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## Notes for Remarks by

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The British economy has two characteristics which, in combination, make it very difficult to devise a sensible tax policy: it is an open economy, subject to all of the pressures of a globalised world; and it is a welfare state, in which all parties have agreed to spend almost 43% of GDP on social services, and to increase that spending year in and year out.

Globalisation demands competitive tax rates; the welfare state demands progressive (in both senses of that word) increases in taxes. The situation is further complicated by the fact that the dictates of economics and of equity often pull politicians in opposite directions -- well, some politicians: the small number

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who consider economics at all. Economics suggests that it is best to prevent marginal tax rates from rising to levels that discourage work and risk-taking, and concentrate taxation on factors of production that are insensitive to the level of taxes levied on them; equity (and politics) demands progressivity -- taxing high earners and avoiding taxes on consumption, since those are generally inherently regressive, and not taxing property that is soaring in value. So we have the strange phenomenon of politicians trying to find ways to tax highly mobile members of the international work and entrepreneurial classes, while hesitating to raise taxes on immobile land. Henry George would be appalled!

So much for a bit of the theory of sound taxation. Now to the real world of today's Great Britain. Theory tells us that taxing jobs is a bad idea -- it discourages hiring by raising the cost of labour, and discourages that extra work effort that often drives productivity upward. Yet in Britain we have in the past decade witnessed an increase in the tax on jobs -- NICs<sup>1</sup> are up -- and a rise in taxes on the incomes of ordinary working people, leaving them with lower take-home pay and a reduced incentive to work. The irony is that the revenues from these anti-job, anti-work taxes have gone to fund payments made to those who do not work, simultaneously reducing the reward for work and increasing the

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<sup>1</sup> Note to American readers: Roughly the equivalent of our social security tax.

reward for remaining economically inactive, to use the non-value-laden phrase that is preferred by the present government. It should come as no surprise that the ranks of the economically inactive have risen sharply -- people know how to do arithmetic.

Theory also tells us that in a competitive world businesses will seek out the most congenial tax regime. But here we must be very careful to define just what we mean by congenial, for several reasons.

**First**, published tax *rates* are of limited use in making international comparisons, just as posted prices tell us little in markets in which discounting is rife. It is *effective* tax rates that matter, and those are often difficult to calculate and compare.

**Second**, it is not only the effective rate to which businesses and the mobile members of the work force look, but what they get for the taxes they pay. High taxes that buy good transport to and from work, safe streets, good schools and an efficient health service will not be a competitive disadvantage. This is not the place to discuss whether Britain's taxes, now so high that even international agencies are concerned about the nation's future, are buying those public services.

**Third**, in addition to the effective level of taxes, and the efficiency with which they are spent by government, there is the question of complexity. Complexity adds to the cost of compliance

and the temptation to avoid taxes -- not evade, avoid, quite a legal thing. Complexity gives intrusive tax collectors scope for harassment, for interpreting and re-interpreting regulations, for first encouraging small businesses, and then redefining the entities that qualify. Now, some complexity is inevitable in a democratic society. Social engineers come in all colours -- red, of course; yellow, certainly; and blue, at time apologetically -- although less so now that the Tories have discovered the importance of stable families and decided that home ownership has social values sufficient to justify granting tax benefits to first-time buyers. Good idea or not, this adds to complexity -- and Britain has one of the most complex, and increasingly complex, tax codes known to man. A decade of social engineering by one of the most unapologetic, imaginative, and egalitarian Chancellors ever to bestride the Treasury has had the inevitable result of a tax code -- not to mention a tax level -- that in a less supine society might have brought taxpayers to the streets. This complexity is more of a problem for small businesses, who do not have on staff or retainer the army of accountants and lawyers employed by large corporations.

**Fourth**, it is less the current level and structure of taxes than prospects for the future that affect competitiveness in a globalised world. Businessmen thinking of making investments,

and mobile talents considering where to ply their trades, look not only to how things stand today, but to how they are likely to be in the near- and medium-term future. I sat next the CEO of one of Britain's largest companies during the Prime Minister's speech last week. Like many of us, he was fighting vainly the old ennui, to borrow a phrase from Cole Porter. Except when the Prime Minister listed the new gifts he intends to bestow on voters: 12-months maternity leave with pay; scholarships for 600,000 students; one-on-one tutors for all. These expansions of the welfare state mean higher labour costs and higher taxes. I assure you that hiring policy and investment levels will be adjusted accordingly.

Businesses also look to the future when appraising the quality of life they will be able to offer the talented workers they must attract in order to compete in a very tough world. I remember when major corporations fled New York -- not so much because the streets were littered with aggressive homeless and muggers, the state schools were sink holes in which no student could learn, and taxes were rising to fund the voracious appetites of the public sector trade unions and the poverty and race lobbies -- but because there was no hope for the future. As soon as Rudy Giuliani restored hope, the economic climate improved.

Any businessman looking around the world cannot help noticing that many countries -- even France -- are trying to lower taxes, while both major parties in Britain are committed to spending levels that will almost mandate further tax increases, overt or covert. The British dilemma will be accentuated by the following trends:

1. Tax receipts from high-earners will decline as the economy softens.
2. Government expenditures will rise as promises to expand the welfare state are kept -- odd, isn't it, that among all the promises politicians make, the ones they keep involve more spending?
3. The public finances will deteriorate -- as well they should in a slowing economy, *if* they had been in order before the slowdown.
4. The hunt for new sources of tax revenue will proceed apace, but those will be difficult to find in an economy already over-taxed. So praise to the Shadow Chancellor, who has found the non-doms<sup>2</sup> -- a group that can be made to pay tax, but cannot vote in the UK.
5. The hope that all of this will be offset by greater value for money -- schools so good, streets so safe, the NHS so

efficient, transport that is less uncivilised -- was dashed when Gordon Brown moved left: back to targets instead of patient choice, increased bureaucratic control of city academies, so special encouragement of the traditional families that studies show produce the least burden on the social system.

But let me end on a more cheerful note. I have never been as concerned about global warming as Al Gore, or even David Cameron. In part that is because I think the scientific evidence a bit shaky; in part that is because there will be winners as well as losers; in part that is because I have faith that markets will produce technologies that substitute for fossil fuels as those become more expensive. But the debate by those who are more concerned than I am -- or who say they are, has helped to push tax policy in the right direction. In elementary economics courses we like to say “tax bads, not goods”. Pollution is bad; jobs are good. Consumption of non-polluting goods is fine; consumption of goods that produce CO2 emissions is not -- unless the consumers pay the cost they impose on society by their acts of consumption.

Gordon Brown took an early stab at the problem by taxing electricity generation -- but that caught non-polluting nuclear

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<sup>2</sup> Note to American readers: these are the folks who have residence status that allows them to work in Britain, but are not “domiciled”, and hence pay tax only on the incomes they earn and the things they buy in Britain. These non-doms, as they are called, do not pay tax on their worldwide incomes or on capital (not income) brought into the UK.

power in the tax web. We are now in the process of refining just how to tax carbon emissions. A few thoughts:

1. Taxing big cars is a bad idea. Taxing the use of cars in proportion to their emissions is a good idea. A Range Rover that sits in the garage most of the time should pay less tax than a smaller car that is driven tens of thousands of miles annually.
2. Tax the plane, not the passenger. An aircraft flying empty across the Atlantic should pay the same tax as one crammed with holiday-makers, or one in which tired executives have plenty of room to stretch out.
3. All emissions should be treated equally. Green taxes should not be used as a means of imposing government's views as to the desirability of various forms of consumption.

I could go on, but best to stop here and allow time for questions.

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