# PUBLIC FINANCE

Volume 4

The Economic Study Association

London

Public Finance - Volume 4

March 2020

ISBN: 978-1-9163716-4-4

# Public Finance

Studies in Economics by

Ronald Burgess

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Ronald Burgess practised as an economist for more than fifty years. His aim was to offer practical advice to government based upon study, research, instruction and public speaking.

The editors have drawn upon a collection of manuscripts and recordings to prepare four volumes of his work on public finance supplemented by notes, commentary and references:

**VOLUME 1**

**Economics Now** 1979-1980. Ten seminars setting out an approach to macroeconomics with particular reference to government policy.

**VOLUME 2**

**Ten Public Talks** 1980-1983. A series of public lectures on topical issues such as monetarism, inflation, unemployment and taxation.

**VOLUME 3**

**Spatial Economics** (ten lectures) and **Normative Economics** (six lectures) 1983-1984. Original work on the relationship between the spatial aspects of macroeconomics and the role of the polity.

**VOLUME 4**

**Further Work** 1971-1994. A collection of essays and public talks on such topics as privatisation, local government finance, and the economic position of Greece within the European Union.

In 1993, with the support of the Economic Study Association, Ronald Burgess completed and published his book *Public Revenue Without Taxation*. The editors hope that these four volumes will provide a fuller picture of his work and assist the general reader with an interest in public finance.

# Volume 4

## Contents

# Preface

This book contains selected further work by Ronald Burgess. It includes two essays first published in 1977, and the transcripts of six further public talks given between 1971 and 1994.

The first essay examines the relationship between employment and public spending in a period of rising inflation and recession. An important finding is the stability of real wages, as compared with the steady increase in taxation and public spending as a share of national output.

The second essay firmly rejects the 'wage/price spiral' theory of inflation and the government's proposals for statutory controls on prices and incomes which were then current.

The first of the six public talks included here, on the question of Britain's entry into the Common Market, draws upon Colin Clark's work on spatial economics and the early theory of gravity models.

The lecture on privatisation took place in 1984, and was given shortly after the ESA seminar series on normative economics.

The next three lectures were given to invited audiences at the request of the Liberal Party prior to the General Election of 1987.

In 1981 the Liberal Party had formed an alliance with the Social Democratic Party, and it was expected that the alliance might form a government after the next General Election; the Liberal Party at that time retained its connection with the work of Henry George.

The last lecture was given in 1994 when Burgess was invited to speak to the American–Hellenic Chamber of Commerce in Athens on the possibility of the economic recovery of Greece.

The original references are shown at the end of each essay and footnotes have been added throughout to assist the general reader.

The editors are grateful to many colleagues and associates for helpful suggestions and corrections, and for proof-reading the final draft. Any remaining errors or oversights remain the responsibility of the editors.

## Historical note

Over the last twenty-five years the conditions under which the UK economy operates have changed.

By 1990 the Soviet Union had ceased to be a world power, and in December 1991 it was formally dissolved. The re-unification of East and West Germany began in 1990, and the introduction of the Euro – a currency union – followed on 1st January 1999.

The World Trade Organisation (WTO) came into operation in January 1995 as the successor to the General Agreement on Tariffs and Trade. According to statistics issued by the WTO international trade as a share of world economic output has doubled since 1995. China formally became a member of the WTO in December 2001; the Russian Federation joined in August 2012.

The financial crisis of 2008 prompted central bank interventions on an unprecedented scale. In the UK government borrowing rose to more than 10% of GDP. Interest rates dropped almost to zero, and have not returned to previous levels after more than ten years.

Throughout the period since 1995 government expenditure has absorbed close to 40% of GDP. Government net debt has exceeded 80% of GDP for the last five years, and the overall rate of inflation of 93% from 1995 to 2020 has halved the value of the currency.

The population of the UK increased from 55.6 million in 1970 to 58.0 million in 1995. Over the next 25 years it rose by a further 10 million people, reaching 68.0 million at the end of 2019.

According to official figures, the number of people employed is now the highest ever recorded. Unemployment, however, stands at 1.3 million people (3.8%), as compared with 2.0 million in 1990.

On 31st January 2020 the United Kingdom withdrew from the European Union. The government has recently announced a policy of ‘levelling up’ the whole of the United Kingdom, to be achieved mainly by investment in new infrastructure outside London and the south-east.

# FURTHER WORK

# Full Employment and Public Spending

August 1977

## I FULL EMPLOYMENT

The end product of political economy is to put forward practical proposals which, when they are put into effect through economic policy, will attain an intended political objective.

Inevitably full employment will always be a most attractive political objective in any modern developed economy enjoying universal suffrage and some freedom of choice at elections. The overwhelming majority of electors will be employees and their families.

It falls to political economy to give economic meaning to this political objective of full employment so that it is both attainable and, in the long run, sustainable. The post-war full employment objective was never given an economic meaning. It was a political concept which rapidly deteriorated into an emotive slogan, used to justify profligate spending policies which were in themselves self-defeating.

The successive post-war governments have only succeeded in adding inflation to unemployment. Today the number registered as unemployed is about the same as in 1937, but remedial measures are constrained by a double-figure rate of inflation.

Some advance towards providing policymakers with a target level for employment is gradually emerging from the debate over monetary policy. The concept of full employment has now been abandoned, and replaced by the so-called ‘natural unemployment rate hypothesis’.

This hypothesis implies that, in any given conditions, there is a natural, or minimum sustainable, rate of unemployment. Attempts to raise the level of employment above this rate must fail in the long run.

The natural unemployment rate may be permanently reduced only by improvements in the labour market and the structure of the economy. It has been suggested that, for Britain, the natural rate may be a little less than 2% (1, p.45).

Politicians of monetarist persuasions are not, it would seem, inhibited from campaigning for a substantial reduction from the present high levels of unemployment.

The research approach used by the Economic Study Association differs from that of the monetarists, and leads to a clear distinction between full employment, and the minimum sustainable rate of unemployment.

Full employment may be defined as the consequent level of employment in conditions under which, at stable prices, maximum attainable output coincides with output potential (see Chart A).

That is to say, conditions under which the economy's potential output at the existing level of technology and knowledge is fully achieved.

## Output and unemployment

The minimum sustainable unemployment rate is related to the maximum attainable output which, in the prevailing conditions, is consistent with stable prices or a fully anticipated rate of inflation. The difference between output potential and maximum attainable output is largely determined by government monetary and fiscal policies.

Unemployment in the UK has been on a rising trend for the past 20 years, and statistical investigations show that to halt this trend the economy needs to sustain a steady growth rate of a little over 3% each year. In effect, this percentage rate is the growth rate of UK output potential on a full employment basis.

Taking the fourth quarter of the year 1955 as the base period (output potential and actual real output = 100) then real output, calculated at an annual rate, expressed as a percentage of output potential, provides an index of real output relative to potential.

This index is given in column (i) of each of the three tables. In column (ii) the index is expressed in terms of output deficiency.

Since output deficiency is derived from output potential on a full employment basis, a significant statistical relationship is to be expected between output deficiency and the rate of unemployment.

As shown on Chart B, there is a highly significant relationship between these two quantities and, given a time lag of two quarters, the coefficient of determination has a value of 0.91.

The fitting of a curve to the output deficiency data, as shown on Chart A, provides a measure of the maximum attainable output. The cyclical output deficiency is the difference between actual real output and maximum attainable output, and the figures are given in column (iii) of the tables.

It is to be expected that changes in the rate of inflation will be associated with cyclical output deficiency, with an accelerating inflation rate frustrating any attempt to expand real output beyond the maximum attainable – which is equivalent to a zero cyclical output deficiency. This expectation is confirmed by UK evidence as illustrated on Chart C.

Provided that cyclical output deficiency is not less than 2%, an increase in deficiency is followed in about two years by a fall in the rate of inflation, and conversely. However, attempts to sustain actual real output at a level above the equivalent of a 2% cyclical output deficiency have been associated with the rate of inflation accelerating out of all proportion. Thus, inflation increased at the end of 1963, and then rose rapidly from the beginning of 1974 as cyclical output deficiency fell below 2%. Inflation fell in 1962, and again in 1972 and 1976, as output deficiency rose above 2%.

On the basis of current policies, we can see that the minimum sustainable unemployment rate for the British economy in 1978 will be about one million wholly unemployed, and this figure must be expected to rise each year. Attempts to reduce unemployment below the minimum figure dictated by maximum attainable output will be frustrated, probably by accelerating inflation.

If a million and more unemployed are not to become endemic in the UK, then government policy must be directed towards creating the conditions in which the maximum attainable output converges with output potential, so providing the opportunity for a sustained expansion of output.

Given the right policies, unemployment could be cut gradually to around 1 to 1½%. This is to say that full employment for Britain is an average of some 300,000 wholly unemployed. In boom years the number would be less; in a recession the number would rise.

## II TAX INCIDENCE

A policy implication to be drawn from the work of Keynes is that in certain conditions it may be necessary to increase spending by the public authorities in order to expand economic output and reduce unemployment. To achieve the same objective in other conditions, the empirical law formulated by Colin Clark implies that it may be necessary to reduce public authorities' spending.

Clark's conclusions apply in a situation where spending by public authorities necessitates a total tax revenue plus borrowing requirement which, by reason of its size, restricts both output and employment as well as pushing up costs and prices (2, 3).

Again, Hayek has argued that both output and employment are restricted by persistent inflation (4). Taken together, the works of these economists suggest that there is a right amount for public authority spending – or tax revenue plus borrowing requirement – which sets the conditions for achieving an optimum level of output and employment without deleterious side effects.

### A Clark/Hayek effect

For British policymakers the works of Professor Hayek and Colin Clark are much more pertinent today. Indeed, the divergence between maximum attainable output and output potential (Chart A) may well be considered as illustrating a Clark/Hayek effect.

The prime cause of this effect is the burden of public authority spending. In this context, ‘burden’ must be distinguished from the level of tax rates, or the mere size of the total public authority revenue and spending.

A relative measure of tax burden can be obtained by expressing the total tax revenue as a percentage of taxable capacity; total tax revenue plus borrowing requirement similarly expressed provides a measure of the burden of public authority spending.

The effective incidence of taxation resulting from the system of public finance common to most western developed nations enables taxable capacity, for practicable purposes, to be calculated as total tax revenue plus post-tax net property incomes (5).

The majority of economists assume a tax is paid by those on whom it is levied, except where it is intended the tax should fall on the consumer by being passed on in prices.

For example, the incidence of employers’ contribution to social security tax is assumed to be on the employer; the incidence of employees’ contribution on the employee. The pennies on a pint of beer are levied with the intention that they should be passed on as price increases, so the assumption is that taxes of this kind are paid by the consumer.

These assumptions are highly misleading in the formulation of macro-economic policy, as they are not valid at the macro-level in respect of the effective incidence of taxation.

## Slicing the cake

The net ‘domestic cake’ of an economy may be divided into three slices, so that: $Y = W + T + P$. Here, $Y$ is the net ‘domestic cake’, $W$ is post-tax income from employment, $T$ total tax revenue, and $P$ post-tax net property incomes. Shares in the net ‘domestic cake’ of the UK for the past hundred years are shown on Chart D.

Empirical studies (5, 6, 7) have confirmed that in any particular economy $W/Y$ (i.e. the take-home pay slice) has a constant secular trend, although the actual ratio is not the same for all economies.

It follows from this that an increase, or decrease in *T/Y* (the tax revenue slice) must be matched by a decrease, or increase in *P/Y* (the rent and profit slice) since, when combined, they must equate to a constant also. This is to say, the effective incidence of taxation must be wholly upon net property incomes.

In a market economy enjoying any degree of freedom, total tax revenue plus post-tax net property incomes is in reality the taxable capacity, as total tax revenue cannot exceed this sum without the introduction of controls, directed towards the aim of depressing post-tax employment incomes below the level determined by open market forces.

The hypothesis that the effective incidence of taxation is wholly upon net property incomes (i.e. $dT/Y = -dP/Y$) implies a significant linear relationship between the two variables, and also a regression coefficient equal to unity.

This means that a percentage point increase in the share of the net 'domestic cake' to be appropriated by taxation is balanced by a one percentage point decrease in the share accruing as post-tax net property incomes, and conversely.

Calculations on the basis of annual first differences, drawn from the UK estimates shown on Chart D, yield a regression co-efficient of -0.999 and confirm a highly significant linear relationship.

Corroborating this result, other investigations show the share of the net 'domestic cake' enjoyed by post-tax employment incomes to be independent of the share appropriated by tax revenue.

Thus, an understanding of the effective incidence of taxation is essential if our macro-economic policy is to produce the intended result. A lack of this understanding contributed to the failure of so-called 'Keynesian economics'.

It is the effective incidence of taxation which produces the results observed by Colin Clark, and leads to the circumstances in which governments seek inflationary solutions; but it must also be remembered that an excessive level of tax revenue plus borrowing requirement is a result of profligate spending by public authorities.

Driven by the need to cover increased spending, governments turn to raising those taxes, such as income tax and social security contributions, having direct impact on incomes from employment.

Contrary to common belief, the imposition of these additional taxes raises employers' labour cost rather than depressing the take-home pay of employees (5, 6, 7). Faced with rising labour costs, firms reduce their demand for employees and attempt to raise the prices of their finished products. Those firms unable to cover their tax-inflated costs by higher prices eventually cease production.

**Taxation and jobs**

When governments attempt to cover excessive spending by additional indirect taxes, the immediate effect is to raise prices directly. Higher prices tend to reduce demand, which in turn leads to a restriction of output. Also, a rising general price level reduces the purchasing power of take-home pay, and generates insistent claims for more money wages and salaries. In the final analysis, as Adam Smith stated explicitly, there is little to choose between indirect taxes and direct taxes on employment. Both will result in higher costs, rising prices, restriction of output, and fewer jobs.

No matter how the additional tax revenue is raised, in the long run the effective incidence is upon net property incomes in general and net profits in particular. Directly, it is the squeezing of profits that forces firms to raise prices, restrict output, and cut jobs.

Price control merely intensifies the pressure on output and jobs. In 1960 the share of the UK net domestic product appropriated by taxation was around 30%, and the post-tax net profits of private sector companies represented a 10.6% share. Today, tax revenue appropriates around 40%, and the profit share has been all but squeezed out of existence.

During recent years any real post-tax profits which may have been earned by some companies have been cancelled out by the real post-tax losses incurred by other private sector companies.

## III TAX, PROFITS AND UNEMPLOYMENT

With the expansion of mixed economies in the Western world it has become fashionable to play down the vital role of profits. But it still remains, and as Sir Keith Joseph has forcibly argued: "A profitable, efficient and thriving industry should be regarded as the precondition of a human, compassionate and civilised society."[1]

Without profits firms cannot be efficient or thriving; they will be uncompetitive, lack the funds necessary for investment, and be unable to generate the jobs people need in order to earn a living.

The direct, but negative association existing between profits and unemployment during the past five years is shown by the scatter diagram on the left of Chart E. The coefficient of correlation for the two sets of variables, given a time lag of six quarters, is -0.95.

### Labour costs and the political factor

The private sector can generate more jobs only when employers can afford to do so given the current level of labour costs. But the level of labour costs today is determined not so much by what an employee receives, as by the taxes on employment imposed by Parliament. As is shown by Chart D the slice of the cake received by employees has remained fairly static for the past hundred years yet, during this century, the slice represented by labour costs has expanded by 60 per cent. It is the politician, not the trades union negotiator, who effectively determines an employer's labour costs.

As may be seen from the scatter diagram on the right of Chart E there is a direct, and positive association between labour costs and unemployment. Given a time lag of two quarters the coefficient of correlation for these two variables over the past five years is +0.91.

Direct taxes on employment inflate labour costs and tax-inflated labour costs create unemployment. Further, tax-inflated labour costs combine with other forms of taxation to depress profits, and tax-depressed profits lead to the destruction of jobs.

1 In the paper *Why Britain needs a social market economy*, published in 1975.

"Absurd and destructive" was Adam Smith's description of the taxes on employment then levied by some foreign governments.[2] Now, two hundred years later, such taxes provide a major source of public revenue in the UK.

Even more "absurd and destructive" is a policy of subsidising employment in an attempt to minimise the destruction of jobs by taxation. More subsidies mean more public authority spending. This leads in turn to higher taxes and an intensification of job destruction. The founder of modern political economy could not even envisage such a spiral to disaster by deliberate acts of policy.

With the tax burden reducing profits to near non-existence, the massive public authority borrowing requirement of recent years provided a final straw for the British economy. First, government appropriated by all forms of taxation (not merely corporation tax) the income that firms needed for essential investment to continue in competitive production. Then, through its extensive borrowing operations, government proceeded to appropriate such funds as became available on the open market.

Ministers persistently upbraid British industry for its low level of investment; what is to be wondered at is the high level of new investment which the private sector maintains under the adverse conditions created by bad government. Public authority spending appropriates the resources needed for new productive investment, whilst taxation plus the public authority borrowing requirement appropriates the funds needed to finance the investment.

Fortunately for the people of this country, many British private sector companies regularly earn a substantial income overseas.

## Government-created inflation

Some argue that when and where the private sector is unable to operate profitably and provide an acceptable level of employment, the public sector should expand to make up for any deficiency.

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2 In *The Wealth of Nations*, Book V, Chapter II, Part II, Article III: Taxes upon the Wages of Labour.

This proposal would gain credence if it could be shown that public corporations have, without any recourse to their monopoly powers, always a natural advantage over private sector companies in efficient and profitable production.

Admittedly, it is possible for the public sector – unlike the private sector – to incur persistent losses and still maintain, or even expand, both output and employment, but this possibility depends upon the continuing ability of the private sector within a mixed economy to generate sufficient taxable capacity as a source of finance for public sector losses.

Unemployment is directly increased by excessive taxation. It is indirectly increased by a massive borrowing requirement which restricts necessary investment. It follows, looked at from the other side, that beyond a certain limit increases in spending by public authorities will tend also to increase unemployment.

The economic upper limit to taxation, as defined by Colin Clark (3), marks the point at which the effective incidence of taxation causes the results of excessive tax and public authority borrowing to be statistically measurable.

It is the point at which additional public authority spending may be seen to raise prices, restrict output, and increase unemployment.

This is the point at which governments may find inflationary monetary policies irresistible. In the UK, successive governments have created inflation in an attempt to mitigate the effects of their disastrous fiscal policies.

## IV IMPLICATIONS FOR POLICY

In the economic sphere the political objective of the majority of the British electorate is the same as it was thirty years ago – full employment in a free and prosperous society.

If you ask a misleading question you will get a misleading answer. Public opinion polls conclude that halting inflation is now the political objective of the vast majority in the country.

A double figure inflation rate, 16% output deficiency, and over one million unemployed was not, and is not, an intended objective of the British people.

Fundamental to Britain's recurring economic difficulties is the persistent attempt to maintain personal liberties and at the same time approach socialism through the creation of an all-embracing welfare state. As the great visions of those who formed the Attlee administration crumble,[3] the impossibility of the task is now a matter of harsh experience.

In the absence of state controls effectively limiting personal and corporate freedom the economy cannot carry the public authority spending burden which socialistic policies impose. If economic chaos is to be avoided then, beyond a certain limit, any increase in revenue plus public authority borrowing requirement necessarily entails the government taking powers to depress take-home pay.

This is what income policies and the so-called social contract are about. The development of socialistic policies in a welfare state is incompatible with free wage bargaining, collective or otherwise.

To sustain full employment without inflation in a free and prosperous society the present system of public finance must be radically reformed so that cyclical fluctuations may be minimised by methods which do not restrict maximum attainable output to a level less than output potential. The research approach of the Economic Study Association enables the implications of this requirement to be considered in two parts, one concerned with eliminating output deficiency induced by past errors of policy, and the other concerned with minimising cyclical output deficiency.

Today, past and present policy errors have relegated the many problems associated with cyclical fluctuations to a position of minor immediate importance. Although now, a severe economic recession does exist, compensatory financial policies cannot be put into effect at the current levels of public authority spending when they are coupled with a double figure inflation rate.

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3 The Attlee administration was in power from July 1945 until October 1951.

The precondition for eliminating output deficiency induced by past errors of policy is to stop repeating the errors. If the statutory enforcement of reductions in take-home pay is unacceptable, then public authority spending must be geared to the available taxable capacity. The existence of mass unemployment does not justify excessive public spending. Persistent public prodigality is a cause of the rising unemployment.

The immediate priority is for a policy directed towards reducing significantly the slice of the net ‘domestic cake’ appropriated by tax revenue plus the public authority borrowing requirement. This does not require a government to act perversely, but it does require the prompt implementation of an integrated economic policy and the acceptance of both monetary and fiscal disciplines.

## Reverse the trend

An effective and sustainable counter-inflation policy is wholly compatible with progress towards full employment. A reduction in the burden of public authority spending – by combining tax cuts with spending cuts in a way that will then allow for a sustained expansion of output – is basic to both policies.

The essential point is the right combination of cuts. It does not necessarily follow that spending cuts will reduce the burden of public authority spending. Indeed, in isolation spending cuts could precipitate an economic depression which would so restrict taxable capacity as to result in an increase in the burden of public authority spending. Men and resources made idle by public economies will remain idle unless positive action is taken to ensure their speedy reallocation into productive employment. Spending cuts can never be more than half a policy; for a complete policy they must be combined with selective tax cuts.

As has been argued in this paper, the worst of all forms of taxation are direct taxes on employment. By inflating labour costs they cause firms to be inefficient and uncompetitive. They raise prices, restrict output and destroy jobs.

A great deal of present spending by government appears to be necessary only because successive governments have pursued tax policies which have inflated labour costs. In 1955 the share of the product represented by labour costs was 66.6%. In 1975 this share reached an all-time high of nearly 74%; yet, during the same 20 years, the share of the product accruing as take-home pay declined.

Since 1975 there has been a slight, but relieving, fall in the product share of labour costs, largely as a result of voluntary pay restraint and reductions in income tax, but this year all of this relief will be absorbed by higher tax revenue, as a result of the surcharge on employers' social security contributions.

Progress towards full employment is dependent upon reversing the rising trend of direct taxes on employment and adjusting public spending accordingly. A start must be made now - by abolishing the damaging National Insurance Surcharge.

Editors' note:

The National Insurance Surcharge was introduced by legislation in 1976, and was removed by further legislation in 1983. Between April 1977 and the end of September 1984 it was applied as an addition to the employers' contributions, with the rate changing at different times of the year. During this same period, however, the standard rates of both the employees' and employers' contributions rose steadily, with changes being introduced generally in April of each year. The following table gives an indication of the overall effect:

| Year | Employee | Employer | Surcharge | Total rate |
|---|---|---|---|---|
| 1976 | 5.75% | 8.75% | - | 14.50% |
| 1977 | 5.75% | 8.75% | 2.00% | 16.50% |
| 1978 | 6.50% | 10.00% | 3.50% | 20.00% |
| 1979 | 6.50% | 10.00% | 3.50% | 20.00% |
| 1980 | 6.75% | 10.20% | 3.50% | 20.45% |
| 1981 | 7.75% | 10.20% | 3.50% | 21.45% |
| 1982 | 8.75% | 10.20% | 2.00% | 20.95% |
| 1983 | 9.00% | 10.45% | 1.50% | 20.95% |
| 1984 | 9.00% | 10.45% | 1.00% | 20.45% |
| 1985 | 9.00% | 10.45% | - | 19.45% |

Table 1

Output deficiency

First cycle (1955 - 1964)

1955 = 100

| Year | Qtr | (i) Output index | (ii) Total output deficiency % | (iii) Cyclical output deficiency % |
|---|---|---|---|---|
| 1955 | 4 | 100.0 | 0.0 | 0.0 |
| 1956 | 1 | 99.4 | 0.6 | 0.6 |
| | 2 | 99.9 | 0.1 | 0.0 |
| | 3 | 99.0 | 1.0 | 0.9 |
| | 4 | 98.7 | 1.3 | 1.2 |
| 1957 | 1 | 98.7 | 1.3 | 1.1 |
| | 2 | 98.5 | 1.5 | 1.2 |
| | 3 | 98.2 | 1.8 | 1.5 |
| | 4 | 97.4 | 2.6 | 2.2 |
| 1958 | 1 | 96.6 | 3.4 | 3.0 |
| | 2 | 95.1 | 4.9 | 4.4 |
| | 3 | 94.6 | 5.4 | 4.8 |
| | 4 | 94.1 | 5.9 | 5.3 |
| 1959 | 1 | 93.3 | 6.7 | 6.0 |
| | 2 | 93.5 | 6.5 | 5.7 |
| | 3 | 93.5 | 6.5 | 5.6 |
| | 4 | 94.3 | 5.7 | 4.8 |

Table 1 continued

First cycle (1955 - 1964)

| Year | Qtr | (i)<br>Output index | (ii)<br>Total output deficiency % | (iii)<br>Cyclical output deficiency % |
|---|---|---|---|---|
| 1960 | 1 | 94.9 | 5.1 | 4.0 |
| | 2 | 95.3 | 4.7 | 3.5 |
| | 3 | 95.4 | 4.6 | 3.3 |
| | 4 | 95.5 | 4.5 | 3.2 |
| 1961 | 1 | 95.6 | 4.4 | 2.9 |
| | 2 | 96.0 | 4.0 | 2.4 |
| | 3 | 96.3 | 3.7 | 2.1 |
| | 4 | 95.8 | 4.2 | 2.5 |
| 1962 | 1 | 94.9 | 5.1 | 3.3 |
| | 2 | 94.5 | 5.5 | 3.5 |
| | 3 | 94.0 | 6.0 | 4.0 |
| | 4 | 93.6 | 6.4 | 4.2 |
| 1963 | 1 | 93.4 | 6.6 | 4.4 |
| | 2 | 93.4 | 6.6 | 4.2 |
| | 3 | 93.6 | 6.4 | 4.0 |
| | 4 | 94.3 | 5.7 | 3.1 |
| 1964 | 1 | 95.4 | 4.6 | 1.8 |
| | 2 | 95.9 | 4.1 | 1.2 |
| | 3 | 96.4 | 3.6 | 0.5 |
| | 4 | 96.8 | 3.2 | 0.0 |

Table 2

Output deficiency

Second cycle (1965 - 1973)

1955 = 100

| Year | Qtr | (i) Output index | (ii) Total output deficiency % | (iii) Cyclical output deficiency % |
|---|---|---|---|---|
| 1964 | 4 | 96.8 | 3.2 | 0.0 |
| 1965 | 1 | 96.7 | 3.3 | 0.0 |
| | 2 | 96.4 | 3.6 | 0.2 |
| | 3 | 96.4 | 3.6 | 0.1 |
| | 4 | 96.1 | 3.9 | 0.3 |
| 1966 | 1 | 95.9 | 4.1 | 0.4 |
| | 2 | 95.5 | 4.5 | 0.7 |
| | 3 | 95.1 | 4.9 | 0.9 |
| | 4 | 94.8 | 5.2 | 1.1 |
| 1967 | 1 | 94.8 | 5.2 | 1.0 |
| | 2 | 94.8 | 5.2 | 0.8 |
| | 3 | 94.7 | 5.3 | 0.8 |
| | 4 | 94.2 | 5.8 | 1.2 |
| 1968 | 1 | 94.2 | 5.8 | 1.1 |
| | 2 | 94.0 | 6.0 | 1.2 |
| | 3 | 94.1 | 5.9 | 0.9 |
| | 4 | 94.6 | 5.4 | 0.2 |

Table 2 continued

Second cycle (1965 - 1973)

| Year | Qtr | (i)<br>Output index | (ii)<br>Total output deficiency % | (iii)<br>Cyclical output deficiency % |
|---|---|---|---|---|
| 1969 | 1 | 94.0 | 6.0 | 0.7 |
| | 2 | 93.6 | 6.4 | 1.0 |
| | 3 | 93.1 | 6.9 | 1.3 |
| | 4 | 93.1 | 6.9 | 1.2 |
| 1970 | 1 | 92.7 | 7.3 | 1.5 |
| | 2 | 92.5 | 7.5 | 1.5 |
| | 3 | 92.2 | 7.8 | 1.8 |
| | 4 | 92.0 | 8.0 | 1.8 |
| 1971 | 1 | 91.5 | 8.5 | 2.2 |
| | 2 | 91.1 | 8.9 | 2.4 |
| | 3 | 91.2 | 8.8 | 2.2 |
| | 4 | 91.1 | 8.9 | 2.1 |
| 1972 | 1 | 90.8 | 9.2 | 2.3 |
| | 2 | 90.7 | 9.3 | 2.3 |
| | 3 | 89.9 | 10.1 | 3.0 |
| | 4 | 89.7 | 10.3 | 3.0 |
| 1973 | 1 | 90.9 | 9.1 | 1.6 |
| | 2 | 91.2 | 8.8 | 1.1 |
| | 3 | 91.9 | 8.1 | 0.2 |
| | 4 | 91.9 | 8.1 | 0.0 |

Table 3

<u>Output deficiency</u>

Third cycle (1974 - 1976)

1955 = 100

| Year | Qtr | (i) Output index | (ii) Total output deficiency % | (iii) Cyclical output deficiency % |
|---|---|---|---|---|
| 1973 | 4 | 91.9 | 8.1 | 0.0 |
| 1974 | 1 | 90.4 | 9.6 | 1.5 |
| | 2 | 89.9 | 10.1 | 1.9 |
| | 3 | 89.7 | 10.3 | 2.0 |
| | 4 | 89.3 | 10.7 | 2.2 |
| 1975 | 1 | 89.3 | 10.7 | 2.1 |
| | 2 | 87.9 | 12.1 | 3.4 |
| | 3 | 86.1 | 13.9 | 5.2 |
| | 4 | 84.9 | 15.1 | 6.4 |
| 1976 | 1 | 84.3 | 15.7 | 6.9 |
| | 2 | 83.6 | 16.4 | 7.4 |
| | 3 | 83.5 | 16.5 | 7.5 |
| | 4 | 83.4 | 16.6 | 7.5 |

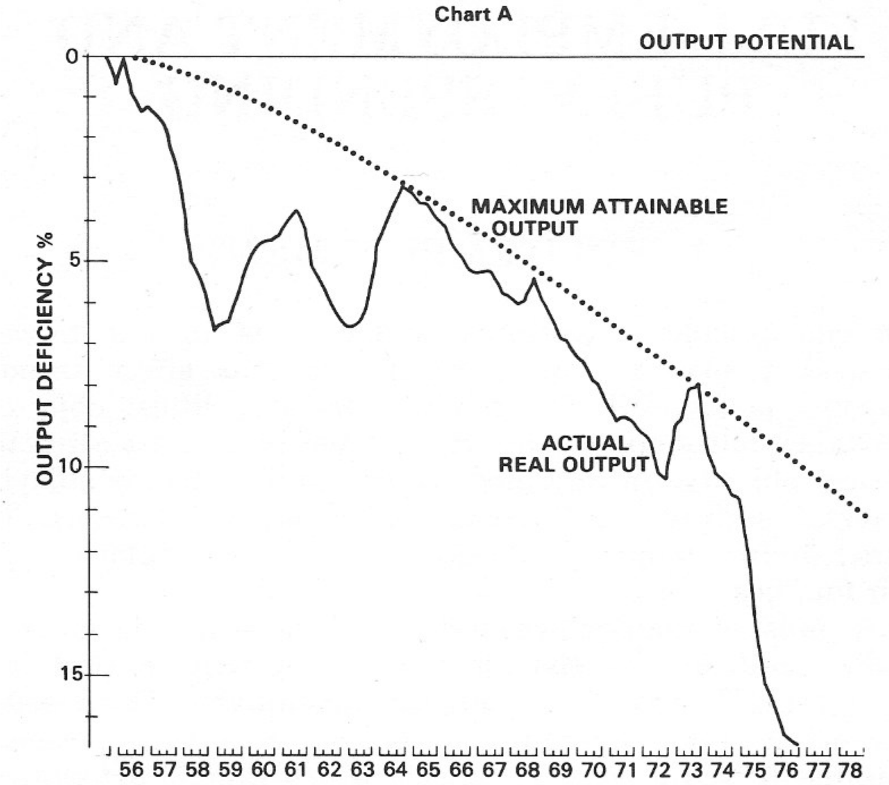


Chart A
Output deficiency 1955 – 1976

*Source:* Economic Trends, HMSO.

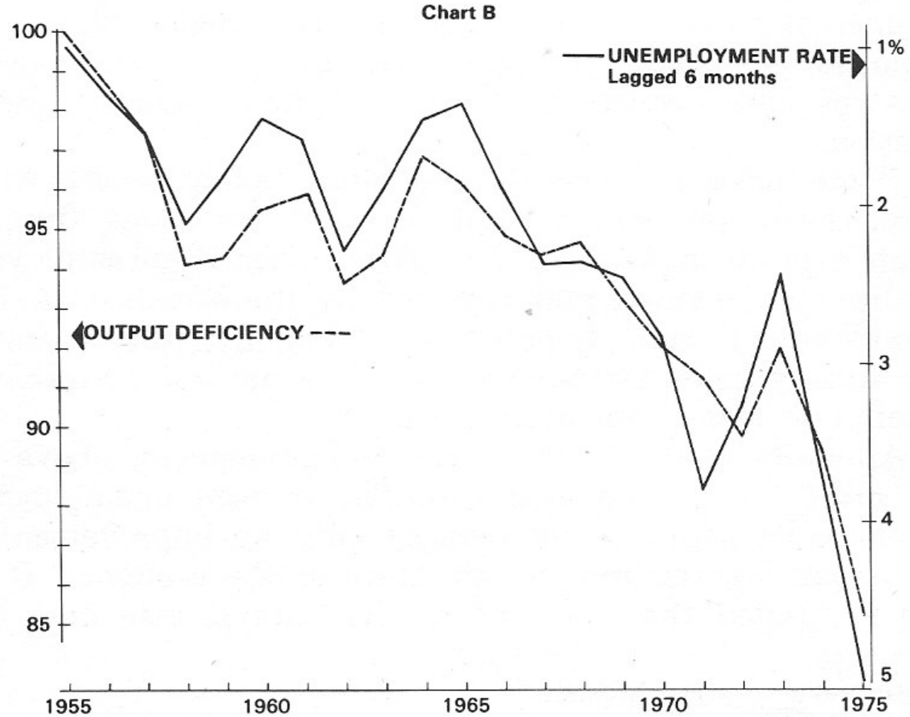


Chart B
Unemployment 1955 – 1976

*Source:* Economic Trends, HMSO; and Department of Employment.

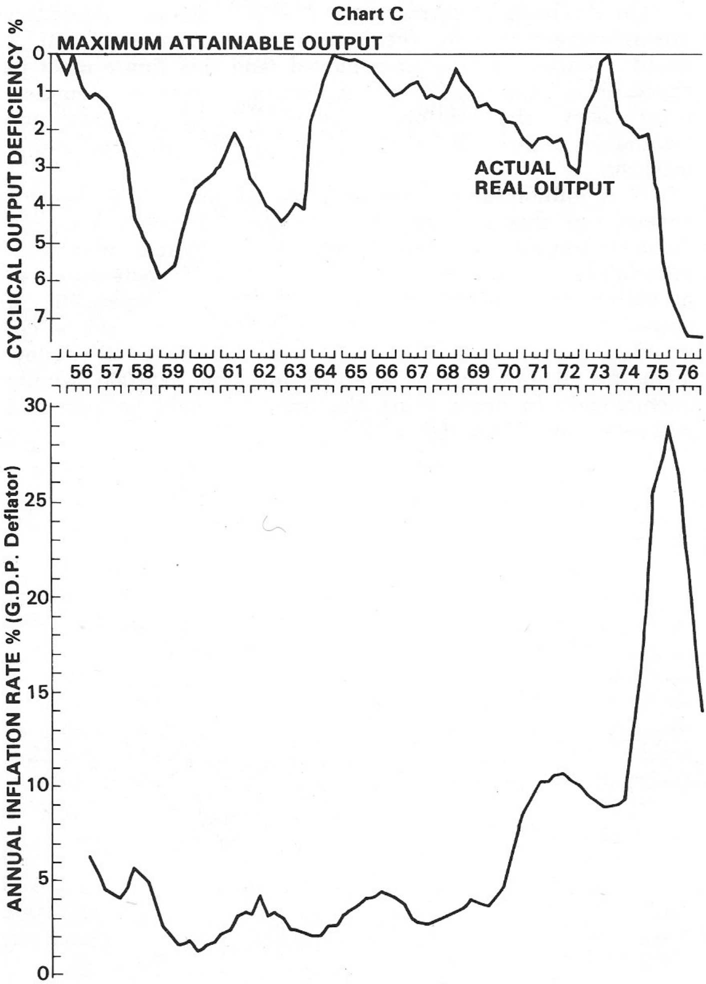


Chart C
Annual inflation rate 1955 – 1976

*Source:* Economic Trends, HMSO.

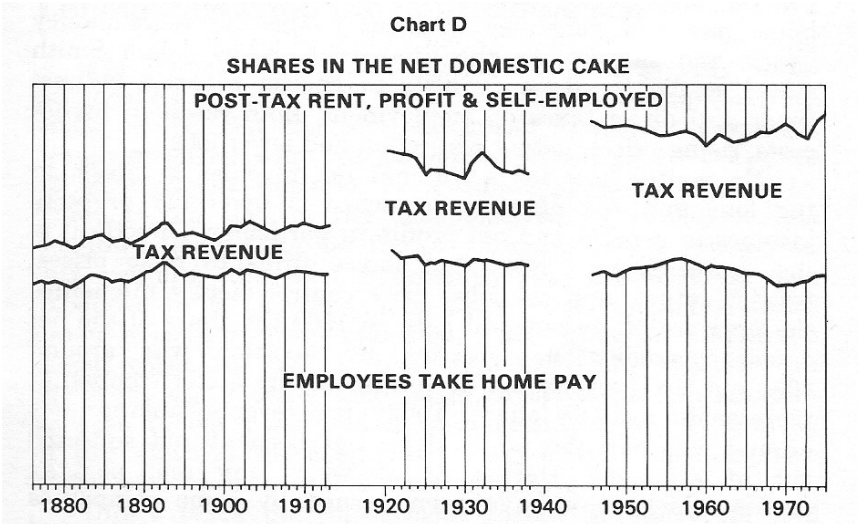


Chart D
Changes in share of UK Net Domestic Product

*Sources:* For the years prior to 1946, from (i) C. H. Feinstein, National Income, Expenditure and Output; (ii) Mitchell and Deane, Abstract of British Historical Statistics, HMSO; (iii) Annual Abstract of Statistics, HMSO. For the years after 1946 and through to 1975, from the National Income "Blue Books", HMSO.

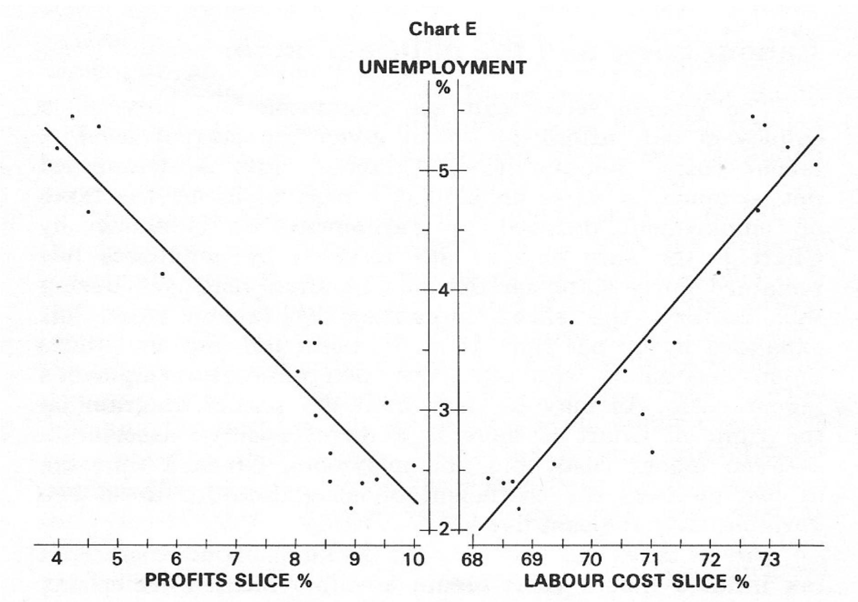


Chart E
Profits, labour costs and unemployment 1971 – 1976

*Source:* Economic Trends, HMSO; and Department of Employment.

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# The Chance to Change

September 1977

## I THE CHANCE TO CHANGE

There now exists a time of great opportunity for the British people – the opportunity to make a lasting break from an economic disaster spiral, and to lead the world out of economic depression.

To achieve these objectives public economic policy must now be directed towards creating conditions in which earned incomes may rise without an acceleration in the rate of price increases or an erosion of our competitiveness in international markets. As a pre-condition, the constant repetition of past mistakes must cease.

Oppressive measures as used by the 19th-century industrial masters are no basis for 20th-century economic policy. Prices and incomes policies cannot for long be imposed on a free people with a sense of justice. The efficacy of these policies depends upon restricting freedom and depressing both prices and incomes, and this inevitably leads to more injustice.

As Adam Smith pointed out, men will not work for less than they are prepared to accept – a fundamental observation applying to the whole community.

When the purchasing power of take-home pay falls below what is considered to be a reasonable minimum then employees will strike; and when profits fall below the necessary minimum then employers cannot provide employment, and firms will simply stop producing.

The British people have suffered more than most from excessive public expense, incurred with the best of intentions but without due regard to the inevitable consequences.

At first, moderate inflation seemed an acceptable price for the prevention of mass unemployment and the mitigation of the worst effects of poverty.

In 1958 the newly-formed Council on Prices, Productivity and Incomes[4] expressed its concern about the rate of inflation. At that time prices were increasing at about 3 per cent a year, yet it could report: “The post-War years have been good years for the United Kingdom” (1).

However, it is now apparent that unemployment has been on a rising trend since 1955, and this year the numbers registering as wholly unemployed will approximate to the 1937 totals. Our social services have begun to fail; the standard of living is falling, whilst for the past three years output has stagnated; and persistently rising prices have become a major cause of our economic tribulations, including unemployment and relative poverty.

As the present economic depression steadily deepened the fear of accelerating the rate of price increases has rendered government incapable of effective remedial action, and so the British economy has slid into a condition described by Professor Milton Friedman as ‘slumpflation’ (2, p31).

The depression of the thirties was intensified by 19th-century conventions, which for decades had restricted public finance and justified restrictive policies. The Keynesian revolution swept away these old conventions, but since then the subsequent decades of public prodigality have imposed new constrictions which are even more limiting than the old.

Now we have the opportunity to effect a second revolution in which the art of government is employed to ensure that ‘self-interest prompts what justice demands’.[5]

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4 The Council on Prices, Productivity and Incomes was set up in August 1957. Its official terms of reference were: “Having regard to the desirability of full employment and increasing standards of life based on expanding production and reasonable stability of prices, to keep under review changes in prices, productivity and the level of incomes (including wages, salaries and profits) and to report thereon from time to time”. It published its reports in February 1958, August 1958, July 1959, and July 1961, and was formally wound up in January 1962.

5 Quoted from *Christianity and Social Order*, W. Temple, published in 1942.

## II THE PRICE OF STERLING

The world economic depression of the 1970s was precipitated by the oil-producing and exporting countries combining to enforce a sharp increase in the price of oil. Their declared intention was to provide oil exporters with some measure of protection against the then rapidly accelerating depreciation in the purchasing power of the national currencies of oil-importing countries, but it resulted in wrecking the balance of world trade.

Although the impact of OPEC's action on the British economy was severe, it is now, paradoxically, instrumental in providing an opportunity to escape from the full consequences of past mistakes.

High oil prices stimulated exploration, and the new North Sea discoveries have added a much needed 20th-century dimension to our previously known generous endowment of national energy resources. Already, more than half of the United Kingdom's oil requirements are being supplied from newly discovered national oil reserves.

Next year the supplies from these reserves will be sufficient to ensure a substantial surplus on our current balance of payments.

Continued profitable production will make significant additions to the annual revenues of government.

### Oil – boon or bane?

However, all extractive resources are finite and North Sea oil is more limited than most. Whether a period of self-sufficiency in energy supplies is to be the boon or the bane of lasting economic prosperity depends on action taken now. The new discoveries offer the time and opportunity for effecting lasting solutions to our troubles. They do not, of themselves, provide the lasting solution.

Throughout the next few years oil-generated surpluses will transform the United Kingdom's balance of payments, and this could be crucial both for industrial harmony and the attainment of a relatively stable general price level.

An important factor contributing to the breakdown of the social contract was the failure of government policy to reduce the rate of retail price increases to single figures within the agreed time. To a large extent the government were prevented from honouring their promises in respect of prices by the persistent weakness of sterling on the foreign exchange markets, and in turn this weakness was near inevitable given the continuing massive deficits on current balance of payments.

The last year in which our international transactions showed a current surplus was 1972, and since then sterling has depreciated by an average of some 40 per cent against other major currencies.

This means that even if the price of our imports had not risen in terms of foreign currencies, which it has, the average increase in their sterling price would still have exceeded 60 per cent, and each 4 per cent rise in the sterling price of our imports is estimated to produce about a 1 per cent rise in the level of domestic prices.

**Let the market decide**

In 1978 oil-generated surpluses will be causing a measurable upward pressure on the sterling exchange rate both by directly increasing the demand for sterling, and through the associated confidence effects. This pressure is being anticipated already by the market. Provided the government does not intervene sterling will appreciate, thus tending to stabilise the level of prices on the home market by lowering the sterling price of imports.

In the case of imported consumer products the effect on prices will be direct; in other cases it will be indirect and take time before being reflected in retail prices.

An initial deceleration in the rate of price increases would be magnified if it were met with moderation in money wage claims leading to a slower rise in all domestic costs, and consequently to smaller price increases for home-produced goods and services.

To take full advantage of the opportunity presented by North Sea oil in the struggle against ever rising prices market forces must be allowed to operate freely, for, in the medium term at least, they will be tending to reduce prices.

The government needs to concentrate instead on policies which complement market forces, and in particular, those policies which will regain and enjoy the full co-operation of both employees and employers.

## Intervention unnecessary

However, when formulating policy, oil-generated balance of payment surpluses must not be confused with an export-led boom. Oil surpluses are not job-creative, and do not result from increased activity throughout the economy.

Further, an appreciation of the exchange rate which lowers the sterling price of imports automatically erodes the price advantage of British labour costs relative to those of foreign producers. Such a reduction in relative labour costs, argue those who favour more government intervention, can be achieved by a further extension of statutory controls.

Thus the interventionist argument concludes that to safeguard, let alone expand, home production and employment, there must be continued intervention by government to hold down the exchange rate, or even induce a mild depreciation, together with protection against imported manufactures and effective controls over prices and incomes.

On the other hand, the supposed danger of lasting damage being inflicted on UK industry and employment prospects by allowing market forces to determine the exchange rate exists only on the basis of unchanging government fiscal policies.

## Tax effects unobserved

At root the argument for and against government intervention is an argument about the effective incidence and burden of taxation. Admittedly, if sterling does appreciate then, other things being equal, labour costs of employers in Britain will tend to rise relative to those in other countries, and the competitiveness of British products will be eroded in both home and overseas markets.

Note, however, that the condition of other things being equal is of vital importance, for it includes tax effects, and taxation is not only significant in determining the level of labour costs, it is also wholly determined by government policy.

What may be described as the interventionist argument cannot take the effects of government tax policy fully into account since its advocates do not distinguish clearly between employers' labour cost, wages and salaries, take-home pay, and the purchasing power of take-home pay. This simple confusion is one of the reasons for the persistent failure, in practice, of economic policies based on interventionist and similar arguments.

There was a time when the basic concepts of economic theory reflected practice, as for all intents and purposes labour costs, wages and salaries, and take-home pay, were so indistinguishable that they could be safely lumped together under the term money wages, in contrast to real wages or the purchasing power of the money sum actually received by employees. Such a time has long since passed, and today the old concepts of economic theory no longer reflect current practice – indeed, they have become thoroughly misleading when directly applied to the formulation of economic policy. The level and methods of taxation have created a new situation where British labour costs can be cut immediately by right fiscal policy, whilst at the same time take-home pay may rise both in money terms and in terms of purchasing power.

## III THE FOUR PRICES OF LABOUR

In accordance with its 18th century origins, current economic theory considers real wages to be *the* price of labour (3, p15). This one and the same price, or real wage, is a factor income from the standpoint of an employee and a factor cost from the standpoint of an employer. But conditions have changed – even forty years ago Keynes's statement that "factor cost is, of course, the same thing, looked at from the point of view of the entrepreneur, as what the factors of production regard as their income" (4, p23) was no more than an approximation of the truth and today it is wholly invalid.

Factor cost and factor income have ceased to be the same thing from a different view of point. The cost of labour to an employer is not the same sum of money as that which represents real wages to an employee. The tax system now operating in the UK and in most western nations has created more than one price of labour.

**The employees' view**

The price of labour that matters to employees is the purchasing power of take-home pay over the assortment of goods and services they wish to buy – that is, over the assortment which both Pigou and Keynes described as wage goods. This price is an indicator of the standard of living represented by take-home pay.

An approximation of this price may be obtained by inflating aggregate money take-home pay with a suitable consumer price index to show a standard of living index. An index calculated in this way for the UK is given in column (i) of Table 1.

To provide the equivalent to real wages as used in economic theory, or factor income, the standard of living index must be further adjusted for economic growth, as has been done in column (ii) of Table 1. Thus, in a modern mixed economy the index may be considered as relating to the average real supply price of labour.

**The employers' view**

To an employer, take-home pay is no more than one of the components of labour cost.

Other components include income tax on wages and salaries, the social security contributions of both employees and employers, and any other taxes which, from time to time, may be directly assessed on employment, as well as contributions to employees' pension funds and the like.

The money sum paid out as labour cost in relation to the total money sum received as a result of incurring that labour cost determines the price of labour that matters to an employer. The total money sum received includes, not only the proceeds from the sale of value-added produced, but also items such as subsidies and indirect taxes collected on behalf of the tax authorities.

This ratio of labour cost to the total money sum received may accurately be described as the effective demand price of labour, as it is a significant factor in determining an employer's demand for labour (see Section V) and directly affects unit selling prices of the goods and services produced.

An average effective demand price of labour can be calculated by expressing aggregate employers' labour cost as a percentage of the net domestic product at market prices plus subsidies, and an index for the United Kingdom based on such a calculation is given in column (iii) of Table 1.

Finally, in column (iv) of Table 1 is given an index of the average effective supply price of labour corresponding to the demand price that is shown in column (iii). The average effective supply price is calculated by expressing aggregate take-home pay as a percentage of the net domestic product at market prices plus subsidies.

It is apparent from Table 1 that in a modern developed economy at least four prices of labour can be isolated, and each of them has some validity for limited purposes. The column (i) index shows the purchasing power of aggregate take-home pay more than doubling during the post-war years, and yet, during the same period, the average real supply price, column (ii), exhibits no definite trend.

These two indices are calculated from the employees' viewpoint and suggest a rising standard of living is closely associated with increased production, but the so-called inflationary wage claims have done no more, after allowing for economic growth, than keep money take-home pay in step with rising prices. In respect of pay, it seems that the trade unions are defensive, rather than offensive.

**Funnelling taxes**

Of the two indices calculated from the viewpoint of employers, the average effective supply price of labour, column (iv), is similar in trend to the real supply price index. Both appear to have a long-run stability, and the differences which do arise between these two supply price indices may be explained in terms of shifts in the price level of wage goods relative to non-wage goods.

However, the index of average effective demand price shows a persistent rising trend, and the divergence between the effective demand and the effective supply price indices implies that the factors making for higher labour costs must be other than pressure from employees seeking a larger slice of the cake.

The evidence is consistent with the hypothesis that employees offset, but no more than offset, the effects of increased direct and indirect taxes by demanding and getting more money wages which in turn tends to raise the average effective demand price of labour.

This is to say that employees act as a kind of tax conduit pipe, funnelling the taxes levied upon them through to their employers.

Adam Smith fully appreciated that taxes levied upon employees are shifted on to their immediate employers, and he argued that a direct tax on wages, or an indirect tax on goods purchased out of wages, would raise gross wages by a greater proportion than the tax applied. A twenty per cent additional tax on wages would, he maintained, lead to a 25 per cent increase in gross money wages.

It was left to the post-war Keynesians to fondly imagine that by the use of the regulator, or by changes in income tax, they could directly affect real take-home pay.

Statistical investigations using the ample evidence published by the Central Statistical Office over the past thirty years now fully confirm the conclusions reached by Adam Smith, writing some two hundred years before the practice of demand management.

**The effect on labour**

Table 2 gives figures for each year from 1946 for the average effective demand price of labour and for its component parts, expressed as a percentage share of the product and as a percentage of the demand price. In the last thirty years the share of the product represented by direct taxes on employment has multiplied nearly three times, and these taxes are now about equivalent to a 50 per cent rate of VAT on aggregate take-home pay.

On the basis of annual first differences, the changes in the tax component in column (iii) of Table 2 are not significantly related to changes in the take-home pay component in column (ii) but they are significantly and positively related to changes in the average effective demand price of labour in column (i).

These results imply that an increase in direct taxes levied on employment will increase the employers' labour cost rather than depress take-home pay, and that conversely, a reduction in direct taxes on employment will reduce employers' labour cost rather than increase take-home pay.

Again, on the same basis, changes in the tax component and in the take-home pay component are each significantly and positively related to changes in the average effective demand price of labour. This result suggests that to the extent that an incomes policy is successful in depressing take-home pay it will tend also to reduce employers labour cost, but whether this tendency is actualised will depend on tax policy.

The indices given in Table 1 are consistent with the hypothesis that changes in indirect taxation, such as VAT, assessed on goods and services purchased out of take-home pay, are fully reflected by changes in money take-home pay.

The percentages given in Table 2 are also consistent with the hypothesis that any changes in direct taxes on employment, and changes in take-home pay, are fully reflected by changes in the average effective demand price of labour.

Both these hypotheses accord with Adam Smith's observations as to tax effects made some two hundred years ago, and lead to the conclusion that government tax policy is the important factor in determining changes in employers' labour cost.

## IV THE BURDEN OF TAXATION

Taxes which inflate labour costs are only part of the total tax burden, although in the United Kingdom they are a significant and rapidly expanding part.

In 1938 direct taxes on employment accounted for 13 per cent of total tax revenue. By 1950 this had risen to 20 per cent; by 1960 to 28 per cent; by 1970 to 38 per cent; and it is now near the 50 per cent mark.

A multiplication of four times in the proportion of this one part of total tax revenue must be seen in the context of a persistently expanding whole.

The share of the product appropriated by total tax revenue has doubled in comparison with the inter-war years.

### Are we over-taxed?

Some of our politicians today, supported by a few economists of interventionist convictions, argue that Britain is not over-taxed in relation to our main trading competitors, and quote approvingly the tax league tables published annually in Economic Trends.

The latest published figures prepared by the Central Statistical Office relate to the year 1974. They show that UK tax revenue as a percentage of GNP (Gross National Product at factor cost) is, by international standards, relatively low. In 1970 we were the fifth highest out of thirteen countries, but by 1974 we had dropped to tenth place amongst the same thirteen; only Italy, the United States and Japan returning lower percentages.

Unfortunately these percentages do not carry the meaning that is often ascribed to them. They do not provide a measure of the relative tax burden as between one nation and another (5), for no western developed economy fulfils the necessary conditions in which total tax revenue expressed as a percentage of the Gross National Product at factor cost might provide a useful measure of national tax burden.

Twenty-five years ago in The American Economic Review, Alan Sweezy showed that to express a government's income, or spending, as a percentage of the standard concepts used in national income accounting would normally produce results of uncertain meaning, if not absolute nonsense (6). He also concluded that such percentages would have some limited validity only in an economy where there are no indirect taxes and no transfer incomes.

**Who finally pays?**

Measuring the tax burden is a matter of first determining the effective incidence of taxation, and since economic theory as now established is uncertain as to effective incidence, it follows that it is uncertain also as to the burden a given tax revenue imposes on any particular economy.

For practical purposes the majority of writers on public finance assume the effective incidence to fall upon the person immediately assessed for the tax. That is to say, employees are assumed to pay employees' social security contributions and employers to pay the employers' contributions.

On the other hand, indirect taxes are assumed to be passed on to the consumer through higher prices. For example, an indirect tax on beer is assumed to be paid by the person who eventually buys the beer for consumption and not by the brewer, or the landlord, or some other intermediary, although they may in fact pay the money to the tax collector.

However, a few exceptions to these general rules have been admitted. Dalton[6] believed that in periods of full employment, taxes imposed on employees might be shifted on to prices (7, p58), and in a recent article in The Economic Journal, some evidence

6 Chancellor of the Exchequer in the first Attlee administration of July 1945.

was presented suggesting that in Canada additional direct taxes on wages were being shifted on to employers (8).

Adam Smith observed, as noted above, that employees shifted both direct taxes on wages and indirect taxes on wage goods on to their immediate employers. In the final analysis, however, his real conclusions as to the effective incidence remain uncertain.

Smith concluded, for example, that the effective incidence of taxation rested in part on the rent of land, thus reducing the income of landlords, and in part upon consumers.

The conclusion that the effective incidence of taxation would, in part, rest upon consumers followed on directly from a prior assumption – that manufacturers pass on to consumers any taxes levied directly upon them, or shifted on to them, by raising the prices of their products.

However, to follow Smith's argument through, if the consumers are employees and the price rises affect wage goods then the tax will be shifted yet again back on to the manufacturer who, as an employer, will have to pay out increased money wages. In turn the increase in money wages will lead to even higher prices, and so on *ad infinitum*.

In this respect the discussion of tax incidence in the *Wealth of Nations* may be considered as anticipating the concept of a self-generating cycle now popularly known as the wage/price spiral.

But this is to avoid the issue – taxes cannot be passed on for ever. Eventually some person, from some source, must pay the tax and suffer a reduction in income.

## The appropriation of property income

If it is accepted that taxation tends to leave post-tax labour incomes unaffected, which is to accept Smith's conclusions, as confirmed by recent statistical investigations, then it necessarily follows that the effective incidence of total taxation must be on net property incomes; that is, rent and profits after allowing for stock appreciation and capital consumption.

Taxes must be paid by someone from some source. If post-tax labour incomes are excluded then the only remaining source is net property incomes. As an additional tax assessed on the rent of land reduces the income of landlords, so also any additional tax must reduce aggregate post-tax net property incomes.

The increases in prices and gross money wages and salaries which are associated with the imposition of taxes other than those on the rent of land are simply the mechanics of tax shifting which inevitably come into play when the formal incidence, or impact, of a tax is other than where the effective incidence must rest.

The hypothesis that is implied by concluding that the effective incidence of total taxation is wholly upon net property incomes, is that an expansion, or contraction, in the share of the product appropriated by total tax revenue will be matched by a contraction, or expansion, in the share of the product represented by post-tax net property incomes.

This hypothesis is capable of being tested by statistical methods and the results are illustrated on the scatter diagram Chart A. As official estimates do not provide a basis for isolating the post-tax labour income component of self-employed incomes, these are included as part of property income.

In the United Kingdom for the last 100 years since 1876, the relationship between total tax revenue, expressed as a percentage of the net domestic product at market prices, and post-tax net property income similarly expressed, yields, on the basis of annual first differences, a regression coefficient of -0.999 ($t = 9.660$).

This means that within the United Kingdom economy in the long run, every percentage point increase in the share of the product appropriated by total tax revenue since 1876 has been matched, almost exactly, by a percentage point decrease in the share of the product accruing as post-tax net property income.

A similar calculation relating changes in the take-home pay of employees to changes in total tax revenue, indicates that these two variables have no significant statistical relationship.

**Measuring the burden**

Statistical evidence amply confirms that the effective incidence of taxation is wholly upon net property income, and it is to be deduced from this that the total tax revenue plus home-produced post-tax net property income in any given period is effectively the domestic taxable capacity of an economy.

A measure of the domestic tax burden which will be meaningful, both nationally and for the purposes of international comparison, may be obtained by expressing total tax revenue as a percentage of domestic taxable capacity.

Another advantage of this measure is that it avoids the fallacy of Say's *golden maxim*, for it does not imply that 'The very best of all plans of public finance is to spend little, and the best of all taxes is that which is least in amount'.

The real tax burden will be reduced if any additional public authority spending which necessitates an additional tax, expands taxable capacity by more than the additional taxation.

In other words, an increase in taxation will result in a reduction of the tax burden, provided that the additional public authority spending covered by the extra tax leads to an increase in pre-tax rent and profits that is greater than the tax increase.

Conversely, a cut in taxation will increase the tax burden if the associated cut in public authority spending results in taxable capacity being reduced by more than the cut in taxation.

Unfortunately only a few countries publish national accounts in sufficient detail to provide a basis for an international comparison of their domestic tax burden. On available evidence, it appears that in the UK we have persistently borne a much heavier tax burden than our main trading competitors, although the United States after 1969, being among other things, heavily committed in a South East Asian war, provides a possible exception.

The marked difference between the tax league tables derived from Central Statistical Office (CSO) estimates of tax revenue as a percentage of the GNP at factor cost, and comparative tax burden, is illustrated on Charts B and C. On any basis it is readily apparent that the highly competitive Japanese economy is lightly taxed.

On the other hand, while on Chart B the CSO calculation of tax percentages places both Western Germany and Belgium above the UK, Chart C shows that, after 1971, the UK domestic tax burden, on a comparative basis, remains substantially heavier than either of these countries.

As has been argued, total tax revenue expressed as a percentage of taxable capacity provides a comparative measure of domestic tax burden which is directly related to a country's economic performance. However, where governments rely to a significant extent on deficit financing, the borrowing requirement will also have an effect on the economy and must be taken into account when making comparisons.

Thus, a comprehensive comparative measure of what may be described as the public authority spending burden can be obtained by expressing total tax revenue plus borrowing requirement as a percentage of taxable capacity. An excessive spending burden, like an excessive tax burden, will erode the competitive ability of home producers by pushing up prices, limiting investment, restricting output and destroying jobs.

In this country it is an excessive public authority spending burden which has made it near impossible for manufacturers to compete with foreign products in the home and overseas markets, even with the assistance of a depressed sterling exchange rate.

The domestic tax burden and public authority spending burden for the United Kingdom from 1957 are shown on Chart D. The inter-dependence of tax revenue and the borrowing requirement is very apparent between the years 1970 and 1971. The spending burden increased while the tax burden was reduced by the simple method of a sharp expansion of the borrowing requirement.

By 1975 the UK spending burden actually exceeded domestic taxable capacity, which means that public authorities were eating into overseas earnings and piling up foreign debts.

## The correct level

An overburdened ship is in danger of becoming a total loss. On the other hand, a ship which is persistently lightly burdened will not provide its crew and owners with a decent living.

Similarly, with an economy, where the public authorities are too parsimonious, the economy is likely to be depressed with massive unemployment and all the associated injustices. Equally, where the public authorities are profligate, this too will result in a depressed economy with all the associated injustices.

It follows that between these two extremes there must be a right level of public authority spending burden which, when properly apportioned, will lead to prosperity and facilitate justice.

In this country the domestic tax burden is excessive in relation to our main trading competitors, and a cut in taxation is urgently required. There must also be a cut in the level of public authority spending since, at present levels, it exceeds our capacity to pay, and is steadily impoverishing the nation.

## V TAX-CREATED UNEMPLOYMENT

Direct taxes on employment raise labour costs; an excessive tax burden depresses profits.

When these are combined unemployment is inevitable. Except in the very short run, tax-created unemployment cannot be reduced by additional public authority spending. More spending must lead to more taxation and thus to even more people being unemployed.

In the UK unemployment has been on a rising trend since 1955. Most of this is the result of an excessive tax burden necessitated by excessive public authority spending, and to improve employment prospects in the UK, public authority spending must be curtailed and the tax burden reduced.

The relationship between the average effective demand price of labour, aggregate effective profit, and the UK unemployment rate lagged by five quarters, is shown on Chart E.

The demand price of labour rose sharply from the beginning of 1974 to reach an all-time high in the 3rd quarter of 1975. Since then, two years of voluntary pay policy, coupled with some cuts in income tax, have effected a small decline.

This movement in the price of labour was positively reflected in the unemployment rate, which rose sharply from the end of 1974 until the last quarter of 1976, and then began to moderate.

Since the average supply price of labour in 1975 was lower than for any post-war year prior to 1967, the all-time high for the average effective demand price recorded in the 3rd quarter of 1975 must result from long-run increases in direct taxes on employment.

This confirms the analysis given in Section III above.

**Zero profits**

As is readily apparent from Chart E, changes in aggregate effective profit are significantly and negatively associated with changes in the effective demand price of labour. As the price an employer must pay rises, so his profit declines.

This negative relationship is consistent with Adam Smith's observation that taxes imposed on employees are shifted on to their employers. However, whilst effective profits are directly affected by changes in taxes on employment, they are also affected by other forms of taxation.

The persistent declining trend in profits reflects a rising trend in the domestic tax burden. Since mid-1974 an excessive burden of taxation at a time of economic depression has reduced aggregate effective profits to around zero, that is to say, the real losses incurred by many companies have been sufficient to cancel out the true profits earned by other companies.

So long as this situation continues, unemployment will rise – employers can offer employment only when they can afford to do so, and aggregate effective profit is a measure of what they can afford. Although two years of voluntary wage restraint did produce a very slight fall in the demand price of labour, this has not been followed by a reduction in unemployment. Any price of labour is too high when profits are being squeezed to zero by an excessive tax burden.

The domestic policies needed to expand employment coincide with those needed to maintain and improve our international competitiveness. Public authority spending, the tax burden, and direct taxes on employment, must all be reduced so that output and employment can expand on the firm foundation of competitive ability. Any re-inflation of the economy will make matters worse. No purpose is served by taking the ‘flation’ out of ‘slumpflation’ and then re-introducing it as a policy for mitigating the slump.

## VI THE CHANGE-OVER TO PROSPERITY

For economic revival, our inherited wealth from North Sea Oil needs to be used to advantage. At present it is being wasted.

The authorities are merely dissipating the surpluses which this newly discovered wealth is now providing by the purchase of foreign currencies, in an effort to hold down the price of sterling.

An artificially low price for sterling may give some immediate boost to exports but, in the longer run, this is more than offset by the artificially high sterling price of imports.

The British people cannot afford to waste resources in attempts to control the currency market. By allowing the sterling rate of exchange to be determined by market forces, government would be freed to concentrate fully on the domestic issues that will eventually determine the continued well-being of the British economy. For Great Britain, the key to lasting economic prosperity is the level of labour costs, as measured by the average effective demand price of labour – as shown in Table 1, column (iii).

When the price an employer must pay for labour is high and persistently rising, then all other costs and prices will be high and persistently rising. High prices contract demand, restrict output, and increase unemployment.

If the prices of British goods tend to be higher than those of foreign producers then imports increase their share of the home market and British exporters are priced out of overseas markets. Thus, output and employment in Britain are restricted still further.

This process pressures the government into devaluing sterling; it also creates pressures for protection and controls. But protection and controls are, by their very nature, restrictive – and sterling devaluation leads to an even faster rate of price increase on the home market. Employees, faced with rising prices and restricted employment opportunities, quickly discover that the purchasing power of their take-home pay is being eroded – Table 1, column (i) – and, in recompense, demand more money wages.

Since more money wages unrelated to increased output also raise the level of labour costs, the process becomes self-generating.

## The wage/price spiral

Successive post-war governments have attempted to break this self-generating economic disaster spiral by a variety of prices and incomes policies relying on a combination of exhortation and statutory powers.

Without exception all these attempts have enjoyed some initial success only to meet with final failure, the last state being worse than the first. Such policies must inevitably fail eventually, for they attempt to achieve a stable level of prices and costs by depressing the purchasing power of take-home pay and profits below the level that employees and employers are prepared to accept. This is impossible to sustain in a free society.

The only way the spiral can be broken, other than by recourse to a fully controlled totalitarian state, is by cutting labour costs – without depressing the earnings of employees, or the profits received by their employers, below what they consider to be an acceptable minimum, or what they know to be the going market rate.

Historical evidence suggests that employees and employers never knowingly price themselves out of the market, although there is much evidence which suggests they are frequently forced out by government interference and taxation.

## Industrial warfare unnecessary

Current economic theory confuses policy makers by implying that there is only one price for labour but, as has been argued, there are in practice many prices, and the price received by employees is not the same price as that paid by an employer. By allowing the sterling prices of imports to fall, cutting taxes, and reducing the public authority borrowing requirement, government can create the necessary conditions for an expanding economy in which the purchasing power of take-home pay may rise and pay anomalies be resolved by negotiations between the parties directly concerned.

Given the right conditions, these negotiations will not result in industrial warfare, nor impair the competitive ability of British industry.

Whilst they will lead to an improvement in the purchasing power of take-home pay, they will not lead to an explosion in the average real supply price of labour (shown in Table 1 column (ii)), which is the price of labour most closely corresponding to the *real wages* of economic theory.

If the average real supply price of labour remains relatively steady, then it follows, from the analysis presented in this paper, the average effective supply price of labour (Table 1 column (iii)) will remain relatively steady also. Thus, any cuts in direct taxes on employment incomes will tend to reduce the average effective demand price of labour of column (iv) which to an employer is the cost of labour that matters.

This latter price of labour matters equally to employees, for it is a significant factor determining the demand for labour which, in turn, governs an employee's ability to maintain his level of earnings.

**The first positive step**

The positive action that government must take, in order to make possible the first step along the road to sustained economic recovery is a cut in direct taxes on employment.

To ensure the intended result the tax cut must have the greatest immediate effect on labour costs with the minimum net loss of revenue.

If the net loss of revenue is too large, success is pre-empted by the sharp increase in borrowing requirement.

Immediacy is equally vital; for, during a time lag between the tax cut and its effect on labour costs, the competitive advantage of British producers may continue to be eroded, thus dissipating the intended benefits before they arise.

The most effective method open now for government to achieve a significant and immediate reduction in labour costs is the abolition of employers' contributions to social security, including the recent surcharge, with a pro-rata reduction in self-employed rates.

Such action would have an immediate effect since, within a month, the actual paid-out costs of all UK employers would be significantly less. To marginal firms, the effect could mean the difference between making true profits, or real losses.

This direct and effective result could not be achieved by cuts in other forms of taxation. For the most part, other reductions would make little or no immediate contribution to economic recovery.

For example: with a cut in income tax it takes some months for the tax tables to be adjusted and, assuming the twelve-months rule is adhered to, it will then take up to another year before the tax cut is reflected in the average demand price of labour, with yet a further time lag before unemployment is noticeably reduced.

The immediate priority is to get the economy moving again, after which income tax and other direct employment taxes could be cut with advantage to sustain the momentum.

## A tax cut

In a full year, estimates of the gross loss of revenue arising from the abolition of employers' contributions might be around £6,000 million. The precise figure would depend upon the assumptions, but it is the actual net loss of revenue which is of importance to public finance, and this would be far less.

Firstly, public authorities are large employers of labour and in their case employers' contributions amount to no more than a self-cancelling book transaction.

Secondly, a reduction in employment taxes would reduce the need for employment subsidies, and most of these could be phased out with advantage to overall employment prospects.

Thirdly, the proposed tax cut is the equivalent to a reduction of 4 to 5 percentage points in the average effective demand price of labour and, by stemming the tax drain, would improve the liquidity of employers.

From past experience, the combined effect may be expected to reduce the number of unemployed by some 400,000 people within fifteen months. A reduction in unemployment will automatically cut public spending through savings in social security payments for unemployment.

Yet again, the expansion of output and employment improves the buoyancy of the yield from other taxes, thus reducing the net loss of revenue still further.

## A tax increase

In the 1840s Sir Robert Peel turned a large budget deficit into a surplus by cutting the tax rates. In the present circumstances the power of government to cut taxation is constrained by the size of the current borrowing requirement. Thus, notwithstanding Peel's example, they now have little choice but to cover a substantial proportion of the net loss of revenue from the proposed cut by an increase in other tax rates.

Since a reduction in social security benefits is not part of the proposed measure, it seems likely that government may feel bound to claw back in other taxes some £2,000 million of the original tax reduction. This new revenue needs to be raised immediately with the minimum of administrative costs, which necessarily excludes the consideration of any new method of raising revenue.

Again, the additional revenue must be raised in a way that will not significantly depress the purchasing power of take-home pay, raise labour costs, or impair the competitive ability of British producers relative to foreign producers. The least harmful method within the framework of the present tax structure by which these requirements could be met is by raising the standard rate of VAT to, say 12½ per cent. This one measure would provide sufficient revenue and could be implemented immediately with the minimum of administrative expense.

**How they balance out**

The common argument against an increase in the rate of VAT is that it tends to raise directly the price of consumer goods, and thereby reduce the purchasing power of take-home pay.

When considering tax effects in isolation this argument is valid, but, within the total immediate policy package proposed in this paper, the VAT effects on the general consumer price level will be more than offset.

The appreciation of the sterling exchange rate will reduce directly the sterling prices of all imported consumer goods (for example, tea and coffee prices about which the Government are expressing much concern), and will reduce indirectly the price of other consumer goods to the extent that their manufacture depends upon imported raw materials.

The reduction of labour costs by the abolition of employers' contributions will tend to reduce the prices of all consumer goods, particularly where labour cost is significant, whilst the increased VAT rate will apply only to a limited range of consumer goods and services. Some items may rise in price as a result of the VAT effect not being fully offset, but many essentials, such as food, will be significantly reduced, for they are not subject to VAT.

In general, the consumer price index may be expected to fall, with the greatest benefit accruing to those on low incomes and families with children, since those sections of the community spend a larger proportion of their incomes on essential items that are excluded from VAT.

## Effects at home and abroad

The advantage of raising additional revenue from VAT is that it is less harmful to the competitive ability of British producers than direct taxes on employment. Direct taxes on employment do not affect firms based overseas but they directly affect British costs and prices.

Changes in the employers' contributions to social security affect British labour costs immediately. Changes in income tax, or in employees' social security contributions, affect labour costs after a time lag through changes in money wages and salaries.

However, goods and services liable to VAT are charged at the same rate of VAT when sold on the home market, whether they be produced in this country or imported, whilst VAT is not charged on exports. Thus an increase in the rate of VAT will not discriminate between home or overseas production, but a cut in direct taxes on employment will provide British producers with a much needed opportunity to improve their competitive edge in all markets.

Editors' note:

VAT was introduced from 1st April 1973 as a condition of Britain's entry into the Common Market. It was initially applied at a flat rate of 10% for most items. In July 1974 this was split into a lower standard rate of 8%, and a higher rate of 12.5% for petrol and some luxuries. The higher rate was increased to 25% from November 1974, and reverted back to 12.5% in April 1976. Then, in June 1979, the higher rate was abolished, and the standard rate increased from 8% to 15%. The standard rate for most items was further increased to 17.5% in March 1991.

## VII PROPOSALS SUMMARISED

1. Non-intervention in the foreign exchange market.
2. Abolition of employers' social security contributions, including the present surcharge.
3. Phasing-out of all employment subsidies other than payments in respect of re-training.
4. Continued restraint in public authorities' spending, and an acceptance of monetary disciplines.
5. Excessive net loss of revenue to be covered by raising the basic rate of VAT.
6. Government revenues from oil to be used in the following order of priorities:-
   a) Phased abolition of employees' social security contributions.
   b) Reduction of income tax.
   c) Reduction of public debt.
7. Investigate methods for the future reform of the system of public finance. This investigation to include:
   a) The eventual abolition of all taxes on employment.
   b) The re-financing of the system of social security.
   c) Reform of local government finances along the lines suggested in ESA Paper No. 2.[7]

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7 *Local Government Finance*, published by the ESA in January 1970. The recommendations included the determination of rateable values on the basis of situation rent (location value) only, accompanied by a centrally regulated equalisation fund to which all local authorities would contribute.

Table 1

The Four Prices of Labour

1948 = 100

| | (i) Standard of living | (ii) Average real supply price | (iii) Average effective demand price | (iv) Average effective supply price |
|---|---|---|---|---|
| 1948 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1949 | 103.6 | 99.9 | 101.6 | 100.4 |
| 1950 | 106.4 | 99.4 | 103.4 | 102.3 |
| 1951 | 107.5 | 97.4 | 103.9 | 102.5 |
| 1952 | 109.2 | 99.3 | 103.3 | 102.6 |
| 1953 | 114.1 | 100.3 | 102.6 | 102.5 |
| 1954 | 119.9 | 101.8 | 103.3 | 103.3 |
| 1955 | 126.5 | 103.6 | 105.8 | 105.2 |
| 1956 | 131.4 | 106.2 | 107.3 | 106.3 |
| 1957 | 133.7 | 106.3 | 107.7 | 105.9 |
| 1958 | 132.7 | 105.6 | 107.7 | 104.0 |
| 1959 | 138.0 | 105.7 | 107.0 | 103.5 |
| 1960 | 146.9 | 106.5 | 107.2 | 103.5 |
| 1961 | 153.1 | 108.2 | 109.2 | 104.2 |
| 1962 | 153.7 | 107.3 | 110.1 | 103.9 |
| 1963 | 158.3 | 106.6 | 109.1 | 103.4 |
| 1964 | 166.3 | 105.7 | 108.8 | 102.5 |

Table 1 continued

1948 = 100

| | (i) Standard of living | (ii) Average real supply price | (iii) Average effective demand price | (iv) Average effective supply price |
|---|---|---|---|---|
| 1965 | 167.6 | 103.7 | 109.1 | 100.7 |
| 1966 | 169.8 | 103.0 | 110.7 | 99.9 |
| 1967 | 171.1 | 101.7 | 110.4 | 97.7 |
| 1968 | 171.2 | 97.8 | 109.2 | 94.7 |
| 1969 | 171.7 | 96.2 | 110.1 | 93.9 |
| 1970 | 178.4 | 98.0 | 110.1 | 94.7 |
| 1971 | 182.0 | 98.2 | 108.9 | 93.6 |
| 1972 | 192.1 | 101.3 | 110.4 | 95.0 |
| 1973 | 201.0 | 100.0 | 111.6 | 94.6 |
| 1974 | 203.2 | 101.9 | 118.1 | 97.2 |
| 1975 | 205.2 | 104.6 | 122.4 | 96.4 |
| 1976 | 199.9 | 99.8 | 120.5 | 93.2 |

Table 2

The Price of Labour

| | (i) Average effective demand price % | (ii) Take home pay % of (i) | (iii) Direct taxes % of (i) | (iv) Other employers' contributions % of (i) |
|---|---|---|---|---|
| 1946 | 59.6 | 86.0 | 11.4 | 2.6 |
| 1947 | 60.1 | 86.5 | 10.7 | 2.8 |
| 1948 | 59.5 | 85.6 | 11.5 | 2.9 |
| 1949 | 60.0 | 84.5 | 12.3 | 3.2 |
| 1950 | 61.1 | 84.7 | 11.9 | 3.4 |
| 1951 | 61.8 | 84.5 | 12.1 | 3.4 |
| 1952 | 61.7 | 85.0 | 11.5 | 3.5 |
| 1953 | 61.5 | 85.6 | 10.9 | 3.5 |
| 1954 | 61.7 | 85.7 | 10.7 | 3.6 |
| 1955 | 62.6 | 85.3 | 11.2 | 3.5 |
| 1956 | 63.9 | 85.0 | 11.4 | 3.6 |
| 1957 | 64.2 | 84.3 | 11.8 | 3.9 |
| 1958 | 64.3 | 82.7 | 13.3 | 4.0 |
| 1959 | 63.6 | 82.7 | 13.2 | 4.1 |

Table 2 continued

| | (i) Average effective demand price % | (ii) Take home pay % of (i) | (iii) Direct taxes % of (i) | (iv) Other employers' contributions % of (i) |
|---|---|---|---|---|
| 1960 | 63.0 | 82.6 | 13.3 | 4.1 |
| 1961 | 64.3 | 81.7 | 14.2 | 4.1 |
| 1962 | 64.7 | 80.8 | 15.1 | 4.1 |
| 1963 | 64.1 | 81.1 | 14.6 | 4.3 |
| 1964 | 64.0 | 80.7 | 15.1 | 4.2 |
| 1965 | 63.9 | 79.0 | 16.8 | 4.2 |
| 1966 | 65.1 | 77.3 | 18.3 | 4.4 |
| 1967 | 64.9 | 75.9 | 19.6 | 4.5 |
| 1968 | 64.1 | 74.3 | 21.0 | 4.7 |
| 1969 | 64.3 | 73.1 | 22.3 | 4.6 |
| 1970 | 65.8 | 72.0 | 23.5 | 4.5 |
| 1971 | 65.2 | 72.5 | 22.8 | 4.7 |
| 1972 | 64.7 | 73.6 | 21.5 | 4.9 |
| 1973 | 64.9 | 73.5 | 21.4 | 5.1 |
| 1974 | 68.5 | 71.8 | 23.1 | 5.1 |
| 1975 | 71.5 | 68.4 | 26.4 | 5.2 |
| 1976 | 70.1 | 66.3 | 27.6 | 6.1 |

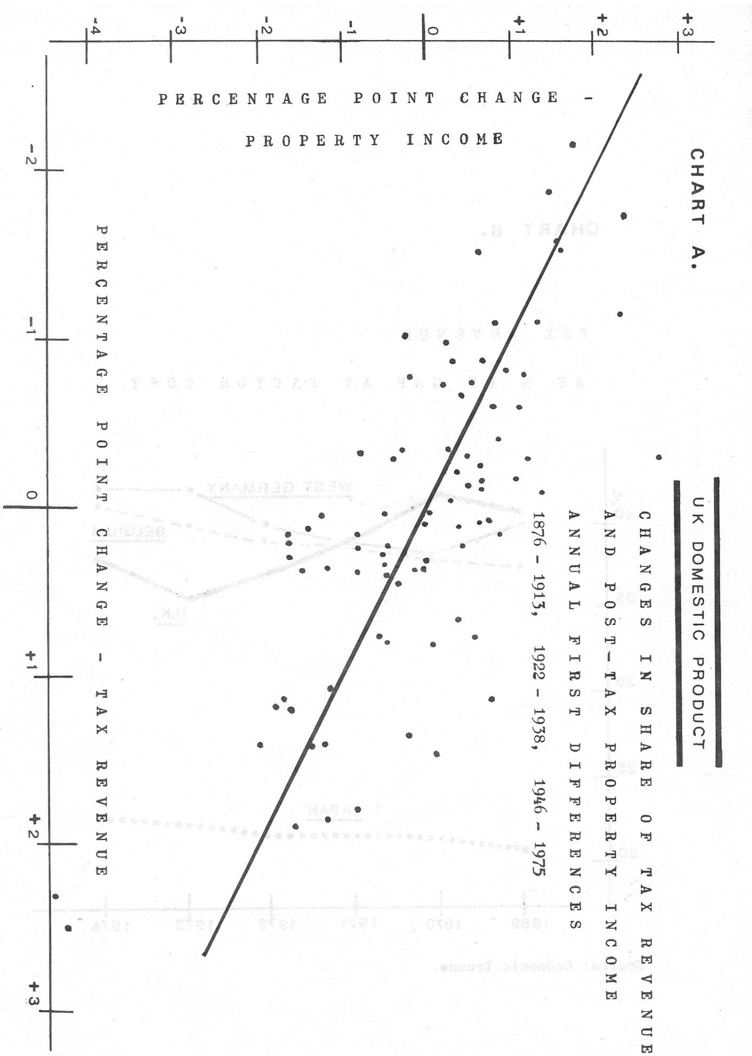


Chart A

Changes in share of tax revenue and post-tax property income

*Sources:* For the years prior to 1946, from (i) C. H. Feinstein, National Income, Expenditure and Output; (ii) Mitchell and Deane, Abstract of British Historical Statistics, HMSO; (iii) Annual Abstract of Statistics, HMSO. For the years after 1946 and through to 1975, from the National Income “Blue Books”, HMSO.

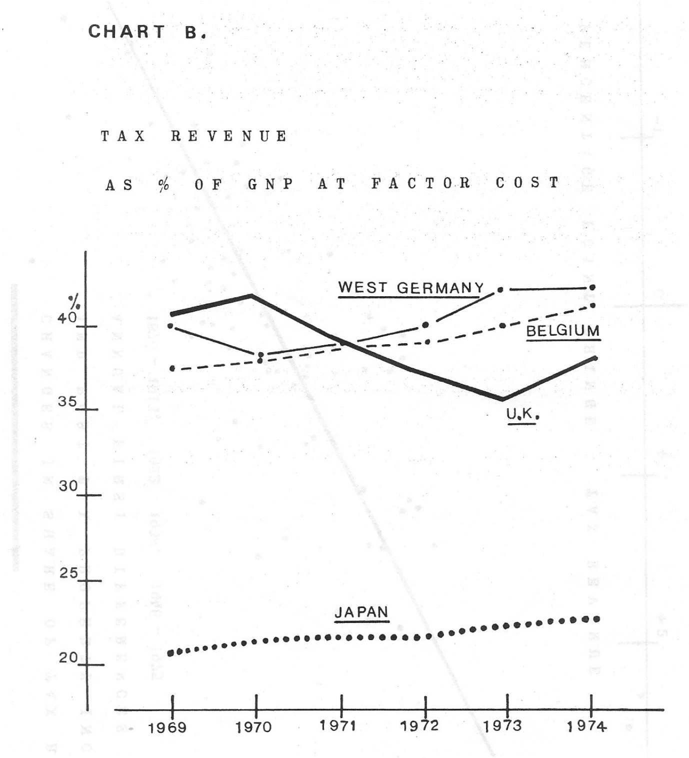


Chart B
Tax revenue as percentage of GNP at factor cost

*Source:* Economic Trends, HMSO.

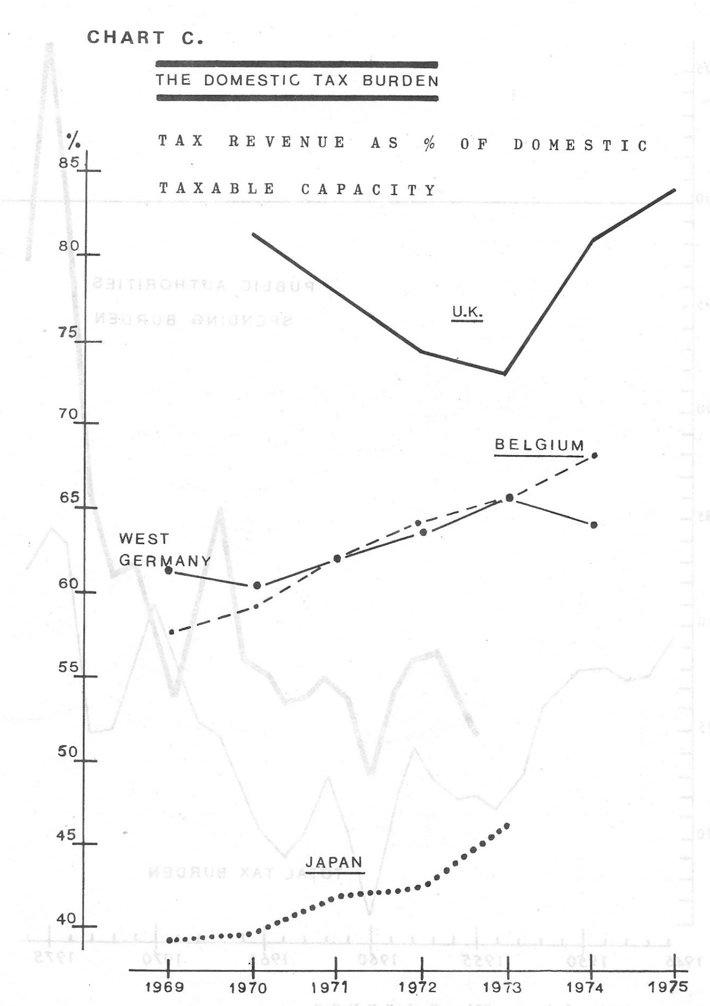


Chart C
Tax revenue as percentage of domestic taxable capacity

*Source:* O.E.C.D.

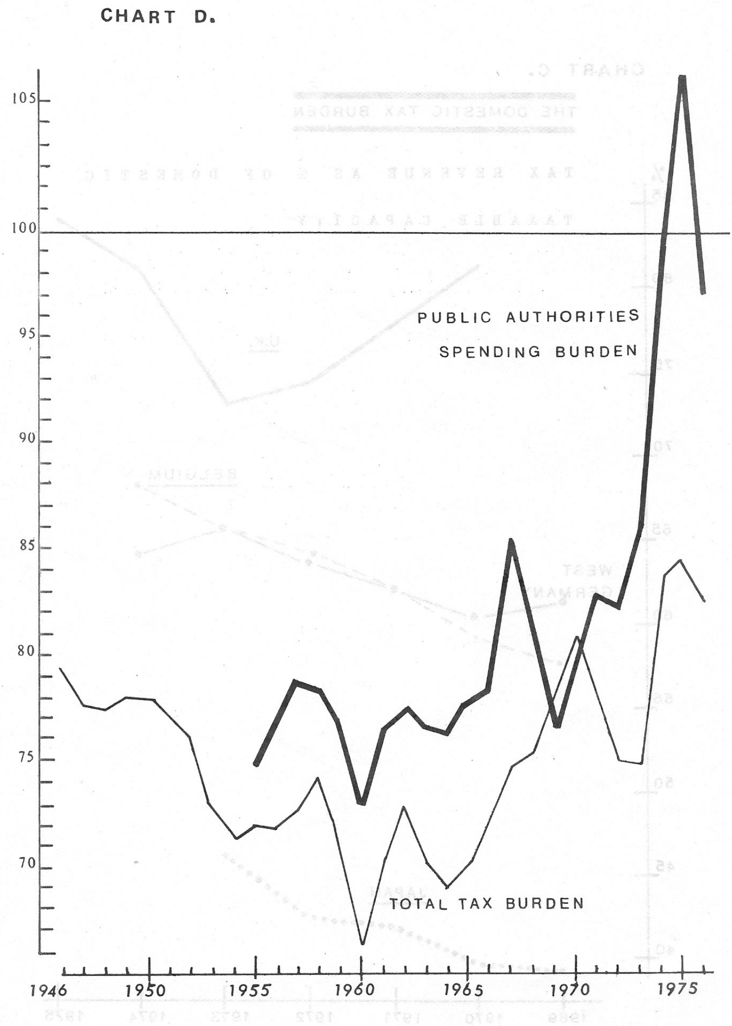


Chart D
Domestic tax burden and public authorities spending burden

*Source:* National Income "Blue Books", HMSO.

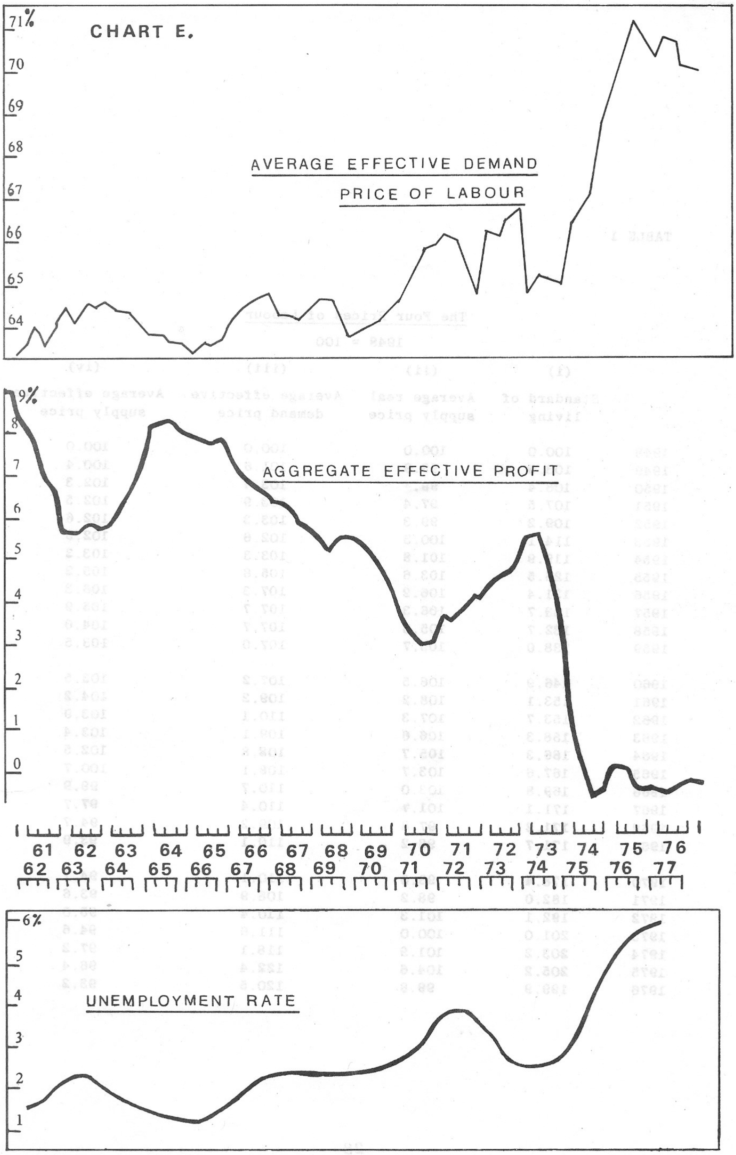


Chart E
The price of labour, profits, and unemployment
*Source:* Economic Trends, HMSO.

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# 1

# The Real Issue at Brussels

1971

By the end of this century the heavy unemployment, the strikes and the rising prices, these things that are most important to us today, will be forgotten.

One issue, however, that will still be affecting the lives of ordinary men and women of these islands in the year 2000 is the Common Market and 1971 is the year of decision.[8]

Recently, in the House of Commons, Mr. Rippon stressed the need for the general public to 'realise what is at stake in these negotiations'.

But what is at stake? Many who oppose entry are concerned with national sovereignty and other constitutional matters: what of that body of law and custom, which for centuries has ensured that the British people have been the freest in Europe? But tyranny has many guises, and 'liberty of the subject' has a hollow ring for the bankrupt or unemployed. To be meaningful, liberty and freedom must have a firm basis – that is, the opportunity for all to earn a good living. How will the United Kingdom's acceptance of the Treaty of Rome affect this most basic issue?

Considerable publicity has been given recently to the 'complex and difficult negotiations arising from the agricultural policy currently being pursued by the six Common Market countries'.

Much has been said about food prices rising if we join, although the Minister has stated that agreement has been reached in respect of pig meat, eggs and liquid milk 'such as to suit the British farmer and customer'. But Britain is primarily an industrial and trading nation, and it is from these activities that the British farmer derives

8 Negotiations for Britain to join the Common Market began in June 1971.

his market.

What then is to become of our factories, mills, ports, shipyards, and mines? Will joining the Common Market bring good work around the Tyne, the Clyde and the Mersey, or in the Ridings, and beyond the Severn? For it is on these places that the strength and prosperity of the British people depend.

The government have also stated that, in an enlarged Common Market, Britain could be in a position 'to attract more investment', 'to achieve economies of scale', and 'to take advantage of the vaster trading opportunities'. They have also asserted that joining the E.E.C. would bring us a domestic market five times greater than the present British market. These and similar statements have now been repeated so often that they are accepted as self-evident; investigation, however, suggests that they have little foundation.

In April 1969 Professor Colin Clark and his associates, working at Oxford, published a research paper[9] showing the shifting pattern of economic potentials in Western Europe.

Their paper showed clearly that the creation of the Common Market had dramatically shifted what might be described as the European balance of economic power away from this country.

As a result of this shift, the UK had become a peripheral region of Europe in respect of its attractiveness as a location for mobile industry. Relatively, this country's attractiveness had been reduced from being on a par with the main centres of European industry and population to about the same level as central Italy.

Furthermore, the paper showed that this situation would not be radically altered by our entry into an enlarged Customs Union, although the position of London and the South East might be marginally improved.

Finally, they concluded: 'Since the Customs Union agreement entails not only the unhindered movement of goods across frontiers, but also freedom of labour and capital, the possibility

9 *Industrial Location and Economic Potential in Western Europe*. Published in Regional Studies, Volume 3, Issue 2, pp. 197–212, by Pergamon Press, 1969.

arises that the labour and capital of Common Market countries which are remote from the potential centre of Europe will migrate to the centre, to the detriment of the countries on the periphery.' The U.K. would be a country on the periphery.

The results of this research, partly supported by taxpayers' money through the Social Science Research Council, cannot now be written off, since proof of its accuracy is already accumulating.

A study of Common Market countries shows that the greatest growth has occurred in those areas where the potential has risen most. A good example is Western Germany where the substantial influx of foreign families is creating local problems.

Already in this country difficulties are arising in the North East and in parts of Yorkshire, where employment agencies have been opened for the supply of skilled contract labour to firms in Western Germany.

Some shipyard and construction companies are now saying that, as a result of this migration of highly skilled men, they are having to operate below full capacity, to the detriment of the less skilled workers they still employ.

The concentration of industry in the Rhine Valley of Western Germany, eastern Belgium, and the southeast Netherlands is in fact the same problem on a larger scale as that which has faced this country for many decades, and which remains unresolved.

Successive British governments have attempted to encourage prosperity in the regions by the creation of Development Areas, and then by Special Development Areas, by cash grants, Regional Employment Premiums, the offering of factories rent free for five years, the issue of Industrial Development Certificates, and many other schemes, but with only limited success.

In 1965 Scotland, the North of England, Wales, and the South West all suffered from unemployment above the average for Great Britain. Five years later, the position is largely unchanged, except that there has been an improvement in Wales, whilst the Yorkshire and Humberside region has joined those areas with unemployment rates above the average.

Even these relative regional unemployment rates understate the real situation, since they do not take into account the continued attraction of both industry and population centres located around the London–Birmingham axis. Colin Clark's work suggests that by joining the Common Market we shall intensify all these regional problems.

What then are the real issues in the Brussels negotiations? One must conclude that they are not matters of pig meat or eggs, nor even whether our share of the Commission's budget is 10%, 15%, or 20%, but they are matters of British industry and trade.

The right terms will surely be those that will encourage regional prosperity in Britain; the wrong terms will be those that merely intensify the problems that already exist this side of the Channel.

The popular assumption that joining the Common Market will automatically solve our internal problems of growth and regional development is entirely unfounded, and is no substitute at all for effective Government policy.

# 2

# Privatisation

22nd September 1984

Privatisation is a word that a lot of people object to – they say that it is an ugly word, and so on, but certainly it's new. It was a new word introduced by the present Conservative administration to distinguish their approach to economic issues from the approach of other political parties.

Like all labels the term 'privatisation' tends to obscure, and so I want to begin tonight by looking behind this label, 'privatisation' – just how did the notion come into existence? What is behind it?

Well now, in this 20th century, a very common form of macro-economic order is the trading community, that is to say, a type of community in which the units of production produce an output for sale, or at least primarily for sale, and not for the consumption of those directly engaged in a particular process of production. The idea is you produce something and sell it; and the United Kingdom is just such a trading community.

Now, a characteristic common to these trading communities of the 20th century is that the return to labour, that is take-home pay, or wages – call it what you will – the return to labour is a private personal income.

It accrues to those who supply the labour, which is a necessary factor in all productive processes, and they may dispose of this labour income as they wish. It is theirs to do with as they please. The condition of slavery is today an exception and this country is not one of the exceptions.

But we may also distinguish between trading communities by reference to another form of income which in economics is known as property income. That is, the income that accrues to those who enjoy property rights over the non-human means of production.

Now, one extreme we may envisage is a trading community in which the property rights to the non-human means of production are vested in the State. In this circumstance all the property income is public revenue and is available to government for the financing of public spending. That's one extreme.

The other extreme we may envisage is a trading community in which all the property rights to non-human means of production are vested in private persons or private corporate bodies. In this circumstance all the property income is, like all the labour income, private income.

This of course creates a problem for government and indeed for the trading community as a whole, for in the process of production and trade there does not arise automatically any public revenue available to government for the financing of public spending.

The problem is usually resolved by the trading community accepting the need for government to impose by force or the threat of force an arbitrary levy on all or any private income, as in their wisdom they may so decide, called taxation. In the absence of an automatic public revenue, government appropriates a tax revenue which is used to finance public spending – the way it works in this country for example.

In the early stages of a developing trading community the incidence and amount of taxation is very unlikely to be the cause of any major distortions in the economy, or to be the direct cause of substantial personal hardship.

For example, at the beginning of this century, in this country, taxation appropriated only a ten percent slice, or slightly less than a ten percent slice of the 'national cake' – the bite was not very large, and it didn't cause much trouble.

But you see, as a trading community grows and develops it has to start spending increasing amounts on all kinds of things, such as securing its trade routes or, at home, more roads, street lighting, and police forces; whilst in the industrialised areas and expanding towns more and more money has to be paid out on such things as public health. Of course, as public spending grows, then so also must the tax take, out of which this spending has to be financed.

As I have said, while at the beginning of this century United Kingdom taxes took about a ten percent slice of the national cake, during the inter-war years this bite had more than doubled – in the twenties and thirties, the tax take was around twenty-five percent.

But there is a more important cause of a sharp increase in public spending, and it comes of necessity in any trading community in which both labour and property incomes are private incomes. A sharp increase in the tax take comes when the social conscience is aroused by the inevitable and growing disparity between the few very rich and the many who are relatively poor, and it arises from the very nature of things.

You see nature in any event does not bestow individual abilities equally as between one person and another; and even when labour incomes are generated as private personal incomes, there will be a spread of incomes as between the well-endowed and the not so well-endowed. But in that case nature does impose a limit, for no person can work every day for say more than about 16 hours a day, without losing edge – you just can't do it. Everyone has to cease work in order to eat and sleep, and in the normal way of things, it is beneficial to take some time off for a holiday every so often.

So, irrespective of ability, the amount that can be earned or truly earned by a person from their labour is very definitely limited. But you see, when one turns to property incomes then no such limits apply. Property rights over non-human means of production may be accumulated almost without limit, and property income may be generated 24 hours a day, seven days a week, year in and year out.

Thus, in a trading community where both labour and property incomes are generated as private incomes, there arises the near inevitability of a few multi-billionaires counter-balanced by a mass of underprivileged persons and those close to the poverty line.

Now, when that arouses the social conscience, that conscience can at first be soothed away by gifts from the rich to the poor. But that solution doesn't last very long, and very soon there arises the demand for the government to do something.

One of the popular demands that normally arises under these circumstances is that for redistributive taxation – the Robin Hood concept of robbing the rich to give to the poor. But you see, this cannot really reduce the disparity, for however good may be the intentions of government, taxes are, by definition and in practice, arbitrary.

With redistributive taxation some poor may become a little bit richer and some rich may become a little poorer; but you may rest assured there will be some poor who will be poorer and some rich who will be richer.

There is only one certain outcome from a policy of so-called redistributive taxation, and that is that the slice of the national cake appropriated by taxation will increase, and the rest of the trading community as a whole will be that much poorer.

Eventually there will arise, as has arisen in just about every one of these trading communities, there will arise demands leading to what we now call the welfare state – that is, public spending on a wide variety of social services and social security payments.

Now, a welfare state does work to mitigate the worst results of poverty but in so doing it sharply increases public spending and in the kind of trading community that we are considering, this means an inevitable sharp increase in the tax take.

I trust I have said enough to demonstrate to you that in a trading community where both labour and property incomes are generated as private incomes, and where all public spending is financed by taxation – an arbitrary levy on those private incomes – that in this circumstance there is an inevitable and persistent tendency from a variety of causes for the slice of the national cake appropriated by taxation to steadily increase.

It just sort of happens – like Topsy,[10] it just grows and grows, but it's at just this point where economic forces take over.

10 A fictional character in *Uncle Tom's Cabin* by Harriet Beecher Stowe (1852).

Irrespective of the intentions of government, irrespective of the nominal basis on which taxes are assessed, the effective incidence of taxation, where it finally rests, is always and everywhere upon property incomes.

As the share appropriated by taxation increases, so the share accruing as disposable net property income falls. As I said earlier, at the turn of the century in this country taxation appropriated about a 10% share of the national cake, whilst about 40% to 45% accrued as Disposable Net Property Income (DNPI).

Today the position is more or less reversed. It is taxation that appropriates around 40% of the national cake, and Disposable Net Property Income (DNPI) is left with between 10% and 15%. As one rises, the other falls. This is the way economic forces operate – irrespective of government intentions, irrespective of the way they assess the tax, whatever basis they use.

But now, what does that overall picture mean to individual firms – the units of production that are producing this output for sale? It means that, at the margin, their net revenue after paying taxation will be insufficient to pay a decent living wage to their employees and have sufficient left over to finance the investment necessary to keep them in a competitive position.

Such firms if they have political power may get some protection sufficient for their survival at everyone else's expense. They may be able to obtain a government subsidy, which in turn must mean an increased tax take, paid for by the rest of the economy; if they lack political power, then they must go to the wall. That's the way market forces work. Pay up or else, and if you can't pay up, and you can't remain competitive, then you go out of business.

But you see that's fine – good free market stuff – but sooner or later a basic industry, one whose continued production is necessary for the well-being of the trading community as a whole, is itself in danger. Protection and subsidies prove to be insufficient.

Then, it appears to government they have no alternative but to nationalise, and nationalisation of course must happen before you can privatise anything. Political ideology may perhaps aid and abet nationalisation but, as Mr. Heath discovered, political ideologies cannot counter economic forces and, when it comes to the push, the government get driven, irrespective of their beliefs.

The post-war Labour governments may have believed in the idea of nationalisation, but certainly Mr. Heath didn't, and he still had to nationalise,[11] or at least he thought he did, for he could see no other option.

But you see, with nationalisation, whether it stems primarily from political beliefs, or is wholly the result of economic forces, or some combination of those two, there is a fundamental change in the trading economy.

It immediately ceases to be a trading economy in which all property income is generated as private income. It ceases to be so, because some of the property rights to the means of production have now become vested in the State. Thus, there is brought into existence what we now call today the mixed economy; a mixture that is neither one thing, nor the other – somewhere between those two extremes that I mentioned at the outset.

Of course with a mixed economy, with the coming of a mixed economy, the financial difficulties of government are intensified. They are intensified because the property rights they have taken over generate not a property income but a loss – that is why they were taken over. Further these industries, now working at a loss, have been impoverished by taxation over many years, and they need a substantial injection of new funds to finance necessary new investment. The losses and funds needed for new investment mean more public spending. More public spending means an increased tax take, and with the increased tax take more firms go to the wall, leading to more loss-making property rights for the government to take over, more public spending, leading to yet further increases in the tax take, so that more firms go to the wall, and so on and so on.

11 For example, the Rolls Royce aircraft engine manufacturing business was nationalised under the Heath government in May 1971.

So you see, starting from a trading economy in which labour and property incomes are both generated as private incomes and public spending is financed by an arbitrary levy on those incomes, then economic forces cause as it were a tide, carrying the economy evermore closer to a condition in which all property rights to the means of production are vested in the State; a tide which carries the economy as if it were a cockle shell from one extreme to the other, in the popular terms of today from the right to the left.

What then is a policy of privatisation? In reality it is an attempt to stem and turn back this tide – a proclamation that King Canute[12] is alive and well, and presiding over Whitehall. Is a 20th-century Canute likely to be any more successful than the Dane of the dark ages? Let us consider. Private persons and corporations will not, in general, pay out good money to secure property rights over non-human means of production that are making a loss; they are likely, however, to pay out considerable sums to secure property rights over the non-human means of production that are making profits, generating a positive Disposable Net Property Income (DNPI).

Now it is possible for government by spending public money to improve the efficiency and competitiveness of these firms and, on occasion, to secure that position by granting monopoly powers.

When they manage to achieve that, then of course these firms become candidates for privatisation; they can be sold off to private persons or to corporations in return for a capital sum. This capital sum will for a time ease the government's financial difficulty, but we know as a repeated experience, we know, that the government will soon dissipate these capital sums. They will soon get rid of it, and then once again they're left with no money, other than what they can raise by further taxation, and with only the loss-making nationalised industries.

But there is more to it than just that, for unless the conditions in the trading economy have been radically changed, then the same economic forces that caused these newly privatised firms and

12 King of England from 1016; also King of Denmark; and later, of Norway.

industries to be nationalised in the first place will still be at work, and in time it is to be expected that these firms will once again become impoverished, and once again there will arise situations where either they go out of production, or are re-nationalised.

King Canute demonstrated to his courtiers that wishful thinking will not turn the tide; now equally, wishful thinking will not turn economic forces. Privatisation may appear enticing, and may even show some signs of success in the short run, but in the absence of a radical change sufficient to turn the tide of economic forces, then privatisation is bound to be a futile policy in the longer run. You cannot just dam the tide, for it will eventually break through.

But even while all that may be so, the more immediate issue is that in this flowing economic tide, industry has become as it were a beach ball of political ideology.

Whether a firm is included or an industry is to be included in the public sector, or whether it remains in the private sector, or is tossed backwards and forwards from one to the other – all this is determined by political beliefs and expediency.

Successive governments have acted in this manner as if there were no economic principles on which to base their decisions.

Now this is to ignore the mechanism which is fundamental to a trading community – the process of striking a bargain from which the outcome is trade.

This is where we have to look, right at the smallest mechanism of a trading community, in which on one side is what we call a seller wishing to exchange goods and services for money, and on the other side there is a buyer wishing to exchange money for goods and services. The buyer and seller come together and strike a bargain. As a result, the goods and services move from the seller to the buyer, whilst a sum of money, known by convention as the price, moves from the buyer to the seller.

This is all quite simple – when you walk into your local pub, your friendly neighbourhood landlord pushes a drink one way across the bar, and you push a pound note across the other way.

That’s trade. All trade is like that; it is the individual building block of which a trading community is constructed.

One can show it diagrammatically. Let us suppose that there is a supplier of goods and services, whatever it may be, and he has a number of customers, all over the place. He pushes out his goods and services and automatically, as the result of the bargain, the money flows back to the supplier. The arrow is double-headed, as shown in Figure 1.

Now, so long as production and trade give rise to this automatic two-way flow of goods and services in one direction and money in the other, so long as there is this automatic two-way flow, then as a general proposition the operation is best left to the private sector.

The less government interfere in the operation the better for all concerned. Mind you in this day and age of course the government always interfere, because to start with you will always have taxation increasing the amount of money that has to flow in that way, or at least the amount of money that chap has got to pay, because the government will probably siphon some of it off on the way, and so on, so you always get interference. Nowadays such a thing as free trade doesn’t exist in a country such as ours, but so long as you’ve got that automatic two-way flow, then one can say as a general proposition that the less government interference the better it is for everyone who is concerned in that operation.

But whilst that diagram illustrates the general case, it may be observed also that there are exceptions. In some cases there is no automatic two-way flow; the arrow head is not in the nature of things double-headed, and the flow of goods and services in one direction does not automatically give rise to a flow of money in the opposite direction, as shown by the diagram in Figure 2.

Now when that is the case, special arrangements have to be made, and where special arrangements have to be made then it is best for the operation to be included within the public sector, so that the government, be it central or local, may make these special arrangements and apply them to the community as a whole.

Let us take the case of the local fire brigade; you return home and find your house ablaze from top to bottom. It's going so well that there is only one thing that is certain – regardless of whether you call on the services of the fire brigade or not, you will be left with no more than a pile of ashes.

Now if you have to pay for the services of the fire brigade, why call on them in those circumstances? Why add to your already certain loss? If anyone is going to benefit from your calling the fire service it is the other householders in the vicinity, who as a direct result of the fire being contained are not left with a pile of ashes.

Surely, therefore, justice demands that the price of the service should be paid by those who receive the benefit. But how is that price to be apportioned between all these householders who have benefitted? And even if you manage to resolve that question, how is the fire service to enforce payment?

When the fire service presents its demands to the householder whose house was not yet on fire, and maybe a street away from it, is not the householder entitled to say "Yes, I did benefit from your service, and thank you very much, it was most kind, but I didn't request the service; I struck no bargain with you, and I do not see that I am obliged to pay your demand for money".

There has to be some special arrangement by which the services rendered to the community by such as the fire brigade are paid for by the community that benefits from that service, and the two-way flow will not arise automatically as a result of a bargain between a willing buyer and a willing seller – it just doesn't happen.

Now this issue as to the firms and industries that should be properly included in the public sector has not aroused very much interest in Anglo-Saxon schools of economic thought.

Professor A. R. Prest, for example, devotes a whole chapter of his recent work *Public Finance in Theory and Practice*[13] to the matter of allocating resources as between government and the rest of the economy – how big should the public sector be, and so on

13 In Chapter 3, *The Allocation of Existing Resources*, penultimate section.

and so forth – and yet, from all that discussion, he concludes, and his final few sentences read: “The very bareness of the economic principles set forth will make it clear that we are now on the border land where economic and political considerations meet and mingle inextricably one with another. Recent years have in fact have seen the publication of various ideas by economists on the appropriate principles of voting, on the grounds that one simply has to seek a political solution to these issues.”

The issue as between the public and private sectors in a trading community is essentially an economic issue, and economists are falling down on their job if they try to opt out with a few smooth words. Let us leave smooth words to the politicians – but equally, of course, one can’t blame the politicians for basing their decisions on their political beliefs and expediency when the advice they get from leading economists is: “Well, that’s the only way.”

Now, whilst that may be true for the Anglo-Saxon schools of economic thought, there was at the turn of the last century a much more lively debate among the continental schools of economic thought, and the issue was probably most clearly put by the French economist Paul Leroy-Beaulieu. This is what he wrote:

“A new branch railway exerts a beneficial influence over a very wide sphere; it increases the receipts of neighbouring lines which it feeds, and augments the income of not only those who use the new line for the transport of their product, but also of those who do not send their product any distance away, but simply bring them to the nearest market which is now less glutted.”

Thus, the effect of the branch line is widespread, diverse and manifold, but the entrepreneurs cannot make all the beneficiaries contribute to the cost since many of them derive no direct benefit from the line nor even manifestly use it at all, simply stepping into the place of those who do use it. This is why many public works simply cannot be carried out for private account, for they would ruin private entrepreneurs whilst being highly remunerative for the society as a whole.

But you see, eighty years ago Leroy-Beaulieu illustrated the fact that there are indeed certain economic activities necessary for the well-being of a trading economy as a whole, which simply cannot be carried on within the private sector.

Such activities cannot be carried on within the private sector for the simple reason that private persons or companies cannot collect payment from all those who benefit from that economic activity; and if, in this kind of circumstance, a private company attempted to collect the *full* cost from whomsoever it could collect a payment from, then of course it would price itself out of the market and as a result it would go to the wall, unless rescued by government using taxpayers' money.

Special arrangements have to be made so that those who receive the benefit pay for the benefit received. This is the distinguishing characteristic of a public sector operation – a special arrangement has to be made by government, central or local, acting on behalf of the trading community as a whole.

Now, when it comes to making all these special arrangements, governments must of necessity look outside of the tax system. You see, Leroy-Beaulieu was making a good case, but he assumed that government would pay for it out of the taxes they collected.

But this won't really work, or won't work for very long, for by definition and in practice taxes are arbitrary levies, and to finance public sector activities out of tax revenue results inevitably in some growing fat on public goods and services received but not paid for, and others being impoverished by being forced to pay for public goods and services that they do not receive and which are not available to them. You see, as tax is an arbitrary levy, it cannot be used in the way that is required by the nature of the special arrangements that have to be made – because it is quite arbitrary, therefore it can't work.

The detail of these special arrangements is a matter for weekly seminars, and in a public talk like this I can do little more than point to a direction in which the answer may be found.

Local rates, as at present levied in this country, are a tax. They are a tax on development, and their incidence as between various persons and groups is quite arbitrary. As I say, they are a tax. But even though they are a tax, throughout this century, whenever there has been a full revaluation for rates, aggregate rateable values for the country as a whole have increased in step with the aggregate of local government spending throughout the country. For the country as a whole the two have gone up together all the while.

The last revaluation was in 1973. Now, we used to have regular annual re-valuations before the war, when local authorities looked after it. Then it was handed over to central government, or central government took it off the local authorities, and since then, for the past 40 years, we have had only two full revaluations, and the poor old local councillors who are now getting so much stick are forced to work on the 1973 list. Can you imagine the chaos there would be if the Chancellor of the Exchequer had to work on the 1973 tax declarations? But that’s the way the councils have to work.

Again, for the last revaluation in 1973, while there had been inflation and all kinds of things, rateable values in the country had grown in line with the level of local authorities’ total expenditure. I’m not saying so for every case, not in all cases, but in aggregate.

Now you see the evidence then suggests that for the country as a whole the rateable values in aggregate do reflect the quantity and quality of the public goods and services being provided by local government, so that if the arbitrary element and the tax on private development element in the local rates were to be removed from the assessments, then it is possible that some kind of reformed rating system would provide the government with the means by which it could charge those who receive public goods and services the current market price of the public goods and services being made available to them.

Economic Study Association researches suggest that this is the way towards a solution based on economic principles, so that self-interest serves what justice demands – a real practical alternative to political solutions based on political ideology, or on meeting the needs of political expediency.

A policy of privatisation may offer some short-run advantage. Perhaps today the public sector is too big, and privatisation may offer some short-run advantage, but it remains an attempt to swim against a strongly flowing economic tide, and therefore it cannot succeed in the long run.

If we object to being carried ever closer towards a State with a centrally controlled economy in which all the property rights to the non-human means of production are vested in the State – if we object to being carried in that direction – then radical reforms have to be made sufficient to remove our trading economy from that tidal race.

But more immediately the government should at least base its privatisation policy on sound economic principles; and privatise only those firms and industries which should operate, and in the right circumstances could operate, within the private sector. It is the height of foolishness to base privatisation decisions on whether a firm or industry is currently making a profit, and can for the moment therefore be sold off in the markets. That cannot be right.

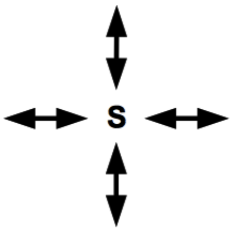


Figure 1

Automatic return
to the specialist

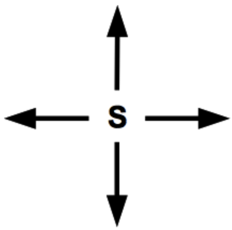


Figure 2

No automatic return
to the specialist

# 3

# Alliance Policy and Economic Realities

12th March 1984

Tomorrow will be Budget Day, but tonight I have been invited to speak on a more important future issue.

The Liberal Assembly last September decided, I understand, to look again at economic policy and to this end set up an adequately funded enquiry. In a discussion with your Chairman and Mr. John Horam at Harrogate, I accepted an invitation to speak tonight to the Gladstone Club on the economic realities that Alliance policy will have to take into account if the party is firstly to win the next General Election, and then to get re-elected at the General Election following; a double-first being a necessity if visions for the future are to be realised.

Party policy is a more important issue than tomorrow's Budget, for there is nothing any of us can do to influence the proposals to be set before Parliament; but, as members of the Gladstone Club, your actions over the next couple of years can exert a significant influence over Alliance policy at the next General Election.

Party policy, to win the approval of the electorate, must not only be relevant, and be seen to be relevant, to whatever the electorate may consider to be the most pressing issue, but it must be capable also of immediate application in existing conditions.

A new government needs to produce a new Budget within a few weeks of taking office. First things first, therefore; what then are the economic realities that this first Alliance Budget, say four years hence, will have to take into account?

For more than 200 years the British people have lived and have also attempted to earn their living in an economy dominated by the employee and employer relationship. Today, more than 90% of the working population are classed as employees.

This is a reality that will not change significantly over the next four years. In order to earn a living these employees must strike a bargain with an employer. The employer offers a chance to earn a living but, since the employer has title to whatever is produced, the employees can offer in return only their labour.

On the one side are the employers – buyers of labour. On the other side are the employees – sellers of labour. Thus, there exists what might properly be described as a labour market. Moreover, on this labour market rest all other markets, because nothing can be produced without labour.

Whether the economy as a whole performs well, or performs badly, depends on the prevailing conditions in the labour market.

One may object to the existence of a market for labour, or one may intend to reform the system so that a labour market ceases to dominate, but unless the Alliance intends an immediate revolution the conditions in the labour market will determine the performance of the British economy for at least the life of the first Alliance government and probably beyond.

This is the fundamental economic reality that Alliance policy must take into account.

Basic to the functioning of any market is the mechanism of the bargaining process – the interaction between the buyers and sellers which, in a monetary economy, determines the ruling market price in terms of money. In any particular bargain this money price is always within a top limit set by the buyer and a bottom limit set by the seller. The buyer has a money sum in mind above which he is not prepared to strike a bargain with the seller. The seller has a money sum in mind below which he is not prepared to strike a bargain with the buyer. Where between these limits the bargain is struck will depend upon the bargaining skills and the bargaining powers of the two parties.

The mechanics of the labour market are not essentially different from any other market. At the very beginnings of the industrial age Adam Smith observed closely the human and economic realities of the system that continues today. He observed that when employees have nothing to sell but their labour then money wages become the price of labour, and this price is determined on the one side by the demand for labour and on the other by the "price of the necessaries and conveniences of life."

In the labour market the buyers of labour are the employers – the employers fix the top limit above which the price of labour cannot rise. However, the employers' demand for labour is in fact a derived demand – it is a demand derived from the prior demand for the products of labour.

This is the accepted supply and demand theory, but I trust with the Gladstone Club, I can now cut through the theory, and be more direct. It is the need to make some margin of profit that determines an employer's demand for labour and his top limit in the labour market. If an employer fails to make that profit then he is forced out of business and drops out of the labour market as a buyer. Given our economic system, employers can demand labour only to the extent and at a price that it is profitable for them to do so.

This is another economic reality Alliance policy must take into account. The first Alliance government will have to work through the mechanisms of the present economic system, and given that we have that system, no good purpose is served by considering profits as a dirty word.

On the other side of the labour market employees are the sellers of labour, and as sellers they fix the bottom limit below which the price of labour cannot fall. But what determines this bottom limit?

According to David Ricardo and associated so-called classical economists, this bottom limit towards which the price of labour tends automatically is determined by the cost of subsistence of the present generation of employees and the cost of raising the next generation. This may have appeared valid enough at the time of the Labourers' Revolt,[14] but today employees do not strike for a slice of bread, but to pay for their television sets and package holidays.

14 Such as the Labourer's Revolt of 1830-1831, also known as the Swing Riots.

As I have mentioned, Adam Smith came much closer to the realities whilst Ricardo was still a toddler. He not only observed that the employees' bottom limit is determined in relation to the "price of the necessaries and conveniences of life", but also that these will vary from place to place and from time to time. In other words Adam Smith calls our attention to the reality that, given a market for labour, the bottom limit – the least that employees are prepared to accept at any time and place – is determined directly by psychological forces, and not by market forces.

These psychological forces are very powerful, and once they have established a limit then that limit will be subject only to a very slow rate of change. This is yet another economic reality Alliance policy must take into account. An incomes policy cannot work. A statutory incomes policy may look tough on paper but in practice the human psychological factors on the one side and the profit factor on the other will prove tougher. Your leader[15] does not have to take my word for this, but the word of his compatriot – 218 years ago Adam Smith, a fellow Scot, recognised the realities of our present economic system.

Within the limits of the most employers can afford to pay and still make a profit and the least employees are prepared to accept, it is reasonable to expect the price of labour, however measured, to be responsive to conditions in the labour market; rising in good times, falling in bad times. This is what pay bargaining should be about – indeed, this is what the established theory of supply and demand predicts. Professor A. W. Phillips accepted this prediction in a well-researched paper he published in 1958.

This was the paper that included what is known as the Phillips curve hypothesis. The relationship between the price of labour and unemployment, which Professor Phillips had calculated from 1860 estimates, performed well enough through the subsequent periods which he investigated, but it was soon found not to hold in the conditions of the 1930s – nor has it held since.

15 David Steel was Leader of the Liberal Party from 1976 until March 1988.

The monetarists stepped in with their own version, which they called ‘the expectations-augmented Phillips curve hypothesis’.

Experience over recent years suggests that this hypothesis too is just as much a broken reed as Professor Phillips’s original version.

How is it that the relationship between pay and the availability of jobs, which appeared to hold for decades, has ceased to hold? How is it that a theory applicable to all other markets now appears inapplicable to the labour market? What has changed? The answer is that what has changed is the method of raising tax revenue.

All contracts of employment in this country, with very, very few exceptions, attract taxation – PAYE, income tax, employers’ and employees’ social security taxes and, tonight if not tomorrow, the National Insurance Surcharge.[16] These pay bargain taxes drive a wedge between what an employer pays out for labour (employers’ labour cost), and what an employee receives for that same labour (employees’ take-home pay).

In the decade after the end of the Second World War, the pay bargain tax wedge contributed about a quarter of the government’s tax revenue. Today it accounts for about 50%. Worse, during the past twenty-five years the share of Net National Product at current market prices appropriated by tax revenue has increased by one half. Thus, the real burden of pay bargain taxes has increased by a multiple of three; from just less than a 7% share of the product, to near a 20% share of the product.

What has happened in the labour market is that successive governments have increased the size of the pay bargain tax wedge, until it has absorbed the whole of the difference between the most employers can afford to pay, and the least employees are prepared to accept.

As a result of this change the labour market ceased to operate as a competitive market, bringing human beings together to strike a bargain with some give and take, and began to operate the other

16 The removal of the employer’s National Insurance Surcharge was announced the following day, in the March 1984 Budget.

way round, as if it were a monopoly market with a take-it-or-leave-it fixed monopoly price determining the market conditions.

An indicator of these labour market conditions is the level of unemployment. A kind of Phillips curve relationship still holds, but it works now the other way around to that originally hypothesised by Professor Phillips.

The price of labour has ceased to be the result of a pay bargain positively responsive to the level of unemployment; today the level of unemployment responds instead to the size of the pay bargain tax wedge, and pay bargaining is a cause of discord. Note well, it is not the power of the trade unions that has created a fixed-price labour market, but the power of taxation, imposed by Parliament.

The mass unemployment that we have today is not the result of employees pricing themselves out of employment; it is the result of successive governments taxing them out of employment.

This brings me to a final economic reality for tonight. Alliance policy must take into account the fact that successive governments, by their tax policies, have created in effect a fixed-price monopoly market for labour. In turn, this underlying discordant condition is largely responsible for our relatively poor economic performance, and for the combination of the social evils of inflation and mass unemployment. A significant cut in pay bargain taxes to free the pay bargaining process is a necessary preliminary for an expansion of employment without an upsurge of inflation.

To sum up: catchy slogans, bright ideas, and visions of Utopia are the stuff of economic policy only for a party that expects to be in permanent opposition.

The economic policies of any party putting itself forward as an alternative government must first take into account the economic realities of existing conditions, for it is in these existing conditions that they will be called upon to implement policies and to resolve immediate issues. Whether or not a new government is given the opportunity to realise its visions for the future will depend upon its ability to resolve immediate issues in existing conditions.

Thus, the economic realities that Alliance economic policy must take into account are:

First, our economic system has called into being a market for labour and it is the conditions in this market that largely determine the conditions in all the other markets, and the performance of the economy as a whole.

Second, employers can offer employment only to the extent that it is profitable for them to do so given the current cost of labour and, outside of a fully controlled economy, statutory powers can never overcome the profit factor and the human factors affecting the labour market.

Third, the tax policies of successive governments have caused the labour market to operate as if it were a fixed-price monopoly market.

From these three realities it follows that the point of effective immediate action for any policy intended to expand the economy without an upsurge of inflation is a cut in pay bargain taxes. A significant cut in these taxes will change the conditions in the labour market and this will change, in turn, the conditions in all other markets and the performance of the economy as a whole.

If the Alliance is to break the mould of British politics then it must first show that it has broken the mould of fixed government thinking on economic issues. Face up to these economic realities, and it is then possible to reduce unemployment without causing an upsurge in the rate of inflation and without recourse to a controlled economy.

I welcome the intention of the Alliance to look again at its own economic policy, but a new enquiry, however well it is funded, will give value for money only to the extent that it faces up to realities and puts first things first. No government can expand output and employment without first freeing the labour market from the ball and chain of pay bargain taxes.

# 4

# Less Pay, More Jobs?

26th September 1985

Today there are in this country, and there have been for some time passed, over three million people in receipt of unemployment benefit; this means most certainly that there are over four million people who are unemployed in the sense that they would take up paid employment if it were available. We are back to prolonged mass unemployment, just forty years after the British Government accepted responsibility for maintaining, as it was put in the 1944 White Paper, a high and stable rate of employment.

The present Conservative administration has reneged on the 1944 White Paper commitment, and does not accept responsibility for maintaining any particular level of employment. It has reverted to nineteenth century economics with its claim that unemployment is largely the result of employees 'pricing themselves out of the market', on occasion with the connivance of employers. Whilst the benefits of a free market and the efficacy of free market forces are applauded, all changes in the labour market conditions during this century are ignored.

The Labour Party, being the official opposition, now assert that government is responsible for maintaining a high and stable rate of employment. They propose to cut unemployment by higher deficit government spending. This is to ignore not only changes in labour market conditions, but also the changes that have taken place in all other markets since the end of World War One. The Labour Party opt for the advice that was given out by most academic economists more than 50 years ago, to deal with the slump of the early thirties.

At that time, following a decade of falling prices, a recovery in the general price level was considered to be a prerequisite for any recovery of output and employment.

The Alliance parties, being presently in opposition also, agree with the Labour Party that responsibility lies with the government.

They propose to cut unemployment by, amongst other things, an increase in government spending, and preventing employees from ‘pricing themselves out of the market’.

This amalgam ignores most of the changing facts of economic life, and in the probable circumstances following immediately after the next General Election, it would be likely to produce the worst of all possible worlds.

Lord Keynes took into account the prevailing circumstances when formulating policy proposals, and as a result he was pilloried persistently throughout his life for changing his mind on issues of economic policy. In the New Statesman and Nation of 4th April 1941 he replied to these critics. Some of you will know the reply, but it does bear repetition.

He wrote: “I seem to see the older parrots sitting around and saying, ‘You can rely on us; every day for thirty years regardless of the weather we have said what a lovely morning, but this is a bad bird – he says one thing one day and something else the next’.”

The unchanging sayings of the older parrots serve no useful purpose in the formulation of economic policy. One may use the tools of analysis fashioned by the earlier masters, or even use those tools fashioned by the older parrots, but if those tools are used objectively, and the conditions are different, then also the policy prescription will be different; as if one applies a lighted match to a gas jet in one set of conditions, one may end up with ‘the cup that cheers’,[17] whereas in a different set of conditions one may finish up in the mortuary.

It is not in the spirit of Maynard Keynes to put forward today policies he formulated to meet the very different circumstances of 55 years ago, any more than it would be in the spirit of free market economics to put forward today policies formulated by free market economists of a century ago.

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17 A cup of tea, from the poem *The Winter Evening*, by William Cowper, 1785.

In particular, employment policies proposed for today must take into account the labour market conditions of today, and the policy is to be assessed on the facts of current experience.

Let us compare with the evidence the Treasury view, and the statement on unemployment the Chancellor[18] made in the House of Commons in October last year.

The Chancellor said: “A 1% change in the average level of real earnings will, in time, make a difference of between 0.5% and 1% to the level of employment; and that will mean, in all probability, between 150,000 and 200,000 jobs.”

The Chancellor went on to suggest: “If average earnings did no more than to keep pace with rising prices, then 500,000 new jobs could be created each year, and the effect would be cumulative.”

He then said: “If one year of pay in line with prices, instead of rising at 3% ahead of prices, eventually means an extra 500,000 jobs, two years of the same would mean 1,000,000 extra jobs, and three years would mean an extra 1,500,000 jobs.”

A talk such as this is not the place for a technical criticism of the Treasury’s method of handling statistics to produce support for their master’s policy. In any event, the Treasury view was stated clearly and concisely in the *Economic Progress Report* which they published in January 1985. The opening paragraph of that report states: “The basic link between pay and jobs is clear. If people cost less to employ, more of them will be employed.”

This Treasury view is of course nonsense. Employers can offer employment only to the extent that it is profitable for them to do so, given the current cost of labour. When creating new jobs, an employer must bear two facts in mind: the cost of labour, and what Keynes called the proceeds – that is, the net income an employer expects to receive from selling the output of that labour.

What matters to an employer is not the nominal or even the real cost of labour, but the cost of labour relative to the expected net income from employing that labour, or in other words the product

18 Nigel Lawson had replaced Sir Geoffrey Howe as Chancellor in June 1983.

share represented by the labour cost. As for an employer, so also for the economy as a whole.

At the beginning of this month the Central Statistical Office published detailed estimates showing how the economy has been performing over the last eleven years.

On the basis of these published estimates, in 1980, the first full year of Mrs. Thatcher's Prime Ministership, the average cost of labour to employers was 67.9 pence out of every pound of the net income generated in the economy as a whole. In 1984, the figure was 61.6 pence in every pound of net income generated. Over four years this is a fall of 3.7%, or close to 1% a year.

Now, if one follows Mr. Lawson's statement to the House of Commons, one might expect this fall to have generated at least an extra 800,000 jobs; but the official estimate is that from June 1979 to June 1984 the number of jobs fell by 2,000,000.

Looking back to the 1950s, the hey-day of full employment, we find that in 1955 when the total number registered as unemployed was less than 200,000 then the average effective cost of labour to employers was fractionally higher than it was in 1984.

Since, over a period of 30 years, the average effective cost of labour has only barely kept pace with growth and inflation, then, on the basis of Mr. Lawson's argument it is reasonable to expect the number of jobs to increase, yet according to the government estimate there was an actual fall. In June 1955 there were 100,000 more jobs than in June 1984.

These official estimates show up even more discrepancies if we take the period from June 1955 to June 1980. During that period 1,714,000 extra jobs were created whilst the average effective cost to employers rose by some 10%. The official estimates, it appears, are one thing, the Treasury view quite something else.

It is the Treasury view and their method of presenting statistics that has enabled Mr. Lawson to stick rigidly to his motto of 'Less Pay, More Jobs' and, in so doing, deftly shift any responsibility for prolonged mass unemployment away from government.

But if he can get away with it, why not do so? He is a politician, holding government office. It is the job of the opposition parties to confound the Chancellor with his own official estimates.

Is the opposition also inclined towards the Treasury view – that if people cost less to employ, more of them will be employed? It's a view highly supportive of those currently holding office, and the opposition aspire to that office.

Nonetheless, political knock-about apart, established economic theory does provide some basis for the Treasury view – the theory of supply and demand tells us, that when the price of a commodity falls, then the demand for that commodity will tend to expand.

This seems to accord with everyday experience, so why should not labour markets operate as do the commodity markets?

Indeed, in November 1958, Professor A. W. Phillips published a well-researched paper based on such a hypothesis, drawn from the theory of supply and demand. Taking money wages to be the price of labour, and the unemployment rate as a measure of demand deficiency, and with the base period the latter part of the nineteenth century, Professor Phillips found a stable statistical relationship between the rate of change in money wages and the rate of unemployment to hold for nearly one hundred years, through to the early 1950s.

This was the paper that gave rise to the so-called Phillips curve hypothesis. It stated: "As the rate of unemployment falls the rate of pay increase rises, and as the rate of unemployment rises the rate of pay increase falls, until at a certain rate of unemployment there is stability, and any additional unemployment results in an actual fall in money wages."

Of course, as you may have noticed this hypothesis does imply a relationship between jobs and pay to be the opposite way round to the Treasury view and to what the Chancellor fondly supposes; rather than 'Less Pay, More Jobs', it seems that Professor Phillips found that in the years prior to 1950 it was more jobs more pay, or less jobs less pay.

But no matter; the Phillips relationship was found not to hold in the conditions of the 1960s, nor has it held since, in the 1970s or in the 1980s. That the relationship ceased to hold does not denigrate Professor Phillips's research, nor does it deny his conclusions – for it could be that conditions have changed.

One changing condition, emphasised by Milton Friedman, was the post-war phenomenon of persistent inflation, which is still with us. As Friedman put it: "You cannot fool all of the people all of the time." Thus, as inflation becomes fully anticipated, he argued, pay settlements in money terms will rise in line with the rise in prices, irrespective of the unemployment rate.

In the longer run, the Phillips curve becomes a vertical straight line, determining what he called the natural rate of unemployment.

For those charged with implementing public policy, Friedman's natural unemployment rate hypothesis has a defect similar to the defect in his monetary theory. If one accepts that inflation may be squeezed out of the system by restricting the money supply then the monetary authorities must needs be informed precisely as to what this money supply is that they have to restrict.

So far the monetarist school of economic thought has not come up with a practical definitive answer. As regards the natural rate of unemployment, all that the monetarist school tells us is that over the past decade the 'natural rate of unemployment' appears to have been rising in the United Kingdom. The all important hows and whys are wrapped up in numerous additional hypotheses, such as the 'expectations augmented Phillips curve hypothesis'.

In this country we have been, for some years, on the receiving end of an interesting experiment; interesting, that is, to academics, and those not on the receiving end of its consequences.

Another change in labour market conditions, and one that is rarely mentioned along the corridors of power or in its waiting rooms, is the post-war phenomenon of imposing withholding taxes on incomes from employment, and of taxing employers for giving employment – what I call pay bargain taxation.

To understand the workings of this phenomenon we need to go back to the great grandfather of all economists, Adam Smith. Over 200 years ago he wrote: “The money price of labour is necessarily regulated by two circumstances; the demand for labour and the price of the necessaries and conveniences of life.”

Pay bargaining is, at root, much the same as any other kind of bargaining. On one side there is a buyer of labour, the employer. An employer’s demand for labour is derived from the demands for the products of that labour, and the most he can afford to pay for labour is determined largely by the net receipts he expects to receive from selling those products. As a buyer of labour the most an employer can afford to pay for the amount of labour demanded fixes the top limit above which a pay settlement cannot be agreed.

On the other side there is a seller of labour, the employee. As a seller, an employee determines the bottom limit below which an agreed pay settlement cannot fall. This is the least an employee is prepared to accept in return for supplying the amount of labour demanded by the employer; and this least is determined, in turn, by the price of goods and services the employee wishes to purchase out of his pay. As Adam Smith put it, it is determined “by the price of the necessaries and conveniences of life.”

All pay settlements must fall somewhere between these limits – determined at the top end by the most an employer can afford to pay for the amount of labour demanded, and at the bottom end by the least an employee is prepared to accept in return for supplying that amount of labour. The precise point between these limits at which the bargain will be struck depends on the bargaining skills and the bargaining power of the two parties.

Thus, given a relatively free and competitive labour market and a stable general price level, Professor Phillips’s relationship can be expected to hold. When labour is much in demand the bargaining power will swing in favour of employees and pay settlements will tend to rise. In a slump, the bargaining power will swing in favour of the employers and pay settlements will tend to fall.

The Phillips curve hypothesis will apply for just so long as the necessary conditions are fulfilled.

Given a relatively free and competitive labour market, but in times of fully anticipated persistent inflation, Milton Friedman's hypothesis is likely to fit the case. As prices in general rise then the most an employer can afford to pay will also rise, and as the prices of consumer goods rise then the least employees are prepared to accept will rise. If both the top and the bottom limits constraining the pay bargain are rising it is to be expected that pay settlements will also rise, irrespective of the rate of unemployment. Friedman's hypothesis will apply for just so long as the necessary conditions are fulfilled.

If government interfere with the pay bargaining process through their methods of raising tax revenue, then both these hypotheses break down, for the simple reason that the necessary conditions are no longer being fulfilled. When governments impose some form of payroll tax, such as employers' National Insurance contributions, or the now abolished Selective Employment Tax, and the National Insurance Surcharge, the impact effect of the tax is to increase the cost of labour to the employer by the full amount of the tax. At the next pay round, the payroll tax will then operate to reduce by the full amount of the tax the most that employers can afford to pay their employees in return for any given amount of labour.

When governments impose withholding taxes on employees' pay, such as PAYE, income tax, or employees' National Insurance contributions, then the impact effect is to reduce the employees' take-home pay by the full amount of the withholding tax. At the next pay round the employees will take the withholding tax into account, and the least they are prepared to accept will be increased by the full amount of the withholding tax.

The Economic Study Association has drawn attention to this in a number of papers and recorded talks, and even the Organisation of Economic Co-operation and Development (OECD) now admits that net of tax wage bargaining is the norm.

Thus, sooner rather than later, from both sides pay bargain taxes squeeze the room for manoeuvre between the employers and the employees, and so make for friction, industrial disputes, and loss of output. Far worse, as pay bargain taxes are increased, a point is eventually reached when there is no room for manoeuvre left, and the burden of payroll taxes causes the most employers can afford to pay for any given amount of labour to press hard upon the least their employees are prepared to accept in return for supplying that amount of labour, which has been inflated by withholding taxes.

When this point is reached a fundamental change occurs in labour market conditions. The labour market ceases to operate as if it were a free market and begins to operate instead as if it were a fixed price monopoly market, with the effective fixed market price determined not by market forces, but by a majority vote in the House of Commons agreeing to the level of pay bargain taxes.

Indeed, in the present case of the teachers,[19] it would appear that the least employees are prepared to accept is well above the most their employers can afford to pay. So long as that is the case there can be no agreed settlement; the difference, however, between the teachers and their employers is insignificant compared with the payroll and withholding taxes the central government collect from both sides. For a settlement of this dispute it is not necessary for government to make more taxpayers' money available, providing they stop taking so much away in the first place.

These are the circumstances brought about by the tax policies of successive governments. Rising unemployment is not something new that has come in with Mrs. Thatcher – it has been a feature of the British economic scene for 25 years or more.

Statistical investigation of the United Kingdom economy shows that the post-war phenomenon of pay bargain taxes now accounts for some 50% of central government tax revenue. This post-war phenomenon of pay bargain taxes has caused the original Phillips curve to be replaced by a kind of reversed Phillips curve.

19 A series of teachers' strikes was taking place across the UK throughout 1985.

One can forget about take-home pay and labour costs, for it is now the rate of unemployment that is switched over from being the independent variable to the dependent variable, and pay bargain taxes now take the place of unemployment as the independent, or causative, variable.

As pay bargain taxes are increased then, in line with a stable curved linear function, the rate of unemployment rises some 12 to 15 months later. On those rare occasions when pay bargain taxes have been reduced for a time, then in line with the same function, the unemployment rate has tended to fall, or at least, not to rise as fast, some 12 or 15 months later.

Over the past 25 years unemployment in the United Kingdom has increased by a multiple of 13 – for every person unemployed in 1960 there are about 13 unemployed today. During this time the pay bargain tax approach explains some two thirds of the increase in unemployment. The longer governments pursue these disastrous tax policies, the more prolonged will be mass unemployment and the more difficult it will be to eradicate this particular social evil.

We're now in the midst of the micro-chip revolution – excellent past experience shows that similar technological advances lead in total to more rather than less jobs. Today, however, the weight of taxes imposed on employing people is misdirecting this particular breakthrough, by placing a premium on labour saving investment, and encouraging the destruction of one existing set of jobs whilst preventing the creation of other jobs. Once firms have invested their capital fund then that investment lasts a long time and is slow to respond to changes in tax policy.

It was no accident that a surge of investment in new self-service shops followed upon the imposition of Selective Employment Tax in the late 1960s by Chancellor of the Exchequer, Mr. Callaghan.

There was a time when the bosses of many retailers had started out as errand boys, but this is no longer a possibility. The bottom rungs of that particular ladder have for some time been knocked away by higher levels of taxation.

Today pay bargain taxes have knocked away the bottom rungs of most of these ladders, and as a consequence the youth of Britain languish in idleness, relieving their boredom from time to time by creating civil commotion or worse.

Whether or not governments should still be held responsible for maintaining a high and stable rate of employment is one issue.

Whether or not governments are to be held responsible for the mass unemployment of today is a different issue.

In the former case there is room for differences of opinion, but in the latter case there is none. The evidence leaves no room for reasonable doubt that it is the methods by which our successive governments have raised public revenue that is, in this country, the cause of a major part of mass unemployment today. The method of raising public revenue is wholly the responsibility of government.

It is not a case of people pricing themselves out of a job; it is a case of government taxing them out of their jobs. Yet, in political circles, it is still being mooted today that the domestic rates should be abolished, and be replaced by a local income tax; that regional governments should be set up, financed by regional income taxes; and so on. In practice, these additional income taxes would mean additional withholding taxes on employees' pay, and the result of such increases in present conditions would be disaster.

They may seem good ideas, and they may initially be calculated to win votes, but the methods proposed to finance them must cause unemployment to rise even further.

At present, mass unemployment here in the United Kingdom is without doubt the responsibility of government, for a major part is the direct result of ill-conceived tax policies pursued by successive post-war governments, continued by this government, and which the opposition parties propose to continue if they are successful in their bid for office.

The eradication of the social evil of mass unemployment is not an issue about what more government should be doing – it is about what the government is doing, and should stop doing.

If political parties wish to pursue their bright ideas, and at the same time eradicate the social evil of mass unemployment, then they must first find other ways of raising public revenue, and then, before anything else, make use of that public revenue to abolish pay bargain taxes.

The facts of experience show that this must be the first step from where we are towards a just and prosperous Great Britain.

# 5

# Rate Reform

20th January 1986

The financing of local government from local revenues has been a topical political issue for a hundred years or more. There have been Royal Commissions, Committees of Enquiry, White Papers, Green Papers, and so on and so forth, but never a solution.

Whenever central government has been goaded into action, the result is that it has made things worse. Mostly central governments have attempted to bribe the ratepayers by handing over to local government ever increasing amounts of the moneys collected from national taxpayers. This process has eroded both local financial responsibility and local independence.

In 1912 Professor Cannan, himself a local councillor, wrote in his book *History of Local Rates in England*: “A few months ago a distinguished continental professor, who had been commissioned by his government to enquire into local taxation abroad, assured me that he, like others, had been brought up in the belief that England was the home of local self-government, but that he found we enjoyed less of it than any other country he knew.”

This judgment was confirmed by reports for a Congress of the International Union of Local Authorities held in Rome during 1955. These reports showed that local government in this country had far greater financial dependence upon central government and enjoyed far less freedom and autonomy than did local government in other comparable countries. Today, some thirty years on, the freedom and autonomy of local government together with its financial responsibility are very near to vanishing point – using the national taxpayers’ money to pay the piper, the men from central ministries call the tune, and the localities must dance to that tune. Is there then an alternative to the present drift?

If, in this modern world, it is not possible for a country with a geographical area as small as that of the United Kingdom to sustain its local government, by providing an independent local revenue sufficient to ensure an acceptable measure of freedom and autonomy with local financial responsibility, then should we not give up the struggle against centralisation and accept that local government must be, and must be seen to be, no more than a local agency financed wholly from central funds? Indeed the point has been reached where if it is not possible to move towards the one goal then we must move towards the other.

Is it possible to provide a local revenue sufficient to sustain a truly local government that is responsible to its local electors? The answer to this question turns on the possibility of reforming the present rating system. In this country the term ‘rates’ has come to signify a form of property tax used exclusively for local purposes, and when we look around the world at comparable countries we find that all their local authorities rely upon some similar form of property tax. It is possible to raise additional local revenue by a variety of methods and many localities in other countries do just this but always some form of tax on real estate is the major source of income. In the United States, for example, property tax revenues account for 90% of total local government tax revenue and form a larger proportion of total general tax and revenue – federal, state and local – than does the revenue from rates in this country.

It is not surprising that a property tax revenue should be so important in the nature of things. The income we receive may be generated anywhere in the world, and the goods we buy with that income may be bought and produced anywhere in the world, but a freehold property is truly local and cannot be moved from its given locality. A freehold is the natural base for a local revenue. So let us consider the main objections raised to present rating system, and whether these objections can be met by reforming the system.

The first objection, and one of major concern to politicians, is the fact that the electorate seems to consider rates to be the most obnoxious of all methods of taxation. With their eye on collecting votes as well as revenue, politicians therefore quietly prefer what Professor Taussig[20] has called "the cynical principle of taxation."

He explained this, being a Harvard man with a homely turn of phrase, as "plucking the goose with the least squawking possible."

Maybe a majority of the electorate would prefer taxes to be extracted under a complete anaesthetic but be wary of the 'cynical principle' – it obscures a very slippery slope. In this country our democratic freedoms rest upon the foundation that many centuries ago our forefathers objected to the use of taxation and successfully demanded a forum in which they could give assent to the raising of any extra-ordinary revenue of this kind. Having obtained this, they went on to gain control over the spending of that extra-ordinary revenue.

Let us not trade our birthright for an anaesthetic. There is no such thing as a good tax and so it is good that rates are considered newsworthy; it is good that any increase in rates usually calls forth vociferous objections from ratepayers. All this keeps politicians on their toes and helps to sustain our democratic freedoms.

A second objection is that rates are a regressive tax and that the twice yearly rate demand presents difficulties for ratepayers, especially those from lower income groups. Admittedly the Allen Committee showed conclusively[21] that when related to household incomes rates are a regressive tax, but even so they found it hard to find actual cases of hardship directly attributable to rate demands.

In any case, that a particular tax is regressive does not mean that it has no place in a general tax system that is either proportional or progressive in its incidence. Moreover, the regressive incidence of the domestic rates is greatly accentuated by the current method of valuation, which results in most domestic rateable values being far higher than they should be relative to non-domestic valuations.

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20 In *Principles of Economics*, vol. 2. Taussig was a Professor of Economics at Harvard. A similar quotation is generally attributed to Jean-Baptiste Colbert.

21 Report of the Committee of Inquiry into the Impact of Rates on Households (Chairman: Professor R. G. D. Allen.) H.M.S.O. London, Cmd. 2582, 1965.

This is admitted by central government and, since 1967, it has spent an ever increasing amount of national taxpayers' money by way of grants and subsidies specifically directed towards reducing the rates of householders – a case of robbing Peter with one hand, to pay that same Peter with the other. These are cosmetic measures by which successive governments have avoided implementing the solution – a change in the basis of valuation.

A further factor which results in rates bearing relatively more heavily on domestic ratepayers than upon others, is that private households must pay their rates from their taxed income, whereas for others in the case, the rates are a tax-deductible expense. The Chancellor could attend to this in his next Budget – but he won't.

The shock of the twice yearly rate demand is simply a matter of administration. Some progress has been made to reduce the shock; more could be done. Those who advocate replacing domestic rates with a local income tax intend to collect it by way of withholding the tax from employees' pay. Where the ratepayer is agreeable, the same could be done with domestic rates. One figure may be fed into a computer just as easily as any other figure.

A third objection to the present system is that its tax base is too narrow, but this is not something that is inherent in the system.

The narrowness of the base is the outcome of successive central governments reacting to powerful pressure groups by granting the privilege of either not paying rates, or of paying less than is due.

When central government create privileged groups in respect of the payment of rates then automatically they also create an under-privileged group. If some pay less than is due then others must pay that much more than is due. To meet this particular objection, it is not the rating system that needs to be abolished, but the legislation creating privileged groups.

Some press this objection further, claiming that rates are levied only upon the owner or tenant of a property. Whilst this is so, it is also true that any tax upon expenditure affects only a proportion of the population so far as its formal incidence is concerned.

That the duty on beer is levied only on the brewers of beer does not mean that the beer drinker is unaffected by the tax. Further, the price of beer affects wage demands, and so in turn the prices which most of us have to pay, beer drinkers or not, for the things we buy.

In the case of rates we all occupy space in a particular locality, some in more than one locality, and the charge we have to meet in respect of any space we occupy takes into account rates along with many other taxes, for when we buy any goods or services the seller will have included the rate demand when fixing the price, in just the same way as with VAT, or a local sales tax, or any other tax.

A fourth main objection to the present rating system was clearly set out in a government white paper, published in February 1966.[22]

This stated: "Moreover rates lack a natural buoyancy; the yield of income tax or purchase tax grows automatically as incomes or sales increase, but rating assessments do not adjust themselves to rising values. Between re-valuations the rate in the pound at which rates are levied has to be increased almost every year to keep pace with rising expenditure, and when re-valuation does take place the resulting shifts of burden are resented by the ratepayers who find themselves paying more."

This objection amounts to no more than our central government expressing a preference for the cynical principle of taxation and attempting at the same time to cover up its own failures. Before the Second World War the job of revaluation was carried out at regular intervals by local government. The result was that until 1939 rating assessments, in total, kept in step with local spending and changes in the value of money. After the war, central government took the job away from local government and gave it instead to a central government department – the Inland Revenue. Since then, during the past forty years, there have been only two full revaluations in England and Wales; one in 1963, and one in 1973.

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22 In para. 3 of *Local Government Finance – England and Wales* (Cmnd. 2932) One of two white papers issued prior to the Local Government Act of 1966; the second white paper dealt with Scotland only (Cmnd. 2921).

Nonetheless, these full revaluations showed that in total, rating assessments did keep in step with both rising prices and rising local government spending. This need be no cause for surprise, for it is common knowledge that a freehold property is a good hedge against inflation and, to the extent that local government spends responsibly, then the resulting improvements in local services will be reflected automatically in the assessments for rates.

If however the central government did its job of revaluing at regular intervals, and also made an annual adjustment for inflation, a matter of pressing a few buttons in this computer age, then all the evidence suggests that rating assessments would have a buoyancy greater than unity. This means that over successive years the local rate poundage would tend to fall.

A fifth objection is that rates as at present assessed are a tax on development. This is a valid objection, but it too can be remedied easily enough by excluding development from the valuation.

At the time of the 1963 revaluation the Rating and Valuation Association, a professional body, carried out a pilot survey[23] which excluded development from assessments for rates. They found that not only did their results give a more equitable spread but also, by either route, the total assessments in the given locality were of the same order of magnitude.

Sixth, and finally, is the objection that there is today insufficient evidence to carry out a full revaluation on a strict rental basis as at present required by Act of Parliament.

Again this is a valid objection, but again it is one that can be remedied easily, and with advantage, by enacting a change in the basis of valuation. What Parliament enacts Parliament can change.

There may be little evidence readily available today of open market rents for domestic property, but there is ample evidence of open market capital values, and it is a matter of simple arithmetic to translate these capital values into an annual income.

23 *Rating of Site Values: Report on a Pilot Survey at Whitstable*. H. M. Wilks, for the Rating and Valuation Association, London, 1964.

I trust I have said enough now about the main objections to the present rating system to show that some of these objections are on closer inspection misguided or wholly invalid; others result from the failure of central government to fulfil its statutory obligations; and, of the remainder, some could be resolved by administrative changes, whilst even the most fundamental could be resolved by changing the basis of valuation. Let us then consider the reform of the present system.

At the turn of the century Alfred Marshall, then the Professor of Economics at Cambridge and acknowledged today as one of the chief founders of the neo-classical school of economic thought, argued that the market price of a freehold property was the sum of two distinct parts.

One part can be traced directly to the work and outlay of the actual individual holders or occupiers of the property and this part he called ‘private value’.

For example, if a farmer is a good cultivator, erects good farm buildings, puts in an efficient drainage system and so on, then the market price of that farm will be that much more than it would have been otherwise. Similarly, if a developer builds a good and pleasing building on a site then that property will sell for a higher price than if he had jerry-built. If a landlord keeps his property in a good state of repair then his property will be worth that much more than if he allowed it to fall into decay. Again, if a householder improves his home, installs central heating, and creates a pleasing garden, then the market price of his property will be much more than if he had not carried out the improvements.

All such enhancements of the market price of freehold property that resulted from the work and outlay of the individual, Marshall included within private value, and this private value, he argued, is not different in kind from what, in business terms, is commonly considered as private profit. From an income point of view private value gives rise to what is properly private income – the return to the work and outlay of private individuals or firms.

The other part making up the total market price of a freehold property is, according to Marshall, largely or entirely the result of the work and outlay of people other than those who are holding or occupying the property. This part he called ‘public value’.

He instanced the case of some barren heath land that becomes valuable from the growth of an industrial population nearby, even though, as he wrote, “its owners have left it untouched as it was made by nature.”

This public value, argued Marshall, depends upon the situation of the property. On this point he wrote: “If in any industry, whether agricultural or not, two producers have equal facilities in all respects, except that one has a more convenient situation than the other, and can buy or sell in the same market with less cost of carriage, the differential advantage which his situation gives him is the aggregate of the excess charges for cost of carriage to which his rival is put.”

Marshall went on to give many other instances, all of which, when added together and translated into money values, give the total money value of the advantage of one situation over another. Mostly these advantages of situation flow from the availability of what today we call public goods and services.

From this Marshall concluded the public value, or site value, of a freehold to be beyond the control of the owner or occupier of that freehold. It is not the use or development of a particular site that determines its public value; but public value determines the margin of profitable private expenditure at any particular site.

As private value gives rise to private profit or private income, so public value must give rise to what is properly public revenue.

If local rates were to be levied on the public value then the local authority would be collecting a revenue generated by the locality for which it is the public authority. In this case, local rates would not be a tax in the strict economic use of that term, for there would be a direct ‘quid pro quo’. The amount paid by a ratepayer to the local authority would bear a direct relationship to the advantages received by that ratepayer in return. In effect, the ratepayer would be paying to the local authority the current market price of all the advantages being made available to him by the locality.

This solution to the levying of rates should appeal to the present administration, who are forever extolling the benefits to be derived from the free play of market forces.

The question to be answered now is whether it is a practical proposition to assess public value for the purposes of levying a local rate?

The people to answer this question are the professionals who would be required to do the job, and their answer is: 'Yes, it is a practical proposition, for we do that job every day for our private clients. The pilot survey in 1963 – conducted by our professional body, the Rating and Valuation Association – was in effect the assessment of what Alfred Marshall called public value. Not only is it possible, but it is easier to assess public value than to assess rental values as required by the present rating system. Further, it is a simple matter to keep a register of public value up-to-date, even annually if needs be.' So speak the professionals.

How would such a reformed rating system answer the main objections to the present system that were outlined earlier?

As regards the first objection ratepayers might not like paying their rates any more than they do now, but who can honestly and justly object to paying the current market price for the benefits and advantages received? Local councillors would be kept on their toes for they would need to adjust their spending to their revenue, and this revenue would be determined, in turn, by the extent that local government spending met the needs of their localities. Thus, local councillors would be subject to the same financial disciplines as the rest of us, and this can be no bad thing.

The second objection is met also, for the regressive nature of the present system would be greatly reduced, if not eradicated, by a more equitable spread of assessments, and by the same token, the excessive burden on householders would vanish.

The central government would no longer need to spend national taxpayers' money on grants and subsidies to reduce domestic rates, and this should appeal to the national taxpayers, to the Chancellor, and to the would-be Chancellors.

Providing central government abolished the legislation which has created privileged groups of non-ratepayers at the same time that new valuation lists were enacted, the base of the rating system would be as wide as possible, and the third objection is met.

The proposed system would meet the objections put forward in the White Paper of 1966, for rates would have a natural buoyancy. Public value moves in step with public expenditure and freeholders over the past forty years know as a matter of experience that public value keeps pace, and more, with the rate of inflation.

Again the new rate would not be a tax on development since all of the development carried out privately, and paid for privately, would automatically be excluded from public value.

Finally, the professionals assure us there is sufficient evidence for them to assess public value for rating purposes, and that it is a much easier task than is demanded by the present system.

So it is possible to reform the rating system in a way that will not only meet the objections to the present system, but will result also in a just and equitable method of financing local government in these small islands, and in a manner that should appeal to the present government, who pay much lip service to the free market and its financial responsibility.

In these days of high unemployment, especially amongst young people lacking work experience, one by-product of an assessment of public value is worth noting. When making assessments in any local area the professional assessors can with advantage make use of a considerable number of numerate but otherwise inexperienced field-workers. Young people could be offered work experience in their own localities, whilst reducing the net cost to the central government of preparing the new valuation lists – for one way or another, taxpayers' money has to be used for their support.

We have been warned; the government have stated that the introduction of additional new local taxes is to be an issue at the next General Election, if not earlier. We have also been promised that the government proposals will be made well in advance of any legislation – with a further Green Paper possibly before the end of this month – and no doubt the opposition parties will follow the government's lead by publishing their own proposals.

Already party spokesmen have been, as it is said, flying flags. It would seem that there is some agreement amongst politicians on the promise to abolish domestic rates and replace them with other methods of taxation. In particular, flags have been flown for a local income tax, and for a poll tax on every person over the age of 18.

In other words, the party politicians are not seeking, it seems, a solution to a public issue that has been the subject of public and private enquiries for more than a century. Rather, they are seeking new ways by which they may step up the plucking, and at the same time reduce the squawking.

Do not rely upon the 1971 White Paper on the Future Shape of Local Government Finance, which stated the central government's view to be: "The objective of new local taxes is not to increase the overall level of taxation; it is to find a means by which a greater part of local authority expenditure can be met out of income raised locally by the authorities themselves, and a correspondingly smaller part therefore met from government grants paid for out of national taxation." These are fine words, but what do they signify?

Experience tells us new taxes mean more taxation. Remember, we are all the geese they intend to pluck. There is, however, as I have outlined, an alternative to local taxes. If you do not wish to be the subject of further plucking, with or without an anaesthetic, then the time to squawk is now.

# 6

# Economic Recovery

22nd November 1994

When I was first approached about attending this conference it was suggested that I might speak during ‘a tax reform session’.

Upon receiving my official invitation I found I was being billed to speak on ‘The International Experience for Recovery’ – a good, wide definition allowing plenty of scope, but it raises insuperable difficulties.

Both history and experience tell us that every so often slumps happen, sometimes as a direct result of government action, but equally for reasons that cannot be explained. After a time, recovery sets in, possibly followed by a boom, which in turn is followed by another slump, and so on *ad infinitum*.

Many theories are put forward which hold until rejected by a more compelling theory. In all these ups and downs, and as decade follows upon decade, governments appear to be at the mercy of the economic elements. So what lessons can be learned for Greece, or for any country?

Earlier this year, I published a book called *Public Revenue without Taxation*. To those who have not thought too deeply about public finance issues, such an aim may appear to be an excursion into cloud-cuckoo-land rather than a conclusion from a lifetime of economic study. At least, that seems to be the reaction of most politicians, businessmen and with few notable exceptions, the view of acknowledged leading economists.

Greece is now part of the European Union. In relation to the whole Union it is, from the very nature of its position, a peripheral region and as such suffers from all the economic disadvantages of those regions located on the outside edge of a continental customs area.

Thus, those who live, work and earn their living in Greece need, and are led to expect, economic help and subsidies from the more central and prosperous regions of the Union. The economic help and the subsidies, if properly used, should do much to assist local prosperity and Greece's own economic recovery.

But there is a darker side to this. The European Union is at root a continental customs union, and such a union automatically works to the general economic advantage of its central region and to the disadvantage of its peripheral regions. Thus, without financial help from Brussels, joining the European Union is likely to work to the economic disadvantage of Greece.

Of course, local businesses like subsidies and financial help from outside, for it improves their competitiveness; governments like outside help for it is a way of reducing their local taxes.

However, the European Union has no revenue of its own from which it may make payments to its outer regions. Its income is made up of taxes, tariffs and other collections from its member countries which work to the restraint of trade. This fund is limited.

The only net contributors to the European Union are Germany and the United Kingdom – the other members already take out more than they pay in. Remember, geography has not placed the United Kingdom in the economic centre of the European Union but it is itself an offshore island with large areas as much in need of assistance from Brussels as is Greece.

If the European Union is ever to play any part in the economic recovery of both Greece and the wider continent then it must cease to be a continental customs union, and begin to collect a public revenue that is particularly its own.

What Greece and the other peripheral regions of the European Union need for their economic recovery is true free trade – what business men call a level playing field – not a so-called common market half strangled by taxes, tariffs and similar regulations in the restraint of trade. This issue of free trade now brings us directly to a mistake common to all developed trading communities.

The fundamental question is never asked. What is taxation? For most people tax revenue is understood as a synonym for public revenue and accepted as a kind of necessary evil. Politicians rant about high taxes or low taxes while, in the United Kingdom today, the political buzzword is 'fair taxes'. High taxes are bad, low taxes are good, and fair taxes are, I suppose, like a seductive blonde. But what are they talking about?

The question is never asked and so no answer is proffered. Let us investigate. If we are going to talk about something like taxes it is as well to know what it is we are talking about.

The national income of a country, or to give the internationally agreed and precise title, the Net National Product at Market Prices, may be divided into distinct parts.

First, there is 'disposable income from employment', or take-home pay; that is, the after-tax private income one receives from working which is available to purchase all the goods and services those workers and their families need. Second, there is what I call 'disposable property income'. I call it disposable property income as it is not received as a direct result of working, but as a private income resulting from property already owned, such as savings, investments, land, company shares and so on.

Both of these private incomes, according to John Stuart Mill, the 19th-century philosopher, are private property. Mill admitted in his *Principles of Political Economy* that 'the laws of property have never yet conformed to the principles on which the justification of private property rests'. The essential element of these principles, he wrote 'consists in the recognition, in each person, of a right to the exclusive disposal of what he or she may have produced by their own exertions, or received by gift or fair agreement, without force or fraud, from those who produced it'.

But now, if we accept that the property from which we may receive a private income was obtained by gift or by fair exchange: what then of government? Where is the public revenue from which government may cover its necessary expenses?

Having failed to make any arrangements for collecting what is truly the public revenue, governments throughout the world have fallen back on the easy road and imposed taxation.

They appropriate by the threat of law, if not actual force, what is produced as private income – income from employment, as well as property income. In the United Kingdom today tax appropriates between 40 to 50 percent of what is produced as private income.

What then is taxation?

Hugh Dalton, a Reader in Economics and later a Chancellor of the Exchequer in the post-war Attlee government, wrote what for years was a standard work called *Principles of Public Finance*. In this work he wrote: 'A tax is a compulsory contribution imposed by a public authority, irrespective of the exact amount of service rendered to the tax payer in return, and not imposed as a penalty for any legal offence'.

This is a good definition by a practical expert which has stood the test of time, but it misses one vital point. Although not legally an offence, taxation is itself an offence persistently perpetuated by governments throughout the world against the most fundamental principles of private income and property.

In total as much as one half of what is produced as private income is thus appropriated by government without any attempt to render to an individual an exact amount in return. There may be a macro-economic argument for using taxation but there is no micro-economic justification. Put bluntly, it is robbery, albeit legalised stealing.

This government stealing automatically inflates, to use the terms of John Maynard Keynes, the aggregate supply price curve.

In non-Keynesian language, it inflates the total supply costs of individual firms. The inflation of these total supply costs inevitably raises prices, causes inflation, restricts output and employment, and thereby causes widespread unemployment and poverty.

In other words, inflation of the aggregate supply price by the use of taxation is the root cause of the malaise which has become endemic in our trading economies.

Subsidies or other transfers of government tax funds offer no solution. More spending by government requires more taxation, and so the last state is worse than the first. One cannot have fair stealing, and so fair taxation is nonsense. It may be the kind of nonsense we have come to expect from politicians, even from the press and many economists, but let not Greek businessmen be fooled by such weasel words. All taxation is effectively an income tax. It operates by the legalised stealing of some part of a person's private income. One cannot make stealing fair. One cannot reform stealing; the only solution is to stop it – to change the law.

If Greece and other members of the European Union are to set out along the road to a sustained economic recovery then we must first uphold the principle of private property and set out along the road to the abolition of taxation.

To speak of the abolition of taxation raises immediately the question: How is necessary government spending to be financed?

This is a question which orthodox economists do not ask; nor do they proffer an answer. Search the established literature of this twentieth century and you will not find the issue even discussed.

This is palpable ignorance on the part of the modern orthodox economists. Go back to the last century, or earlier, to read Henry George, John Stuart Mill, the Physiocrats and so on, even back to early Chinese civilisation – in these works you will find out much about what constitutes true public revenue, as distinct from mere taxation.

Even the British Constitution, which has an unbroken history of over a thousand years, does not allow for the subjects of the Crown to be taxed. In the annual Finance Act that is passed every year by the House of Commons we are required to make only so-called 'gifts' to the Crown; unfortunately for the subjects a rider is added that these 'gifts' may be collected by the force of law as if it were a debt. Such is the way through constitutional fictional. Nonetheless, the old notion that a tax is an anathema to a free people remains.

However, though constitutional fiction may be both interesting and helpful, let us return to the actual world in which we live.

The ideas expressed by Henry George, Mill, the Physiocrats and others, though interesting and worthy of much more research, are not directly applicable to a modern trading economy.

More applicable to our day and age is the more recent work of Marshall, a former Professor at Cambridge who is acknowledged as one of the founders of neo-classical economics.

In his *Principles of Economics*, Marshall made a distinction between what he called ‘private value’ and what he called ‘public value’. Private value is the value produced by the work and outlay, by an owner or occupier, directly upon the property he owns or occupies for the time being. He has produced and financed it, so, in accordance with the principles of private property, it is his own, and may be disposed of in accordance with the law without force or fraud.

Any income generated by principles of private property is likewise a private income. Thus, any attempt to tax private income is an offence against the fundamental principle upon which private property rests.

Public value, in distinction, is the value produced by the work and outlay of public authorities, or by the general public other than directly upon the property which they own or occupy. Any income produced by public value is, in accordance with the principles of property, a public income, and it should be collected by the public authorities as a public revenue to defray their public expenses. This is not a matter of right, but a matter of a duty which public authorities persistently ignore.

Having in theory reached a conclusion as to the real distinction between private income and public income which, when collected by the appropriate public authorities, constitutes public revenue, this investigation leads to a further question – can public value be assessed so that the public revenue could be collected by the public authorities?

This is a question which properly trained assessors can and do answer, and have answered, in many parts of the world.

In Denmark, for example, the equivalent of public value is assessed and published annually, although the government fails to proceed to a full collection. In other countries, including the United States, South Africa, Australia and so on, many localities assess public value and collect some part of the public revenue as a local public income. Thus the professional assessors demonstrate that it can be done, although the full collection of public revenue does require the active political and legal backing of the central government. Professional assessors demonstrate their ability: what is lacking is the political will.

To sum up, it is good that all countries of this continent should work together in co-operation and in peace. The European Union is a great first step but while there are advantages there are also economic disadvantages, and it would be foolish for a peripheral region such as Greece to rely on cash hand-outs from Brussels to stimulate a sustained economic recovery.

Our difficulties, such as high inflation, unemployment, and poor living conditions, stem directly from total reliance upon taxation as the source of public revenue. Recognise taxation for what it is; get rid of it, and then Greece can look forward to a future of justice, freedom and prosperity.

This talk may not have been quite what you expected. For that expectation you should call upon a hack politician rather than an economic research worker. However, I trust you now know what taxation is and why it must be abolished. This is not a panacea but a long road with assured results. The knowledge and the expertise are available. It is up to us to provide the political will. This is the only sure way towards economic recovery.

This is the lesson for Greece and for any other country.

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