Debt Death and Deadweight
CHAPTER 2

Death and deadweight taxes

Fred Harrison

BACK in the 1960s, as a teenager, I heard stories of how people were unwilling to work overtime on Saturday mornings. The problem was not with the overtime rates of pay, but with what was left in their pay packets after tax had been deducted. They chose leisure rather than work. That was not an entirely free choice. Some people would have preferred the extra money, but the intervention of the taxman deterred them. The net result was that both workers, and UK plc, were losers. Income that would have been produced on those Saturday mornings was lost forever.

It was to be many years later that I learnt that this effect is known as the "excess burden" of taxation. The poignant term is "deadweight loss". Many years later still, I learnt that the concept had to be taken literally. For one statistic captures the true extent of the loss that is endured by Britain because of the tax system: the number of people who die needlessly. I shall explain that those deaths are ultimately the responsibility of Parliament, which is failing in its duty of care over the wealth and welfare of the nation.

The number of premature deaths is horrendously large, but they are not spread equally across the nation. The discrimination is at its most acute in certain localities, most of which are concentrated in the north of England. In 2017, a team of researchers added up the numbers. For young adults, it concluded that

> **'We have identified an alarming growth in England's North-South divide in mortality for the population aged 25–44, amid a persistent inequality accounting for 1.2 million northern excess deaths under age 75 over five decades.'**

Political solutions remain elusive. The researchers, unable to shed light on the root causes that victimise tens of thousands of people every year, confine themselves to stating the obvious.

'Effective policies…may require substantial social and economic changes, including a rebalancing of the economy between North and South England that is proportionate to the scale of the problem.'

(Buchan *et al* 2017: 935)

People who live in the locations of deprivation are systematically deprived of up to 20 years of life on earth. The deaths can be predicted with precision, because they conform to an economic process that has divided the nation for centuries (Harrison 2006a, 2015).

If the populations of the four nations of the United Kingdom understood the scale of the damage inflicted on them by their governments, might they mandate the financial reforms that would deliver a fair and efficient way of being governed? If so, those reforms would erase the causes of the premature deaths that mock the notion of "equality before the law".

The problem of "excess deaths" pre-existed the onset of democracy in the 20th century, and it has persisted throughout the era of the Welfare State. If this mortal streak, a deadly blot on the British landscape, is to be erased, reforms will have to be authorised by a mandate from the electorate. Before that can happen, however, Parliament must provide the information which would make governments accountable to the people. A rare glimpse of the nature of that information, and the damage that is caused, surfaced in a document published for the US Government in 2001. The analysis was provided by the Congressional Budget Office (CBO) in a report called Budget Options. Buried on page 381, well away from prying eyes, was this statement:

'Typical estimates of the economic cost of a dollar of tax revenue range from 20 cents to 60 cents over and above the revenue raised.'
(CBO 2001)

No attempt was made to translate what this meant for taxpayers who were not tutored in the arcane theories of economics. A British economist, David B. Smith, explained the implications for the UK. Writing in 2006, he calculated that if the US proportions applied to the UK budget, Britain was losing, every year, a value that ranged from £90bn to £270bn. That loss was attributable to the way government chose to raise the public's revenue by favouring one set of tax instruments (which damage the wealth and welfare of the nation) rather than another set of tools (which do not damage the wealth and welfare of the nation).

Using more realistic assumptions, I have calculated that the "deadweight loss" to the UK is now running at the annual rate of about £500bn every year. (Harrison 2016:11)

We need to pause and reflect on this financial phenomenon. We are told, on a daily basis, that government cannot fund certain essential services because they would cost government a few extra hundred million pounds. An essential project has to be deferred, because it would cost one or two billion pounds – money the government doesn't have. Nurses cannot be employed to care for the sick, because the NHS budget is in deficit. Schools are deprived of the teachers they need to educate our children, because resources have to be redirected to more urgent tasks.

Meanwhile, production running at the rate of hundreds of billions of pounds a year goes begging. That is the additional value that would be created if Parliament, through its Acts, did not impose an artificial ceiling on the nation's productivity.

The absence of information about the losses induced by the public's finances is carefully cultivated. Again, statements in Budget Options are revealing. The economists who prepared this document for the US Congress explained that the criteria for assessing taxes were threefold: efficiency, fairness, and the costs of complying with, and implementing, the revenue system. According to the CBO, those three criteria "are often in conflict [so] Congress faces inevitable trade-offs in its decisions on tax policy". That statement was calculated to deceive. *It only applies to those taxes that do, indeed, impose losses on the nation. The CBO remained silent about the existence of the one set of revenue instruments which passes all of its tests, and therefore create no trade-off dilemmas for government.*

On Fairness with efficiency

All taxes are inefficient, according to the CBO. In one way or another they distort people's economic behaviour. There was, apparently, a single exception. Curiously, it chose the Poll Tax as its example of a revenue raiser that did not distort economic activity.

> **'Because liability under such a tax does not depend at all on behaviour, the only distortion comes from the revenue collection itself.'** (CBO 2001: 381)

At the time that statement was written, the "head tax" translated into a charge of $7,000 on every American. This was pronounced to be "inherently unfair". And so "the country faces trade-offs between doing what is best for the economy and what is fair".

Sounds reasonable, doesn't it? If the Poll Tax was unfair, government had no choice but to make the best of the bad taxes!

What the CBO failed to explain to Congress, or to the taxpayers of the United States, was that government had the choice of raising its revenue by using tools that met the tests of both fairness and efficiency, with minimal costs for compliance. The absence of that information is a persistent feature of treatises on taxation by economists such as David Smith. In his account of the damage caused by taxes, for example, he asserts that “all taxes expropriate the fruits of capital, labour or enterprise, and transfer real resources from the people who created the wealth to those who did not”. He is emphatic: *all taxes distort people’s economic incentives and destroy their property rights*.

> **‘In particular, taxes and inappropriate regulation expropriate either people’s capital or the return on their capital, including the human capital built up by education, training and a willingness to accept the social discipline of the workplace. Arguably this represents a form of legally enforced extortion, which is why moral governments should always feel inhibited about the imposts that they impose on their citizens.’** (Smith 2006: 88)

Information to counter this false account is not provided to the people of the UK. Her Majesty’s Treasury declines to publish assessments of (1) the damage it imposes by its choice of taxes, and (2) the availability of revenue raising tools that do not inflict such costs in the form of diminished wealth and welfare. When I applied for disclosure of such assessments, under the Freedom of Information Act, I was informed by HM Treasury that it held no documentation on such matters (Harrison 2006b: 43-44).

The US Congress and its budget advisory bodies also camouflage the reality of taxation. An example of the censorship of public documents appears in what purported to be an examination of a 10% cut in the income tax rates. The document contained many observations on trends (upwards and downwards) resulting from such a cut. Nowhere to be found was a dollars-and-cents analysis that would arouse the curiosity of the people who pay tax on their incomes (Congressional Budget Office 2005b). If the analysis had offered an estimate of the dollars-and-cents damage that the revised income tax would inflict on taxpayers, might American voters wish to hold their elected representatives to account?

Central bankers are equally derelict in their duty to meet the standards of transparency and accountability. The European Central Bank, for example, frames its observations in generalities and technical language that cannot be decoded by untutored citizens. An example was offered by the reference to the taxation of property, which declares that “The loss of utility increases with the square of the tax” (Afonso and Gaspar 2006: 8). Again, readers are not alerted to the possibility of raising revenue without “loss of utility” to anyone.

Measuring the deadweight losses

What are the best ways of raising revenue? Mason Gaffney is one of the world’s foremost authorities on the way taxes impose negative effects on the individual, on communities and on the natural environment. He grades taxes according to their variable impact on a nation’s wealth and welfare (Table 1). At the top

Table 1

Taxes ranked according to their positive effects on production and equity (fairness)

1. **Best:** Land Value Tax aka Annual Ground Rent
   a. at national level
   b. at state or provincial level
   c. at local levels
2. Pigovian taxes
3. Severance taxes (on mineral extraction, etc.)
4. General Property Tax
5. Corporation Income Tax
6. Personal Income tax
7. Payroll Tax
8. Excise taxes
9. Value Added Tax

of the list, because they do not damage the economy or society, are the tools which raise revenue from what economists technically call *economic rent*.

Revenue raising instruments that are both fair and efficient are those that fall directly on the rents of locations where people choose to live and work; on the rents of natural resources, and on the rents which a society creates through the provision of public services. An exhaustive list of those benign, rent-generating services has been compiled by Gaffney, an emeritus professor of economics at the University of California (Gaffney 1998). Correctly framed, charges on rents are not, strictly speaking, neutral. In the words of one professor, such charges are 'better than neutral' in their effect, because they encourage people to make better use of assets such as urban land (Tideman 1999; similar insights are offered in Feldstein 1977).

The scale of the losses inflicted by taxes that feature at the lower end of Gaffney's rankings is illustrated by the regressive Value Added Tax. VAT falls more heavily on low-income people than on the top income earners. That much, economists will acknowledge. What they do not record, however, is estimates of the ceiling imposed on GDP as a result of employing that tax. Gaffney reviewed the way in which VAT operated across Europe. His cautious calculation concluded that the loss to the 28 members of the European Union was of the order of €1 trillion, *every year* (Gaffney 2016). This estimate was based on the average losses arising from distortions to the way people work, save and invest.

Gaffney advocates that, for the purpose of discussion, an estimate of losses should be based on an average ratio of 1:1. This is higher than the ratio quoted by the CBO, which (as we saw above) had an upper estimate of 60 cents on the dollar raised by taxes, or 0.6:1. Gaffney acknowledges that the actual losses are more in the range of 2:1. That is, for every $1 raised by using the 'bad' taxes, productivity is reduced by $2. But he insists on being cautious, because of the difficulty of estimating the upper bounds of the losses which flow from conventional taxes. *Even with the conservative estimates, however, the scale of the loss is horrendous. Taxation imposes an artificial ceiling on people's capacity to produce the resources they need to pay for the services they want from their government.*

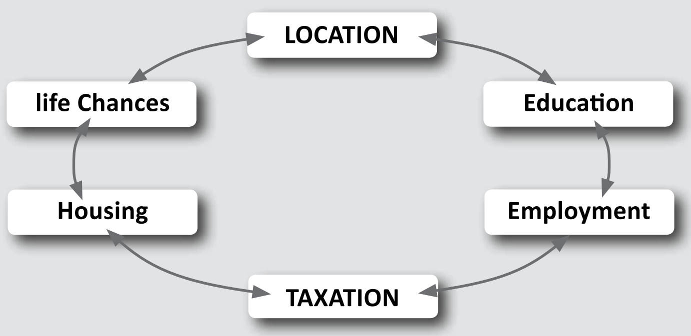
But what about the other taxes, such as those on corporate profits and employee incomes? David B. Smith tars all taxes with the same brush. In fact, some of the tools that are currently used by government do not inflict grievous losses. The least damaging taxes are those on property. The way they are levied in the UK (and elsewhere) is regressive. Nonetheless, I exclude them from my calculation of the deadweight losses of taxes, along with other taxes and public charges that fall primarily on rental income.

Coincidence or causation?

The losses attributable to tax policies are huge, but how can we be sure that the many problems that beset our society must ultimately be attributed to Acts of Parliament? Those problems range from the housing crisis to the ecological crisis, and from the widening gap in incomes to the erosion of social solidarity. If there is a connection, could this be coincidence, rather

Figure 1

UK feedback stress loops compressing economy and society



than causation at work?

Figure 1 is a stylised representation of complex life in modern society. It connects some of the major stress points. Few would disagree that there is a problem with the housing market: many people cannot afford the shelter they need. One of the collateral consequences is that many young people are forced to postpone marriage and defer having children, adding to the demographic crisis (an aging population). Similarly with employment opportunities: these are deteriorating, and prospects in the jobs market are linked to the quality of available education. But why lay the major responsibility on fiscal policy?

Figure 1 highlights the complex feedback loops that cluster around the interaction between two converging forces, whose cumulative effects compress the economy and society.

- **Location** exerts downward pressures on life chances. House prices segregate people according to incomes. This triggers postcode effects on, for example, access to quality education and access to the kinds of social networks that lead to high-income employment opportunities. People's capacity to borrow against the value of housing assets, and to invest in cultural pursuits, also elevates the longevity of their lives.
- **Taxation** exerts upward pressures on prices. Whether it is through over-pricing the wages of marginal workers, or regressively discriminating against the products purchased by low-income families, taxes distort the structure of prices in the labour, capital and consumer markets. One result: the substitution of farm workers with combine harvesters, and car mechanics with robots.

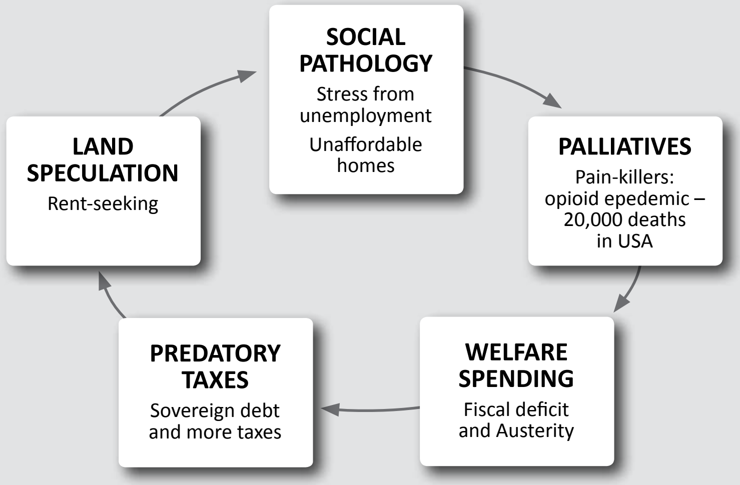
These two pathological forces make it impossible for society to achieve a healthy long-term balance (equilibrium, as it would be called in economics). The symptoms manifest themselves in a wide variety of forms. They include self-harming strategies (ranging from obesity to opioid addiction) and marital breakdown (including the neglect of child rearing practises, which can affect a baby's life chances from birth).

This account of life in a modern urban society does not tell us whether or not there is an overriding driving mechanism at work, of the kind that requires priority attention from policymakers. Getting at the ultimate cause – if it exists – is necessary, if policy-makers are to escape from the perpetual pursuit of palliatives. Figure 2 identifies some of the bewildering forces at work. Are the arrows – implying the direction of influence – misleading?

Social problems generate humanitarian responses that crystallise in the form of palliative action (such as cash benefits distributed to low-income families). But the persistent failure to remove the causes of low incomes drives up the cost of welfare policies. This, in turn, provokes the need for more

Figure 2

Pathological forces at work



taxes to cover budget deficits. Meanwhile, those who can just afford to climb onto the ‘property ladder’ are compensated with the silent accumulation of publicly-funded capital gains. This, in turn, reinforces the culture of rent-seeking. Macro-economic effects surface in various forms. One is the bias against capital formation (on which we depend for the creation of jobs and increases in productivity and wages), as investors favour rent-generating assets (witness the popularity of the property-to-let market in recent years).

At what point in this circular flow of influences should Parliament intervene to realign the socio-economic system to achieve balanced growth, healthy communities and happy families? Distinguishing systemic flaw from private frailty is vital, if public policies are to move beyond palliatives to erase the pathologies that disrupt people’s lives. This issue, of stress caused by phenomena like involuntary unemployment and unaffordable housing, is related to life-or-death outcomes.[1] Is the tax regime and that confluence of interests subsumed under the popular advocacy of Location, Location, Location the product of an organising ideology? The answer emerges when we locate the problem in its historical context.

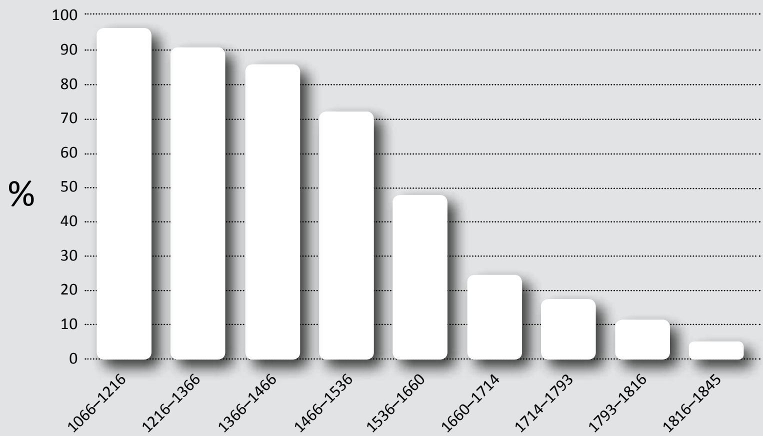
1. In the US, the opioid epidemic claims about 20,000 lives every year. In England and Wales (according to the Office of National Statistics) there were 3,744 drug poisoning deaths involving both legal and illegal drugs in 2016.
https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/deaths/bulletins/deathsrelatedtodrugpoisoninginenglandandwales/2016registrations
http://www.bbc.co.uk/northyorkshire/content/articles/2008/07/10/ripon_hornblower_history_feature.shtml

The culture of Rent-seeking

The historical trend, revealing the share of rent in government revenue, was summarised in a speech in the House of Commons in 1842 by Richard Cobden, the anti-Corn Law MP. The sum had declined from 100% to 4% by the 1840s (Figure 3). Why was this significant? The statistics tell us that *Parliament was determined to reduce the revenue collected directly from rents*. This

Figure 3

Land Rent as % of national revenue



Source: Cobden (1842: Vol 61 cc519-81).

meant revenue had to be collected from other sources. Did those alternative sources of revenue damage the kingdom; and if so, could Parliament have understood the implications of what it was doing?

England learnt long ago that taxes affect people's behaviour. Perhaps the oldest empirical evidence was provided by the citizens of Ripon. Back in the time of King Alfred – that is 1,100 years ago – the decision was made to raise revenue by charging 4d a year for doors located at the front of dwellings, and 1d for doors located at the side or rear of people's homes. The reasoning was that properties that fronted onto the town square were occupied by relatively well-off citizens, whereas those with doors at the side or back were occupied by low-income families. According to George Pickles, the current Ripon hornblower,

'It is still evident today that homes built after this tax was introduced were designed in a way that the position of the door brought them into the lower tax bracket. They were built with a very narrow frontage and most had a ginnell [passageway] down the side leading to the door. There is still evidence if you look at the oldest properties in the city.'[2]

This tax would not have affected the psycho-social welfare of the citizens of Ripon, but it demonstrated, over the course of many centuries, the lengths to which people would go to try to avoid a tax: they reconfigured their homes!

A responsible form of governance would take into account the behavioural implications of taxation. But by the 17th century, Parliament had begun to systematically detach statecraft from good governance. This had a visibly damaging effect on people's health.

- **The Hearth Tax** (1662). Imposed by Charles II, it continued until 1689, and was levied according to the number of hearths in a dwelling. To avoid the tax, fireplaces were bricked up. The deadweight impact surfaced among low-income families who endured the illnesses that came with cold and damp homes.
- **The Window Tax** (1696). In 1747, a house with ten to 14 windows was liable to a tax of 6d per window, increasing to 9d for more windows. People bricked up their windows to avoid the tax, which was repealed in 1851. Doctors chronicled how stagnant air contributed to ill health.
- **The Candle Tax** (1709). To dodge this levy, peasants replaced candles with rushes dipped in animal fat, which was left to harden. The candle substitute was lit at both ends, but the light lasted for a short time. Dwellings were filled with acrid smoke. Tax-relief came at a price: bronchial infections.

Simultaneously, taxes also reconfigured the economy. The new taxes, invented by Parliament to reduce its dependency on rent, curtailed the production of goods and services. This, in turn, prejudiced people's employment prospects.

- **The Salt Tax** (1702). The English salt industry suffered when prices were driven up by the tax on this essential ingredient in people's food. Ireland benefitted, because it was exempt: it became a major producer and exporter of salt.
- **The Beer Tax** (1724). A duty of 6d a barrel in Scotland triggered a riot in Glasgow in 1725. Brewers resolved to discontinue brewing the ale on which peasants relied as the alternative to drinking polluted

2. http://www.bbc.co.uk/northyorkshire/content/articles/2008/07/10/ripon_hornblower_history_feature.shtml

water. The aristocracy brewed beer on their estates, so they avoided the tax.

- **The Glass Tax** (1745). Glass was sold by weight. Manufacturers switched to producing glass with hollow stems to make them lighter. This reduced the tax burden. Ireland, where production was tax-free, increased its output. The production of high quality, thick stemmed glass gravitated away from England's manufacturers.

The impact of these 'excess burden' taxes was understood by parliamentarians. They saw how taxes provoke behavioural reactions which diminish the efficient allocation of labour and capital. Those non-rent taxes also distorted the goods and services provided to consumers. The one source of revenue that was (and remains) free of these effects was rent, if revenue was collected directly in the form of what Adam Smith called the annual ground rent (AGR) in *The Wealth of Nations* (1776).

Parliament had enacted the Land Tax in 1692. It had no choice. The gentry, having executed regicide and prosecuted a civil war against the monarchy, had installed a tame king in its so-called 'Glorious Revolution'. They now needed money – in a hurry. Despite the introduction of the Land Tax, however, Parliament – whose seats were now filled with land-owning gentry – did not abandon the mission of the feudal aristocracy. The nation's political *zeitgeist* was defined by the privatisation of the flow of rents.

As Parliament widened its fiscal net, moving towards what is today rationalized as a 'broad-based tax system', so the ceiling on productivity in the economy and life chances in ancient communities came crashing down. Three examples championed by George Osborne when he was Chancellor of the Exchequer bring us up to date with the devastating logic of fiscal policy.

- **The Apprenticeship Levy**: this payroll tax reduces wages, and therefore shrinks consumption, which in turn reduces the incentive to invest in capital formation, as noted by Stephen Nickell of the Office of Budget Responsibility.

- **Subsidised starter homes**: this was the Treasury's reverse tax: £2.3bn was allocated so that homes could be sold at 20% discount. This contributed to the upward drive in house prices, adding further stress on families that could not afford market rents.

- **Stamp duty**: the increase in rates on expensive dwellings reduced the rate at which people moved home by 27%, according to the London School of Economics, further constipating the malfunctioning property market.

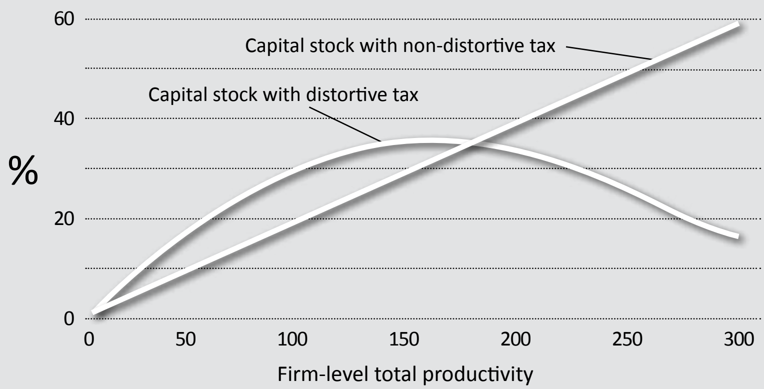
Thus was The Great Clamp-down on the aspirations of the people of England protracted from the early days of the gentrified Parliament to the present-day gentrification of towns and cities across the kingdom.

Towards responsible taxation

Governments that decline to publish audited accounts of the losses they inflict are not encouraged to do so by the international financial institutions. And yet, these institutions are acutely aware of the damage caused by the taxes which they urge on governments. An example is the IMF's account of how distortionary taxes disturb the formation of capital equipment (Figure 4). A revenue system based on tools that did not distort the economy would result in the steady rise in capital formation (illustrated by the straight line). Taxes that distort incentives cause an initial over-investment in capital (= waste of resources) followed by a phase of under-investment (= slump in productivity, rise in unemployment and drop in incomes = waste of resources). Everyone

Figure 4

Capital allocation with distortive taxes



Source: IMF

loses – employees, investors and society – through the under-production of income and the sub-optimal flow of revenue into the public purse.

The impact of deadweight taxation is transmitted through millions of routes, taking many forms – economic, sociological and psychological. In terms of policy priorities, the aim should be to reduce the tax burden on the most vulnerable sectors of society. The impact would be immediate. If Parliament ordained reform to draw more revenue from urban rents, housebuilders would no longer squat on 600,000 plots of land at a time when the UK was suffering from a desperate shortage of affordable homes (Ruddick 2015). The switch to the annual ground rent would encourage

Box 1

How to waste public money (*and get away with it*)

The problem with the honest auditing of the costs and benefits of government spending is that it might reveal how some expenditure of taxpayers' money fails the test of efficiency. According to the authors of one study:

> **'if a public project must be financed by distortionary taxes, the additional excess burden of these taxes should be taken into account. If this deadweight loss is as large as we suggest, it is possible that many projects accepted in recent years on the basis of favourable cost-benefit ratios should not have been undertaken.'**
> (Ballard *et al* 1985:136)

Would the absence of those public projects diminish welfare? Not if the taxpayers' money was returned to the public to be spent according to the preferences of the people who created that value.

the construction industry to increase its supply of dwellings (levelling off rents and sale prices) while helping to fund the costs of the infrastructure on which it depends for profits. Nor would the world's richest kleptocrats use London's property market as the means to cleanse their illicit gains. The flow of oil rents from Nigeria, which ought to be invested in that country's social infrastructure, helped to drive West End property prices to astronomic heights (*Financial Times* 2017).

Such outcomes, which corrupt people's lives, are sanctioned by Acts of Parliament which purport to enhance the fabric of their communities. On a daily basis, lives are routinely damaged without people realising what is being done in their names. If we wish to shift the Westminster form of governance further towards an authentic form of democracy, measures of the deadweight losses need to be published, for two reasons.

First, consider the issue from the perspective of demands on government to take action to alleviate a social problem. The expansion of an existing service, or the creation of a new service, entails the commitment of resources. Money has to come from taxpayers. If the benefits accruing to society are less than the associated deadweight losses (= no net gain), might this lead responsible citizens to withdraw the demand on government? We cannot know, if the relevant information is not made available.

The second reason refers back to Table 1. The performance of governments would be enhanced if (say) VAT was abolished in favour of collecting the revenue from (say) an increase in the rates of corporation tax. Such policy decisions ought to be based on the best estimates of the relative damage caused by each of the fiscal instruments. That information would enable an informed electorate to participate in the discussions. The ensuing consensus would authorise government to behave responsibly in the realm of fiscal policy.

This strategy, of narrowing the revenue base by getting rid of bad taxes in favour of raising revenue from rent, offends one of the cornerstones of conventional fiscal philosophy. Institutions like the IMF and the OECD actively promote the doctrine of "broad-based taxation". This doctrine is intended to conceal knowledge about the taxes that people pay. As such, it offends the philosophy of democracy, which prescribes transparency and accountability. Auditing the tax system, by accounting for deadweight losses, would shift governance closer towards the ideal of a participative system of governance in an open society (Box 1).

The Palace of Westminster is in serious physical decay and is about to undergo a £3.5bn refurbishment. There is no comparable plan to refurbish the reputation of policy-makers, whose status is also in serious decay in the minds of a large part of the electorate. Distrust of those who occupy the seats of governance is at a dangerously high level. This corrodes the fabric of civil society by undermining the institutions on which the state is constructed.

Closer attention to the causes of premature deaths of millions of people ought to inject a sombre mood about the UK's future. The epidemiological evidence that connects unemployment and under-employment to mental ill-health, physical stress and self-harming activities which result in premature death are well attested in the medical journals. The causal links between taxation and land speculation (which result in boom/busts) are well-established (Harrison 2005). Once the government's responsibility for economic instability is admitted, Parliament's responsibilities become clear.

Refurbishing the fiscal structure on which the whole edifice of governance stands is long overdue. The fiscal rules employed by HM Treasury lock the UK into the mortal failures of the past. Parliament, if it is to champion an authentic democracy, should establish a new rule: *documents presented in support of the annual budget must include estimates of the deadweight losses created by taxation*. That would render the fiscal system transparent, and enable the electorate to hold their representatives accountable for the actions taken in their names.

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