

Deadweight, Homelessness and Budgetary Responsibility

The UK's Office for Budget Responsibility is charged with assessing the financial performance of Parliament and government. To enhance the outcomes of legislation, to improve the health and wealth of the nation, the way in which the OBR and HM Treasury assess the impact of financial legislation needs to be improved.

Impact studies placed before Parliament, which purport to evaluate Bills with tax raising and spending provisions, are inadequate. In some cases, they defeat the intention of Parliamentarians – improving people's wellbeing. Problems stem, in part, from the defective way in which the impacts of taxes are evaluated.

Goals are defined, for example, in the statement in the National Planning Policy Framework (2019). This asserts, on page 5, the intention

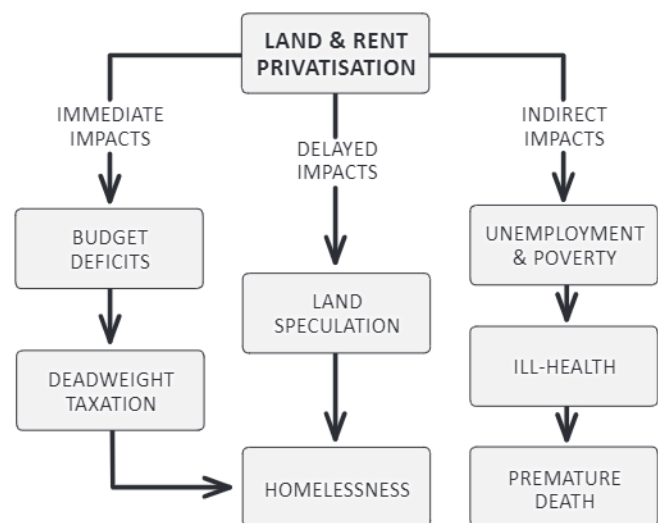
to support strong, vibrant and healthy communities, by ensuring that a sufficient number and range of homes can be provided to meet the needs of present and future generations; and by fostering a well-designed and safe built environment, with accessible services and open spaces that reflect current and future needs and support communities' health, social and cultural well-being.

Laws enacted by Parliament, however, routinely undermine such aspirations. How?

Fiscal policies routinely transmit what economists call "deadweight losses" into communities. These losses are due to the "excess burdens" that flow from the way revenue is raised or spent. This is not intentional, but law-makers are routinely misinformed by not being told about the overall impact of their laws. The trail from fiscal policy to (say) homelessness, or the unaffordability of homes, is shrouded by misunderstandings. There are, in fact, three routes along which we can "follow the money" to the deadweight burdens on the population (see figure). Those burdens fall hardest on families with the lowest incomes, who are least able to evade the feedback effects from legislation.

Revenue-raising policies exist which do *not* inflict deadweight losses. These policies are not the subject of this note.

Deadweight burdens fall hardest on families with the lowest incomes



Source: Fred Harrison, Ch. 5, *Free Riding* (forthcoming)

The first step is to secure maximum information on the costs and benefits of existing revenue raisers, so that Parliament can evaluate all of the possible revenue options.

Flaw in the Methodology

HM Treasury employs a flawed technique for measuring the impact of a proposed fiscal policy. This methodology understates the impact of Bills brought before Parliament.

Calculations of the financial impact of legislation are based on the *marginal* outcomes, by measuring the cost/benefits added to the existing fiscal system. The chancellor, in his annual budget, fails to offer Parliament the overview of the extent to which all of the revenues affect the economy and society.

The present author's central forecast for the losses of wealth and welfare within the UK is of the order of £500 billion every year (see box). Such information is not disclosed to Parliament. Instead, HM Treasury merely

calculates (if it bothers to do so at all) the *marginal* effects of proposed changes to the way revenue is to be raised or reduced.

If, for example, in his annual budget, the chancellor proposed to raise the rate of income taxation by 1p in the £, Parliament is informed of the “behavioural effects” of that 1p change. *There is no public record of the total impact of the Income Tax.*

Calculating deadweight

If the deadweight taxes were replaced with charges on Rent, the four nations of the British Isles would enjoy additional wealth and welfare worth £500 bn a year. This is based on a ratio of 1:1. For every £1 raised by deadweight taxes on earnings and consumption, the distortions to people’s behaviour result in a reduction of production by a further £1.

In response to a Freedom of Information Act request, HM Treasury reluctantly revealed that the ratio of deadweight they used was 0.3:1. This is a trivial ratio which, in 2019, nevertheless translated into a loss of about £150bn! So even if the Treasury can be relied upon to give an honest account of the impact of its revenue-raising policies, the UK lost a sum that far exceeded what ought to have been spent on hiring the additional teachers, nurses and policemen who were needed to deliver efficient public services.

* Fred Harrison (2006), *Wheels of Fortune*, London: IEA, pp. 30, 43-44m 155, 165. Pdf available from <https://iea.org.uk/publications/research/wheels-of-fortune>

This methodology may be illustrated by the donkey working on the site of an Indian brick kiln. The donkey is emaciated and burdened with a pile of bricks which it has to carry to a building site. The owner is invited to add one further brick to the load. He considers what the effect would be on the donkey if that extra brick was loaded on its back. Would that additional brick slow up the donkey’s progress to the building site?



How much time would be lost? Would the cost of that extra transport time be more than offset by the increased value to be derived by speeding up the completion of the building?

Omitted from this reasoning is information about the overall welfare of the animal that lumbers under the load it is already carrying.

What compassion?

If compassion is to be injected into law-making as a matter of routine, the benefits should be available to everyone. At present, the compassion that parliamentarians bring to law-making is piecemeal: by patching up the problems that have been brought to their attention. A new approach to the public’s revenue system could routinely inject compassion into the law-making system.

A Short Bill

To achieve equity, the fiscal system needs to be restructured. The first step, however, is to empower legislators to discuss fiscal policy on an *informed* basis.

A short Bill is needed which instructs the OBR to comprehensively audit HM Treasury’s fiscal policies. That Bill would commission an annual assessment of ALL of the costs and benefits of the policies administered by HM Treasury.

Armed with the baseline information, annual revisions would be easy: adding or subtracting the effects of marginal changes as proposed by each budget or Bill.

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