly complex, and constantly changing. No specific assumptions are made about the reduction of subsidies to firms or any changes to state benefits, other than the partial transfer of health, education and housing services from central to local government. At the end of the transition, however, it is likely that the need for benefits and subsidies will be greatly reduced, and some will be eliminated. (1)

The typical arrangements for the payment of taxation by firms, households and public sector bodies are set out below. In general, the amount of taxation depends upon such factors as the number of employees, or the type and scale of the commercial activity. Both Council Tax and Business Rates are partly influenced by location, but they are in most cases a small proportion of the tax burden.

After the transition, the amount payable as public revenue will reflect only the public goods and services available. In some cases, a firm or household will exercise a choice of location, and may no longer be within the same catchment area as before the transition.

Taxation in the UK

The total amount of central and local government taxation in the UK is approximately £1,010bn per year. The principal sources of taxation for the year 2024/25 are set out in Table 1 below.

Table 1: Total tax revenue (£bn)

Income tax and national insurance contributions	£476
Value Added Tax (VAT) on most purchases	£171
Corporation tax and other taxes on profits	£100
Council Tax and Business Rates	£75
Capital taxes	£41
Other taxes*	<u>£147</u>
Total tax revenue	£1,010

* Within the category of other taxes, tariffs on imports contribute about £4.8bn per year and are additionally subject to VAT at 20%.

On average, this is equivalent to a tax burden of about £35,547 per household per year. Of the total tax revenue shown in Table 1, £450bn per year is used in the supply of public goods and services, equal to approximately £15,838 per household per year. (2)

With the exception of Council Tax, which is paid directly to local government, nearly all tax revenue is collected by firms and forwarded to central government. It is experienced by households as a deduction from income or as an increase in the cost of living.

The total amount of public spending is significantly higher than the total tax revenue. At £1,280bn it is equivalent to £45,000 per household, or about 45% per cent of Gross Domestic Product, and probably exceeds 50% of the Net National Income.

The difference between public expenditure and the tax revenue received leads to an increase in the amount of central government debt. In the longer term, the interest charged on government debt is paid by households through a higher level of general taxation.

The effect on households

For the purposes of comparison, the average amount of taxation is taken to be £35,547 per household, consistent with the summary in Table 1. Within this total amount, the average Council Tax paid to local government is assumed to be £2,000 per household. Prior to the transition, therefore, the position is as follows:

Council Tax	£2,000
Central government taxation*	<u>£33,547</u>
Tax revenue per household	£35,547

* Including debt interest and repayment.

The central government tax burden of £33,547 includes £15,838 per household per year for the supply of public goods and services.

With all taxation removed, households are no longer subject to the deduction of taxes from incomes or the addition of taxes to the price of their everyday purchases. Instead, each household receives a single invoice for government services, and the public goods and services supplied become part of ordinary household consumption.

During the transition period, it is assumed that health, education and housing services transfer from central to local government and that the category of ‘other costs’ is significantly reduced, as shown in the previous chapter. The annual amount payable by the average household, after the transition is complete, is then as follows: (3)

Local Rate charges	£6,400
National Rate charges	£3,200
Debt interest and repayment	<u>£2,000</u>
Total annual charge	£11,600

The total annual charge is 25% less than the £15,838 previously incurred for the supply of public goods and services, and one third of the previous tax burden per household of £35,547 per year. (4)

As a result of the transition there is a shift of responsibility from central to local government. The household is able to influence the Local Rate charges by participation in local expenditure decisions, and since the national elements are proportional to the Local Rate, this will change the total annual amount payable. It may also seek to alter the National Rate charges by parliamentary representation.

A much greater proportion of the total annual charge is brought under local scrutiny and democratic control. If necessary, however, the household may submit an appeal, or request the sub-division of a catchment area into smaller zones, to reduce the amount payable.

In the longer term, the household may be in a position to move to a different catchment area or zone, or establish a business which takes full advantage of the public goods and services offered.

Firms and other organisations

Under the sub-normal economic conditions of today, firms collect income taxes and national insurance contributions and are subject to the taxation of profits as shown in Table 1. Goods and services bought in by the firm for use in production are also subject to prior taxation and, in most cases, VAT is effectively charged at the point of sale to the final consumer. The nominal rate of VAT is 20%.

After the end of the transition, firms are no longer required to collect taxation on behalf of the public authorities. Each firm treats the public services it needs as an intermediate good, and the cost is fully passed on to the final consumer as part of the selling price.

Firms are more likely to be mobile than households and, due to the pressure of competition, will aim to take advantage of the best available offer of public goods and services. During the transition, therefore, the firm may move to a new location, or may change its pattern of activity to take advantage of what is being offered. (5)

The firm may also request the sub-division of a catchment area into smaller zones to facilitate a different specialisation of public services, or it may submit an appeal to reduce the amount payable.

From Table 1, it can be shown that the average firm is currently required to collect and forward to central government tax revenues of approximately £171,770 per year, of which £75,614 is used for the provision of local and national public goods and services. (6)

After the transition period, the firm receives a single invoice for government services based on the market price of the public goods and services made available. The total annual amount payable by the average firm, with all taxation removed, is then as follows:

Local Rate charges	£32,000
National Rate charges	£16,000
Debt interest and repayment	<u>£10,000</u>
Total annual charge	£58,000

The total annual charge is 25% less than the £75,614 previously incurred for the supply of public goods and services, and one third of the £171,770 of tax revenue previously collected and forwarded to central government.

For individual firms, the effect of the transition may be different from the average case, depending upon such factors as the size and scale of the activity, the number of people employed, the amount of corporate profit, and the tax regulations previously applicable.

In the case of a larger firm requiring the issue of a licence, such as for environmental waste disposal, the amount payable would be increased as in the following example:

Licence fees	£32,000
Local Rate charges	£64,000
National Rate charges	£32,000
Debt interest and repayment	<u>£20,000</u>
Total annual charge	£148,000

This general outcome is equally applicable to all kinds of firms and organisations, including those owned by the public authorities.

The public sector

Prior to the transition, the main distinguishing features of a public authority are that its income is chiefly derived from taxation and is exempt from corporation taxes on its surplus or profit, and that it does not collect VAT on the public goods and services it supplies; in most cases, a public authority or central government department is not subject to Business Rates for any property which it occupies.

Conversely, however, public sector bodies collect income taxes and national insurance contributions on behalf of government, and the inputs of goods and services which they receive from suppliers are subject to prior taxation as intermediate goods. In most cases, a public body is therefore required to maintain a VAT account.

After the transition, there is no longer a requirement to collect or forward any tax revenues on behalf of central government. Each public authority receives its income through the invoices issued by the appropriate billing authority, and no longer receives any grants, subsidies, or other transfers of funds from other public bodies.

Like any other firm, however, it now receives an annual invoice for government services, and this will include itemised charges for the catchment areas in which it is located. This change will apply to all public sector bodies, including central and local government departments, and to all government owned facilities, such as parks and open spaces, and national infrastructure projects. (7)

For a typical public authority, the annual charges could be:

Local Rate charges	£320,000
National Rate charges	£160,000
Debt interest and repayment	<u>£100,000</u>
Total annual charge	£580,000

The public authority has the same incentive as any other firm to identify the optimum location for its activities. It may also submit an appeal in respect of the charges for any site which it occupies.

Offshore activities

Like other organisations, all firms operating in the offshore domain collect, and forward to government, income tax, national insurance contributions, and VAT. All the inputs of goods and services which they receive from their suppliers are also subject to prior taxation.

In addition to the taxes shown in Table 1, firms engaged in oil or gas extraction are currently subject to the taxation of corporate profits at a higher rate of 30%, an energy profits levy at 38%, and a supplementary profits charge of 10%. Overall, the total tax payable on profits arising offshore may be as high as 78%.

After the transition, a firm operating offshore receives a single invoice for government services, including any applicable licence fees. The licence fee amount for the extraction of natural resources is set by the general market price for that particular commodity. All taxes are removed, and there is no longer a requirement to forward tax revenues to central government or any other public authority.

In the first instance, the National Rate charge is determined by the Valuation Office Agency on the basis of the cost of supply of the public goods and services made available. The annual charges payable could therefore be as follows:

Licence fees	£14,480,000
Local Rate charges	—
National Rate charges	£320,000
Debt interest and repayment	<u>£200,000</u>
Total annual charge	£15,000,000

As the transition proceeds, however, it may be possible to establish a public authority with responsibility for the development of public infrastructure in the offshore domain. This would be reflected in the addition of Local Rate charges based on the costs incurred. In this way, the proposed system of public revenue can be extended to the offshore catchment area on a consistent basis. (8)

Notes

1. It is likely that the removal of all taxation, combined with the payment of the full market price for public goods and services, will lead to a very different distribution of household incomes.
2. The figures quoted are obtained from official sources, such as the regular publications of the Office for National Statistics.

At the beginning of the year 2025, there were approximately 28,413,000 households and 5,686,770 businesses. The total tax revenue is therefore divided by the number of households, or by the number of firms, to obtain an average figure.

3. The total amount payable is shown on a fully itemised invoice as described in the previous chapter. All invoices are open to public examination, and no expenditure is transferred between categories after the invoice has been issued.
4. The reduction in the amount of the annual charges is a result of the assumptions made in the economic model in Appendix 1.
5. With all internal taxation and external tariffs removed, the firm may perhaps decide to increase its international trade, and this may benefit from the construction of new public infrastructure.
6. The calculation is similar to that for households. The Council Tax component of £45bn is removed from the total tax revenue and the remainder is divided by the number of firms to arrive at the average tax collected. The amount used for the provision of public goods and services is calculated in the same way.
7. The invoice is issued by the local billing authority and the site is added to the central valuation list. This automatically brings the property within the legal definition of a hereditament.
8. Offshore public infrastructure may include aids to navigation, emergency search and rescue services, and facilities to support the extraction of natural resources.

8

Appendices

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Appendix 1: An economic model

This appendix outlines a transition from taxation to public revenue in four stages, as illustrated in Table 1 below. The starting point is shown as Stage 1, with taxation at approximately 45% of GDP.

For simplicity, several assumptions are made. In particular, it is assumed that there is very little increase of nominal GDP during the period of transition, and that there are no external disturbances.

In moving to Stage 2, taxation is reduced from its present level to less than the economic upper limit, assumed to be about 33% of nominal GDP. No allowance is made for an expansion of economic activity that may result from the reduction of the level of taxation.

At Stage 3, the National Rate is introduced and the Local Rate replaces both Council Tax and Business Rates. Taxation is further reduced to about 25% of GDP, and the combined revenue from the National and Local Rates increases to about 7% of GDP.

Finally, at Stage 4 all remaining taxation is eliminated and the National Rate is fully in place. The total revenue received from the Local and National Rate, shown below as the total public revenue, is about 17% of nominal GDP.

Table 1: Four stages of transition (£bn)

	Stage 1	Stage 2	Stage 3	Stage 4
Size of GDP	£2,200	£2,250	£2,300	£2,370
Tax revenue	£1,000	£750	£575	—
Tax share of GDP	45%	33%	25%	—
New National Rate	—	—	£85	£325
Council Tax	£45	£45	—	—
Business Rates	£30	£30	—	—
New Local Rate	—	—	£75	£75
Total public revenue	—	—	—	£400
Rates share of GDP	3%	3%	7%	17%

Table 2 below shows the expenditure of the central government spending departments engaged in the supply of public goods and services to the trading economy at Stage 1, and at Stage 4.

By the end of the transition period, it is assumed that increased efficiency, improvements in the overall supply of public goods and services, and the removal of taxation allow the cost of provision to be reduced to about 75% of the Stage 1 monetary amounts.

At Stage 4, the expenditure of the central government spending departments does not exceed the income from the National Rate.

Table 2: Costs of central government departments (£bn)

	Stage 1	Stage 4
National Health Service	£155	£117
Education	£77	£58
Defence and security	£35	£26
The Home Office	£17	£13
Housing and local government	£16	£12
Justice and the courts	£10	£7
Foreign and Commonwealth	£7	£5
Other departments and budgets	<u>£116</u>	<u>£87</u>
Total expenditure	£433	£325

These first two tables do not include any specific provision for the payment of the interest due on central government debt, or for transfers of responsibility from central to local government.

The national debt is a consequence of the past use of taxation and is not directly related to the market price of the public goods and services being supplied. Nevertheless, provision must be made for regular payments of interest and repayment of the capital sum.

Full elimination of the national debt implies that the cost of all historic government activities funded by borrowing, including the purchase of national infrastructure, has been paid. It is reasonable to spread repayment of the debt over a prolonged period of time.

Table 3 below illustrates the capacity of the trading economy at Stage 4 to support interest charges and repayment of the national debt. As noted in Chapter 5, it is not necessary to provide for the payment of interest due from central government to itself for debt incurred as part of the earlier quantitative easing transactions.

As of March 2023, the amount of central government debt owed to external lenders is £1,690bn. The interest payable is £6bn per month and the forecast for the full year is approximately £100bn.

The average rate of interest on most long-term government debt is however below 4%. Given some expansion of economic activity, it is assumed that a provision of £100bn for interest and repayment can be maintained, and that the total amount of central government debt can be reduced to 50% of GDP by the end of the transition.

From Stage 4 onwards, it is assumed that an annual provision of £75bn would be sufficient to allow for eventual full repayment.

Given these assumptions, Table 3 shows that adequate provision can be made for payment of the interest due on central government debt whilst removing all existing taxes. At Stage 4, the combined government revenue from the National and Local Rate and interest due on the national debt does not exceed 20% of nominal GDP.

Table 3: Debt interest and repayment (£bn)

	Stage 4
Size of GDP	£2,370
Government debt	£1,185
Debt share of GDP	50%
New National Rate	£325
New Local Rate	<u>£75</u>
Total public revenue	£400
Plus: Debt interest and repayment charges	<u>£75</u>
Total expenditure	£475
Rates and national debt charges, share of GDP	20%

Most state-provided health and education services are supplied locally, and it is assumed that responsibility for these functions is transferred from central to local government. Similarly, some part of central government housing costs could also be transferred.

In practice, specialist health institutions and government-funded universities would be retained centrally, together with some overall supervisory functions in each of the three areas.

Table 4 below shows the net effect of transferring the major part of state-provided health, education and housing costs from central to local government. The transfers could be made at Stage 4, when improvements of efficiency are already in progress, and the cost of service provision is no longer distorted by the effects of taxation.

The overall effect of the transfer of responsibility in these three areas would be to reduce the total amount of the National Rate by about £175bn, and to increase the Local Rate by the same amount.

As previously, the table also shows an expenditure of £75bn for central government debt interest and repayment. If necessary, this could be increased to £150bn; total public expenditure would then be increased to £550bn, or about 23% of nominal GDP. This would be approximately half of the present level of public expenditure.

Table 4: Transfers to local government (£bn)

	Stage 4
National Rate before transfers of responsibility	£325
Local Rate before transfers of responsibility	<u>£75</u>
Total expenditure	£400
National Rate after transfers of responsibility	£150
Local Rate after transfers of responsibility	<u>£250</u>
Total expenditure	£400
Plus: Debt interest and repayment charges	<u>£75</u>
Total expenditure	£475
Rates and national debt charges, share of GDP	20%

Taking all these factors into account leads to a transition profile similar to the example shown in Table 5. The table covers a period of about seven years, from Stage 2 through to Stage 4.

At the end of the third year of the transition, central government tax revenue has been reduced below the economic upper limit to £750bn, and the income from Council Tax and Business Rates is unchanged at £75bn. The interest due on the national debt is being paid from the total tax revenue received by central government.

Tax revenue is then progressively reduced by about £100bn per year, and those government activities which satisfy the definition of a public good are transferred to the system of public revenue.

The National Rate is introduced and increases to a maximum of £305bn. The Local Rate replaces the traditional rating system, and continues at £75bn per year. A separate provision is made for the interest due on central government debt, rising to £75bn per year.

In the final two years of the transition, responsibility for health, education and housing services is transferred from central to local government. This results in the Local Rate rising to £250bn, whilst the National Rate reduces to £150bn, and taxation falls to zero.

The total revenue available to central and local government thus reduces from £825bn to £475bn, and those activities not funded by the new system of public revenue are gradually brought to an end.

Table 5: Annual profile of transition (£bn)

Year	3	4	5	6	7	8	9	10
Tax revenue	£750	£680	£575	£465	£375	£250	£165	—
Former rates	£75							
National Rate		£25	£85	£165	£245	£305	£250	£150
Local Rate		£75	£75	£75	£75	£75	£150	£250
Debt charges		<u>£15</u>	<u>£25</u>	<u>£40</u>	<u>£50</u>	<u>£60</u>	<u>£75</u>	<u>£75</u>
Total revenue		£795	£760	£745	£745	£690	£640	£475

Appendix 2: The nature of taxation

The purpose of the state is to protect the lives and property of its citizens from external aggression and to uphold the law. In theory, the state may be granted a monopoly of the legitimate use of force in order to achieve this aim. The use of physical force by the police and by the military is therefore permitted on this basis. It does not follow, however, that the use or threat of physical force must also be the sole basis of the state's system of public finance.

A legal monopoly of force makes possible confiscatory taxation and, in turn, the apparently unlimited creditworthiness of the state. Under these conditions government borrowing is not subject to the discipline of a sound return on investment, but is constrained only by the ultimate risk of the perceived insolvency of the state.

Furthermore, when the state confiscates the private property or incomes of its citizens, it is itself in breach of the moral law it has been established to uphold. This inconsistency leads to discontent.

In a fully developed trading economy firms, households and all the different branches of the polity pay for what they receive, and are paid for the work they have carried out; all are under the same law. Thus, the economic function of the polity becomes an integral part of production and exchange within the trading economy.

The creditworthiness of the polity then depends, not on a power of confiscatory taxation backed up by force, but on public revenue expressed in terms of the market price of public goods and services supplied, and backed directly by the overall productive capacity of the fully developed trading economy under the new conditions.

Taxation contributes to economic inequality in several different ways. Firstly, it restricts the effectiveness of the trading economy to a sub-normal condition, as described earlier. This reduces output and depresses the standard of living, particularly for lower income groups. It also tends to increase both unemployment and inflation, and to reduce the purchasing power of money wages by increasing the cost of production of all items of household consumption.

Under sub-normal conditions taxation is incorporated into every step in the chain of production of the basic commodities, such as a loaf of bread. This can be traced through from the harvesting of the wheat, to milling of the flour, baking and distribution of the loaves, and the employment of staff at the point of sale to the consumer.

Taxation is a one-way transaction unrelated to the needs of the taxpayer. When taxation is replaced by public revenue, however, it sets in motion a different series of two-way transactions. The price of a loaf of bread then reflects only the actual cost of production.

Secondly, taxation has unseen effects. For every increment of tax revenue raised from the production and sale of a loaf of bread, some other product or service will not be produced at all, and some other employment opportunity will not be viable. When taxation is removed a different kind of economy develops, and new economic opportunities arise. This development tends to reduce inequality.

Thirdly, when government is financed by taxation, there will be many situations in which public goods are received and not fully paid for, or are paid for, but not received. When a system of public revenue is in place, the full market price is paid in all cases, and no public goods or services are given away free of charge, or supplied to one group of citizens at the expense of another by majority vote.

High taxation also tends to produce an excessive concentration of economic activity in certain areas. It distorts the distribution of economic potential and makes possible a form of monopoly profit that would not otherwise occur, whilst in all other areas, the same amount of effort does not produce an economically viable result.

Taxation, as defined in this policy proposal, is not a necessary or desirable feature of the fully developed trading economy. It may be seen, in some cases, as the unearned income of government.

The reduction of taxation is a pre-cursor to consideration of the case for the re-distribution of income. The focus here is to improve the distribution of opportunity and income by the introduction of a system of public revenue, and not on the need for re-distribution.

Appendix 3: The effect on wages

Taxation affects wages in many different ways. Direct taxes create a differential between the monetary cost to the employer and the amount received by the employee. This is sometimes known as the 'pay bargain tax wedge'. Indirect taxation reduces the purchasing power of the wages received by increasing the final price of goods and services; and taxation is incorporated into every stage of the production process, even for cases where indirect tax is not levied.

When there is a high level of taxation, any further increases are likely to reduce the demand for employed labour, which is derived from the demand for the output of firms, whilst high inflation and unemployment resulting from a very high level of taxation tend to reduce the real purchasing power of net take-home pay.

The imputed money value of public goods and services received by an employee in return for the total amount of taxation paid is, by definition, an indeterminate and highly speculative estimate.

When taxation is removed, firms and households pay separately for the public goods and services which they each receive and the relationship between employer and employee is not distorted. The pay bargain tax wedge is eliminated, and indirect taxes no longer increase the market price of goods and services offered for sale.

Under these new conditions, firms will pay different amounts to the public authorities as public revenue, compared to the amounts which they previously paid out in the form of taxation.

After the transition from the use of taxation to public revenue, the fully developed trading economy takes on a different form. As economic output expands, the demand for labour, which is derived from the total demand for goods and services, is likely to increase, whilst the degree of risk faced by the self-employed and by smaller firms will be reduced. It is reasonable to assume that real wages as a share of Net National Income and the purchasing power of wages will both tend to increase under the new conditions.

Appendix 4: The effect on housing

One of the adverse effects of the present system of taxation is to concentrate activity in regions of high economic potential, such as London and the south-east, and certain other large urban centres.

As taxation is removed, there will be a tendency for a dispersal of economic activity, and regional disparities will be reduced. Over time, households tend to follow employment opportunities, and the demand for housing will also become more widely dispersed.

Specialisation and competition between public authorities will lead to improvements in the supply of public goods and services, such as new transport networks, and this will further encourage the dispersal of housing demand. The removal of all taxes on property transactions, such as stamp duty, will tend to increase mobility.

Given the transfer of health, education and housing from central to local government, there will be a greater opportunity for policy coordination and the development of new public infrastructure.

The full market price of public goods and services is payable in all cases without exemptions or discounts. The system described earlier for the treatment of externalities will create an incentive for construction and redevelopment on existing brownfield sites where infrastructure is available, and discourage the long-term holding of undeveloped sites by speculative developers.

When all taxes and tariffs are removed, the system of taxation will no longer affect the design or construction of new houses, and building costs are likely to be significantly reduced.

The overall effect of the removal of taxation is likely to be an increase in the quality and quantity of the available housing stock and a dispersal of demand, which may lead to a housing surplus.

The market price of housing is influenced by the expansion of the money supply by the banking system acting through the capital markets. Exclusion of the banking system from mortgage lending would tend to stabilise prices, and is a matter of monetary reform.

Appendix 5: Monetary reform

Since leaving the gold standard in 1931, Britain has used a system of *fiat* currency backed by holdings of long-term government debt.

The Bank of England buys and sells government debt in order to expand and contract commercial bank lending. UK government debt is also widely traded in financial markets as a relatively risk-free investment and is held by institutions, such as pension funds, as an important part of their long-term investment portfolio.

Government debt is, today, backed by the government's ability to use its powers of confiscatory taxation to meet both current and future interest charges, and to renew or increase its borrowing.

Taxation, however, is an indirect method of public finance and is ultimately backed only by production in the trading economy.

The use of taxation increases risk and restricts the output of the trading economy from which it is drawn, thus increasing demand for government debt as a lower risk investment. When taxation is removed, the level of risk within the trading economy is reduced, and a wider range of low risk investments may become available.

Furthermore, in the case of firms, public revenue is the cost of a necessary input to the process of production, reflected in the final price to the consumer; for households, it is part of consumption.

This approach offers a more direct and reliable basis for public finance and contributes to the longer-term support of the currency.

Proposals for monetary reform typically distinguish between the circulation of credit as a means of payment in the trading economy, and money created for speculation in existing financial assets. This distinction would help to avoid increases in taxation, and in central government borrowing and debt, in response to a financial crisis in the banking system as has been seen to happen in the recent past.

This type of monetary reform is primarily a legal and regulatory issue. It is, however, complementary to the replacement of taxation by a fully developed system of public revenue.

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