

# Policy Paper

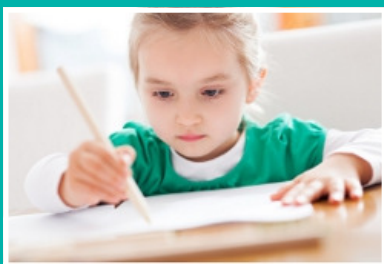
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## Financing the Social State: *Towards a full employment economy*

Richard Murphy and  
Howard Reed

April 2013

# Series: A Social State for 2015



December 2012 marked the 70th anniversary of the Beveridge Report, significant not only for its content but also for its context. In the midst of World War II, with a budget deficit and national debt that makes today's look negligible, the Report laid the basis for the radical reforms introduced by the Labour Government in 1945.

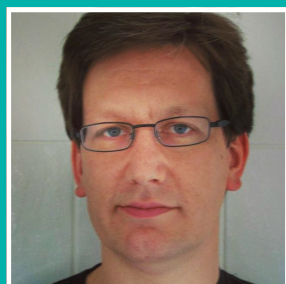
If war-time Britain could summon up the energy and hope to build a better world in 1945, this generation certainly can too. Seventy years ago the Beveridge Report announced the pursuit of a new settlement, one that would dramatically change the structure of Britain for the better. With this in mind, this series of work looks at what Beveridge's analysis of society can teach us about the Giant Evils of today and how we use this to chart an alternative course for a welfare state - or *Social State* - fit for a new settlement in 2015.

This paper was commissioned as part of the series to address the Giant Evil of 'Idleness' and to propose new policy priorities for dealing with unemployment and underemployment.

## Authors



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# Executive summary

There is no doubt that Beveridge saw idleness as the curse of unemployment that had afflicted so many in the 1930s. The cure to idleness was work, and Beveridge believed that the state should make sure work was available for all who wanted it. His thinking was clearly a product of his era. Writing in 1942 he was influenced by the war, but he was also heavily influenced by the thinking of Keynes. Beveridge accepted Keynes' logic and believed that a government could and should tackle this issue to ensure full employment was achieved.

A Social State for 2015 has to be built upon a series of assumptions:

1. That those who would wish to work and who are denied the opportunity to do so are prejudiced against as a result;
2. Leaving people unemployed when they could be and want to be working is economically irresponsible;
3. The vast majority of people who are unemployed have to be fed, housed, clothed, educated and be provided with health care and other services when unemployed. As such unemployment has a double cost to society; the unemployed person is maintained and yet makes no direct contribution to economic well being within the economy whilst society suffers the social consequences of the idleness it has imposed;
4. The inequality of economic treatment between those in and out of work imposes a social cost both on those suffering the impact of that inequality directly and on society at large;
5. Unemployment denies people the chance to fulfil their potential, at least part of which is realised for most people through the process of work. This imposes costs beyond the lost value of economic output.

For these reasons we believe it makes economic, environmental, social and medical sense to tackle unemployment whilst equity, justice and social harmony are also enhanced.

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## Investing to tackle idleness

Idleness has been a fact of life for far too many for far too long in the UK, and as is clear the matter has got worse in the current recession. At a macroeconomic level, involuntary idleness represents a massive waste of economic resources for this country. In this paper we seek to show that the policy of austerity that has increased idleness, and which has now given rise to the additional problem of disguised underemployment, makes no economic sense now we know that in the current state of the economy spending on investment by the government does, at the very least, pay for itself in the short term whilst in the longer term it can generate the revenues needed to deliver deficit reduction. In doing so we suggest nothing more than Keynes made clear was the case eighty years ago, which is that if the issue of unemployment is addressed then the budget looks after itself.

## How to implement a fiscal policy to tackle idleness

There are several reasons for investing. First, people come off benefits and are no longer idle which in turn gives rise to social benefits of the sort already noted. There is also an asset created for the long term, and a boost to the remainder of the economy as confidence rises and so people spend more and businesses invest more - in their own way tackling idleness. Most important though is the impact on borrowing. Even if the funds to invest are borrowed and are not raised from taxation there is a net boost to the economy. This then suggests there is a clear benefit to having a tax and spending policy to tackle idleness, simply because increased activity pays for itself. What this paper notes though, is that capital spending is by far the most effective way to tackle idleness because the impact per £1 spent is by far the highest within the economy.

In that case a fiscal policy to tackle idleness has to have at its core a policy of exploiting the multiplier impact of any spending to the full. This means that:

- Tax cuts have a low priority;
- Cuts in benefits are harmful;
- The greatest impact of a fiscal programme to tackle idleness has to replicate the New Deal of the 1930s and create a programme of rapid and large scale investment in public works.

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## The role of progressive taxation

Tax is, indisputably, the most important way in which any government intervenes in an economy. This inevitably means that when considering how a government is to tackle idleness, as is its duty, tax has to be taken into account. In our opinion there were two ways in which this has to be done. One is a macroeconomic consideration which relates to how the tax system as a whole, the balance between tax and spending, and the relationship between taxes, can be adjusted to tackle idleness. Secondly, there is a micro-economic consideration of tax issues which looks at the detailed design of the tax system to ensure that it does not, by itself, put obstacles in the path of people working.

Our recommendations here are radical: we are committed to strong, progressive taxation. That means we believe that as income rises the proportion of the total income that a person pays in tax should rise as well. It is a principle of tax justice, usually described as vertical equity, that few would wish to dispute. However, the UK tax system does not deliver vertical equity in a great many cases. It is our opinion that this is best addressed by a complete redesign of the Income Tax, National Insurance and benefits systems: nothing less will do if we are to tackle institutional impediments to idleness.

Our proposed system is based around two simple components:

### ***1. Basic income payment – Minimum Income Standard***

All families would receive an unconditional, tax-free basic income payment that would be set at levels sufficient to alleviate poverty.

### ***2. Unified Income Tax (UIT)***

The current Income Tax system and the entire National Insurance Contributions system would be replaced by a single Income Tax structure which would be clear and progressive.

In 1942 Beveridge said the war provided a revolutionary moment and as he noted “*a revolutionary moment in the world’s history is a time for revolutions, not for patching*”<sup>1</sup>. We agree. The global recession is now providing another revolutionary moment in which new thinking is required and that is what we have sought to offer in this paper.

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# Part 1:

## Beveridge and Idleness

The Beveridge Report gave rise to the welfare state. That social security was its focus was deliberate: the report was entitled 'Social Insurance and Allied Services'. However, as Beveridge noted at the beginning of his report:

*Social insurance fully developed may provide income security; it is an attack upon Want. But Want is one only of five giants on the road of reconstruction and in some ways the easiest to attack. The others are Disease, Ignorance, Squalor and Idleness<sup>1</sup>.*

This paper is on idleness. There is no doubt that Beveridge saw idleness as the curse of unemployment that had afflicted so many in the 1930s. Beveridge's view on idleness was quite clear. As the report noted:

*The insured persons should not feel that income for idleness, however caused, can come from a bottomless purse. The Government should not feel that by paying doles it can avoid the major responsibility of seeing that unemployment and disease are reduced to the minimum. The place for direct expenditure and organisation by the State is in maintaining employment of the labour and other productive resources of the country, and in preventing and combating disease, not in patching an incomplete scheme of insurance<sup>2</sup>.*

It was quite clearly not the role of the government to keep people in a state of idleness. He did not see that as responsible from a social viewpoint. Nor did he see it as affordable. He saw it as the role of the state to ensure that there was opportunity for gainful employment for those who wanted it. The cure to idleness was work, and Beveridge believed that the role of the state was to make sure that work was available for all who wanted it.

### Beveridge, the Keynesian

Beveridge's thinking was clearly a product of his era. Writing in 1942 he was influenced by the war, but he was also heavily influenced by the new economic thinking that had been unleashed in the later 1930s as a result of the publication of Lord Keynes' 'The General Theory of Employment, Interest and Money'. This is not the moment to rehearse all Keynes said: suffice to say that in his General Theory he challenged almost all prevailing economic thinking by suggesting that it was possible

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for a market to reach a point described by economists as stable equilibrium where not all the people who wanted to work in an economy would be able to do so. He believed that however the price of labour was adjusted to suit market conditions, the possibility remained that the wage rate might never be capable of being adjusted enough so that employers would demand the services of all who wanted a job. In other words, he argued that without government intervention the possibility of long-term idleness as represented by long-term unemployment was a very real prospect for many in the UK economy.

Beveridge accepted that logic, and along with Keynes believed that a government could and should tackle this issue to ensure full employment was achieved. Keynes, in fact, considered this objective to be at the heart of sound economic management by any government. He considered it so important that he once said “*look after unemployment, and the budget will look after itself*”<sup>3</sup>. In saying so he entirely reversed all known economic logic up to that point in time, declaring “*for the proposition that supply creates its own demand, I shall substitute the proposition that expenditure creates its own income*”<sup>4</sup>.

Keynes’ logic was simple: he argued that if people were in work then, assuming the economy was otherwise in a state where people would be unemployed, if the government were to provide work for these people (either directly or through enabling their employment in the private sector, for example via subsidies to employers) this would generate enough income to pay the taxes that would justify the spending required to ensure they were put to work in the first place. In effect, he argued that there was a beneficial and virtuous circle where borrowing to put people to work in turn created income on which tax was paid sufficient to repay the borrowing undertaken. This was the core of his argument that there was a *multiplier effect* in the economy.

The respected TUC economist Duncan Weldon has explained these fiscal multipliers as follows:

*Simply put the fiscal multiplier is a measure of how changes in fiscal policy (spending and taxation) impact on the wider economy. If we imagine £10bn of spending cuts and the multiplier is assumed as 1, then GDP will be reduced by £10bn. If the multiplier is 0.5, then £10bn of spending cuts will reduce GDP by only £5bn and, alternatively, if the multiplier is 1.5 then £10bn of spending cuts will reduce GDP by*

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*£15bn. In the context of a Government pursuing over £100bn of fiscal tightening (spending cuts and tax rises), then the assumption made about the size of the multiplier is obviously crucial<sup>5</sup>.*

As Duncan's commentary, written in October 2012, shows, the debate that Keynes started on this issue has not gone away. Until that month the IMF had broadly agreed with George Osborne's view that the fiscal multipliers in the UK economy were low, being maybe no more than 0.5 up to 2009. If true this would have meant austerity was a workable path to economic recovery: cutting government spending in this case did not reduce GDP by as much as was saved from the deficit and so, overall, it was argued that a short sharp period of realignment would result in the deficit being cut, the impact on GDP would be small and recovery would follow soon after.

The trouble was that in October 2012 the IMF realised that this logic was wrong: the fiscal multipliers during the recession had not been 0.5 but had been as high as 1.7. That meant that for every £1 of cut in government spending the economy had shrunk by as much as £1.70. And the process also worked in reverse: if spending were to be increased by £1 then income would go up by as much as £1.70. Beveridge's logic, that idleness did not pay, based on Keynesian thinking, had received the most important boost it had been given for a long time.

Perhaps as importantly, the possibility that idleness may not be the fault of those who were idle but was a condition being imposed on them by government choice could now be considered.

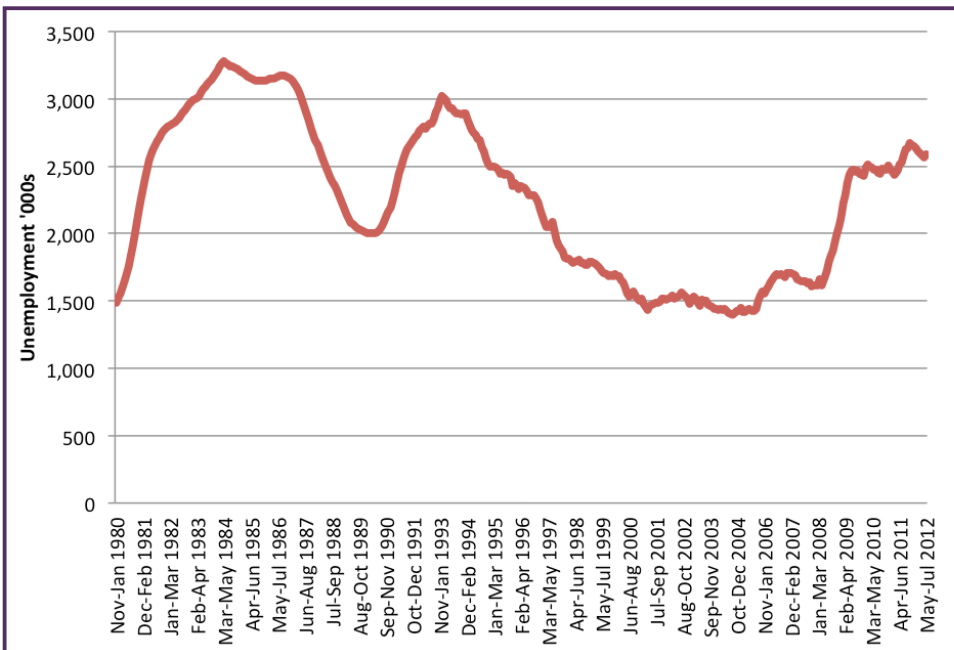
## **On modern idleness**

Idleness has been a fact of UK life for far too many for far too long in the UK, and as is clear the matter has got worse in the current recession (see Chart 1). Chart 2 showing the total weekly hours worked, seasonally adjusted from 2007 to 2012, included in the official Labour Market Statistics for January 2013 offers some insight into this issue.

The recession created idleness in the UK, and that is only slowly reversing particularly as the true picture may be much worse than this data suggests. Firstly, as the TUC has noted recently<sup>6</sup>, since early 2010, nearly 40 per cent of the new jobs

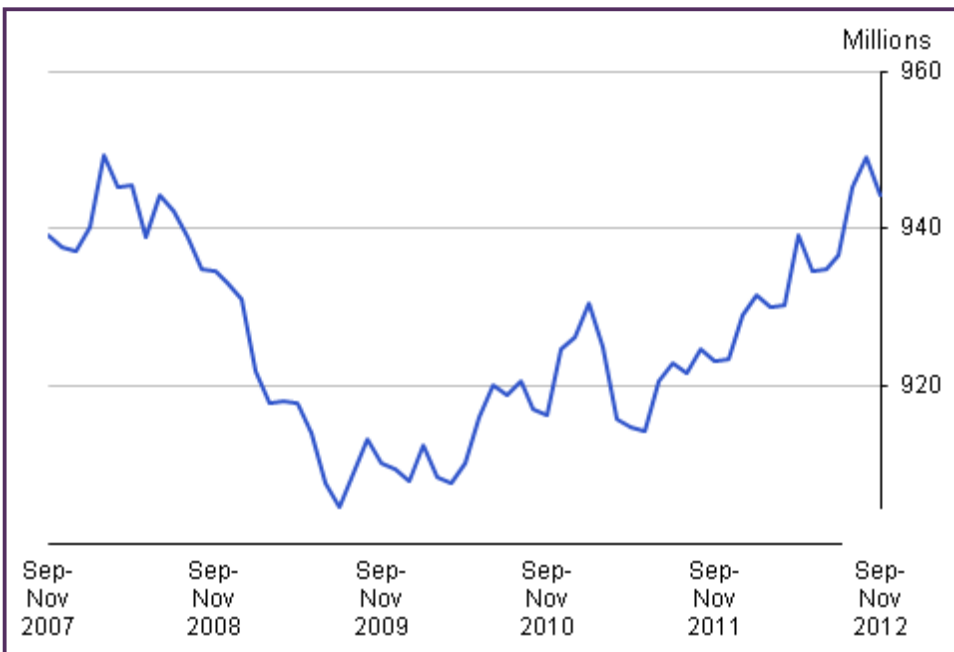


**Chart 1: UK Unemployment, 1980-2012.**



Source: (ONS (A02 LFS)) [http://www.economicshelp.org/macroeconomics/unemployment/natural\\_rate.html](http://www.economicshelp.org/macroeconomics/unemployment/natural_rate.html)

**Chart 2: Total weekly hours worked, seasonally adjusted, 2007-2012.**



Source: Labour Force Survey - Office for National Statistics <http://www.ons.gov.uk/ons/>

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created in the UK have been self-employed roles, even though just 14 per cent of workers are self-employed. It is hard to be sure how many of these newly self-employed workers are in gainful employment and how many are unemployed people simply unable to secure work of any sort who therefore register as self-employed in the hope of securing some work instead. Second, there is now widespread agreement that this data obscures that fact that the extra hours of work generated since 2011 have been very unevenly distributed. Overall work has also been paid less and less per hour over the last few years as average wages have fallen in real terms since 2008. Idleness remains a problem, firstly because 2.5 million unemployed is unacceptable, especially when more than a million of them are young people, and secondly because the data hides a reality of underemployment that affects many who are officially at work.

In the meantime, as Ha Joon-Chang has noted<sup>7</sup>, Europe is haunted by the myth of the *“lazy mob”*, promoted it seems because it suits the wealthy to turn the debate about poverty into a morality tale, but the reality is that there is no evidence to support the stories told by politicians of the right in the UK and across Europe. If there is idleness then its cause is not a lack of willingness to work; its cause is structural inequality and if we are to create a Social State for 2015 then this issue has to be tackled.

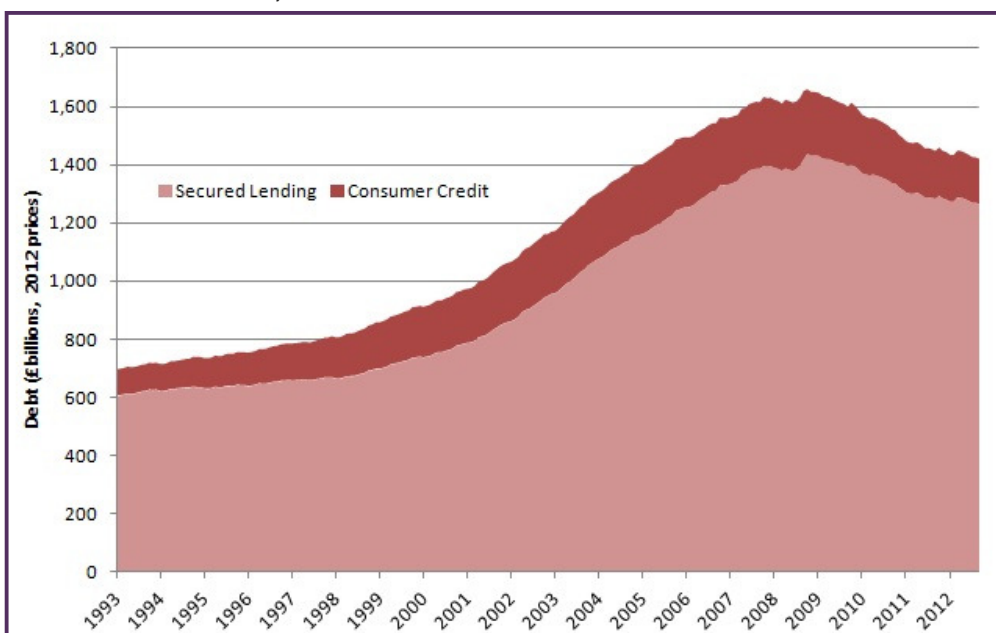
## **Why idleness has increased: what the Coalition got wrong**

Idleness is caused by a lack of demand in the economy. Put straightforwardly there are resources available in the UK in the form of people who are trained and willing to work that employers do not wish to put to use in any gainful way. We have a low minimum wage<sup>8</sup>, and whilst just 4% of employees in the UK as a whole are on that minimum wage over 20% earn less than a living wage (defined as £8.30 an hour in London and £7.20 elsewhere)<sup>9</sup>. There is no evidence that the introduction of the National Minimum Wage in 1999, and subsequent increases in its value over the next thirteen years, increased unemployment<sup>10</sup>. Given that this is the case, it seems clear that in the vast majority of cases, people are not unemployed because they want to be; they are unemployed because there is insufficient work. In that case a Social State for 2015 has to defeat idleness by creating work.

The government's myth was that this would happen as a result of a policy of *expansionary fiscal contraction*<sup>11</sup>. The logic of such a policy was that in the first instance, with fiscal multipliers of significantly less than 1.0, cuts in government spending would result in falls in GDP of much less than the amount of expenditure cut. At the same time it was assumed that as people realised that the government was committed to cutting spending there would, in the long term, inevitably be cuts in taxation. As a result people would feel more confident that they would have increasing future income to spend and anticipating that would go out and borrow more now, so boosting economic growth as a result of increased spending from personally borrowed money. As Aditya Chakraborty noted<sup>12</sup>, by 2012 the only way the Coalition could forecast economic growth was by forecasting an increase in the net debt of UK households from £1.6 trillion in 2011 to £2.1 trillion in 2015.

There was, however, a problem with this logic. In a nutshell, people have refused to borrow as the government expected. As Bank of England data reveals (Chart 3), UK personal debt has not risen as the government expected in the face of its austerity measures. In fact, in real terms, total UK personal debt has been falling from 2009.

Chart 3: UK Personal Debt, 1993-2012.



Source: Bank of England monthly statistics, data series LPMVTXK and LPMBI2O, April 1993-December 2012. Deflated by all items Retail Price Index.

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The assumption that people would borrow and spend in the face of cuts, believing that good times would follow was wrong. They saw the risk of unemployment, declining income and a reduced safety net and as most economists on the left predicted, gave a higher weighting to increased risk than they did to opportunity and decided to save, whether by paying off their mortgages or by reducing the consumer credit.

This failure to assess sentiment correctly is important. It is widely understood that in the short run, there are only four causes of growth in the macroeconomy. These are increases in consumer spending, an increase in net exports, an increase in net business investment and an increase in government spending, with the latter being most effective by far when spent on investment. The government assumed consumer spending would increase: it has not. It also assumed that if consumer spending were to increase business investment would also increase, but it has not. Indeed, Ernst & Young estimates FTSE 100 companies are sitting on £750 billion in cash rather than invest it, so reluctant are they to spend<sup>13</sup>. And the Eurozone crisis never featured in Osborne's planning except as the threat to justify austerity. What all that means though, is that there is but one way left for growth to happen which is essential if idleness is to be tackled, and that is by increased government spending.

## **A plan for growth – the assumptions**

A Social State for 2015 has to be built upon a series of assumptions. In the case of a plan to tackle idleness those assumptions are, we suggest:

1. That those who would wish to work and who are denied the opportunity to do so are prejudiced against as a result: idleness is not a natural choice for human beings who do not have other means of support to meet their needs;
2. Leaving people unemployed when they could be and want to be working is economically irresponsible: it means a scarce and perishable resource has gone to waste and that cannot make economic sense;
3. The vast majority of people who are unemployed have to be fed, housed, clothed, educated and be provided with health care and other services when unemployed: people do not disappear when they are not working. As such unemployment has a double cost to society; the unemployed person is maintained and yet makes no direct contribution to economic well being within the economy whilst society suffers the social consequences of the idleness it has imposed;

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4. The inequality of economic treatment between those in and out of work imposes a social cost both on those suffering the impact of that inequality directly and on society at large where it is expressed as increased social tension motivated at least in part by fear of becoming victim of the resulting disparities in well-being;
  5. Unemployment denies people the chance to fulfil their potential as human beings, at least part of which is realised for most people through the process of work. This imposes costs beyond the lost value of economic output, including the cost of mental and other ill health that results from idleness, the cost of failed relationships and the cost of creativity foregone both now and in the future.

For these reasons we believe it makes economic, environmental, social and medical sense to tackle unemployment whilst equity, justice and social harmony are also enhanced.

## **How tax and idleness are related**

Tax is, indisputably, the most important way in which any government intervenes in an economy, especially if (as can be argued) the benefits system is seen as a related and, in effect, inverted tax system designed to pay out rather than to collect state revenues. This inevitably means that when considering how a government is to tackle idleness, as is its duty, tax has to be taken into account.

In our opinion there were two ways in which this has to be done. One is a macroeconomic consideration. That relates to how the tax system as a whole, the balance between tax and spending and the relationship between taxes can be adjusted to tackle idleness. That is the subject of the next part of this paper.

Secondly, there is a microeconomic consideration of tax issues that has to be undertaken. This looks at the detailed design of the tax system to ensure that it does not, by itself, put obstacles in the path of people working. The same consideration can also take into account whether or not the tax system can place obstacles in the way of people reporting that they are working when that is the case i.e. whether a tax system can in itself encourage tax evasion because of problems inherent in its design. These themes are the subject of the third part of this paper, before we draw them together in a conclusion that makes up the fourth and final part of the paper.

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# Part 2: Tackling idleness – getting fiscal policy right

For all the reasons that we have noted for thinking that involuntary idleness is a social harm we believe that when, for any reason, a market economy creates a sustained rate of unemployment above levels society thinks acceptable then it makes sense to use tax revenues to tackle the problem of enforced idleness. Saying this does mean, however, that tax has a role in the economy that goes beyond the simple raising of revenue to meet the cost of government spending. We believe that is the case.

## The purpose of taxation

In our opinion taxation has five purposes. They are:

### **1. *Raising revenue***

It might sound like a statement of the glaringly obvious to say that tax raises money, but it is of course possible to pay for government services from borrowing as well. That is happening at present. Getting the balance between tax and borrowing right is one of the most critical decisions a government has to make.

### **2. *Repricing goods and services in the market place***

All taxes might raise money, but not all taxes have that as their main purpose. Many items are taxed because the government wants to discourage their use. Tobacco and alcohol are in this category because of their health impact. Taxes on oil and other carbon usage are also in this category, but to counter their environmental impact and to preserve their supply. On the other hand some items are removed from tax to make sure they are more readily available. Most food, children's clothing and books and newspapers do not have VAT on them for this reason.

### **3. *Redistributing income and wealth***

In most countries in the world tax is used to redistribute income and wealth. The UK is no exception. Progressive taxation, which means that the

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percentage of their income or wealth that a person pays increases as their income or wealth increases is designed to achieve this goal, and does do so in the UK.

#### **4. *Recalibrating the economy***

When an economy is overheating and there is a risk of inflation, governments want to take demand out of the economy so that things rebalance and return to normal. Raising taxes can do that by reducing the money available to be spent, which in turn reduces the scale of economic growth. When there's a recession a government might seek to stimulate the economy. That can be done by cutting taxes, which increases the amount of cash available to be spent, which in turn increases demand. This is called fiscal policy. Of course, if government spending is unaffected by the amount of tax raised the difference is made up by borrowing or repaying debt (as happened in the UK for several years around 2000).

#### **5. *Raising representation***

It was little appreciated until recently that countries with higher overall tax rates tend to be amongst the most democratic states in the world, and amongst the richest as well. What observers of developing countries have realised is that this is not an accident. When taxes are higher people engage with their government more, and are also more willing to pay the tax demanded of them because they feel they have some control over the choices made about its use. It seems that people who pay tax also vote. In that case tax is, even if indirectly, one of the key drivers of democracy because people see it is the link between them and the government that makes them want to hold it to account.

The 5 Rs of tax make clear that tax policy is not just a simple matter of making the books balance. Too much current debate about tax has focused on that single issue. It is important of course, but when considering tax policy it is by no means the whole story. Tax also has a crucial role to play in economic policy, including in that case the tackling of idleness when it occurs involuntarily in an economy as is the case in the UK at present.

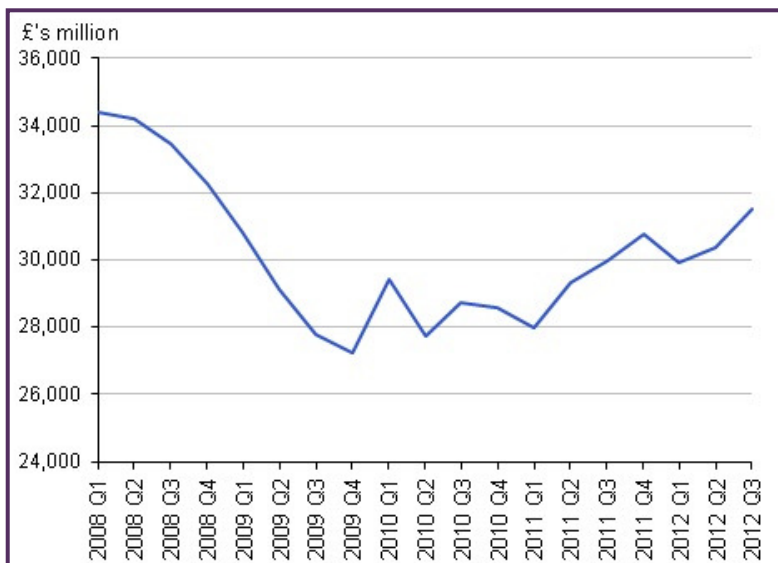
## How tax and fiscal policy can be used to tackle idleness

Idleness in an economy is rarely caused by the tax and fiscal policies that a government pursues. Idleness is the result of the failure within an economy to use the labour available within that country in an economically efficient manner.

There are four drivers of growth in any economy according to generally accepted macroeconomic theory. The first driver is increasing consumer spending. The second is an increase in business investment. The third is an increase in net exports (or a decrease in net imports). Finally, there is an increase in government spending, preferably on investment. There are no other variables but these when considering where demand comes from in any economy: they are it. As a result it is easy to use these variables to explain why we have idleness in the UK economy at present.

As we know from an economy in double dip recession, consumer spending is currently stagnant. Reports suggest that consumer spending fell by 1 per cent and 2 per cent compared to the previous year<sup>14</sup>. In that case there is little prospect on the basis of current policies, of consumer spending growing to create the demand for work that will end idleness. UK business investment gives little more grounds for hope. Since 2008 quarterly business investment spending has followed the pattern: shown in Chart 4.

**Chart 4: Business Investment, Q3 2012 revised, 2008-2012.**

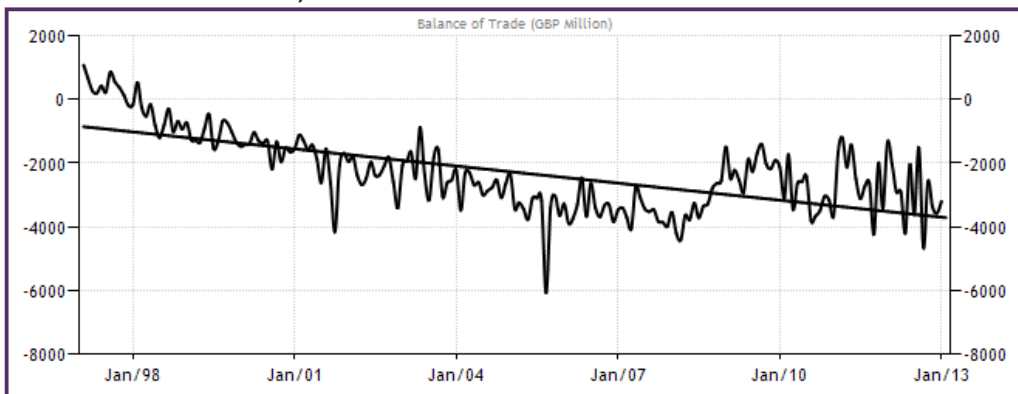


Source: Quarterly Survey of Capital Expenditure - Office for National Statistics <http://www.ons.gov.uk/ons/rel/business-invest/business-investment/q3-2012-revised-results/bus-invest---summ-q3-2012-m3.html>



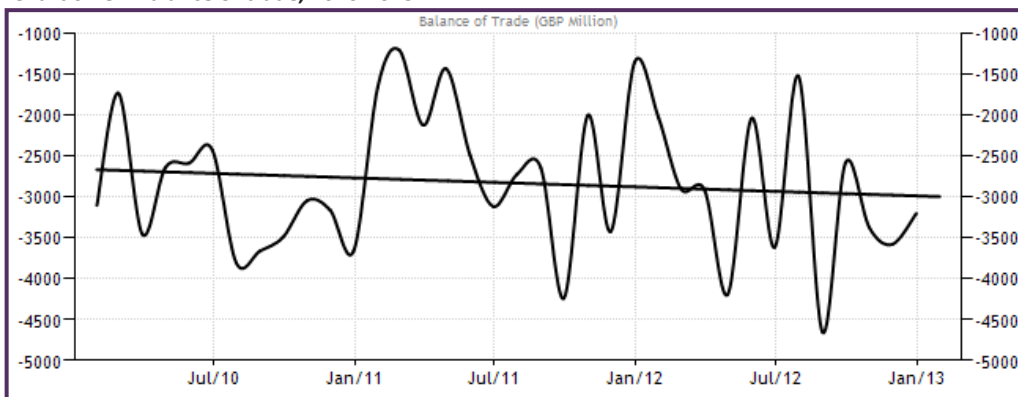
Investment may be recovering at the end of 2012, but it has yet to reach the level recorded in 2008, and that is without inflation adjustment. This is happening despite the fact that according to Ernst & Young, the Big 4 accountants, UK non-financial companies in the FTSE 100 are currently sitting with £750 billion in cash on their balance sheets<sup>13</sup>. At least in big businesses the money that is needed to invest is available for investment even if the failure of the banks is having a significant impact on smaller and medium sized companies. What is clear then is that investment is not taking place not because cash is unavailable; even in smaller businesses steps are being taken to address that problem. It is instead the case that investment is not taking place because businesses cannot see a reason to invest. That is because consumers are not spending and so profit opportunities are limited. The net result is that we cannot look to business investment increasing whilst current policies remain in place if we want to find a way to tackle idleness. The UK's exports are a sorry tale: data from 1997 to the time of writing is shown in Chart 5. A trend line has been added for the sake of clarity, and it will be noted that it is downward. That admittedly, would not be the case for a graph drawn from 2007 to date, but is for 2010 to date, as shown in Chart 6.

**Chart 5: UK Balance of trade, 1998-2013.**



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com) - UK Office for National Statistics

**Chart 6: UK Balance of trade, 2010-2013.**

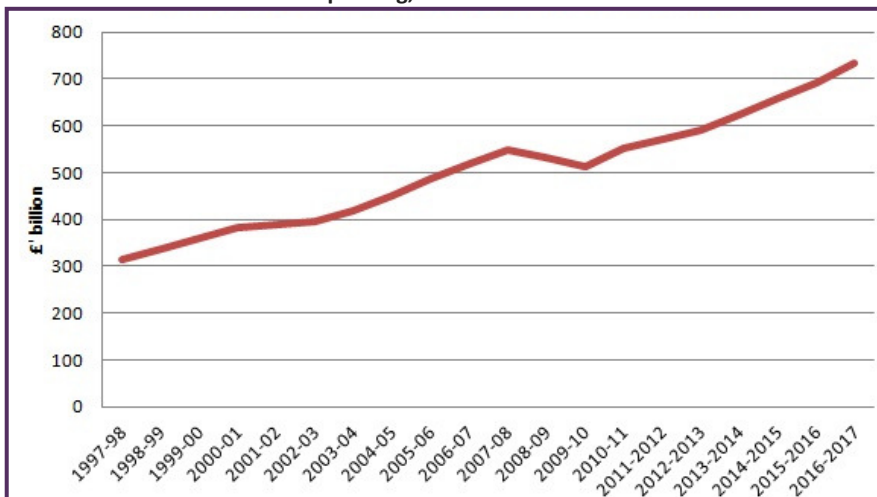


Source: [www.tradingeconomics.com](http://www.tradingeconomics.com) - UK Office for National Statistics

Whilst the Eurozone crisis and global recession, both of which developed significantly during this period, continue to suppress any real prospect of export growth it is unrealistic to think that exports can provide a path to growth and as such a way out of idleness.

That leaves just one way to achieve this objective, and that is through government spending. This is, of course, the way that the government is choosing not to go. It is quite true that government spending as a whole has not fallen in absolute terms during the recession as Chart 7 from Budget reports and forecasts up to date to 2012 shows.

**Chart 7: Current Government Spending, 1997-2017.**



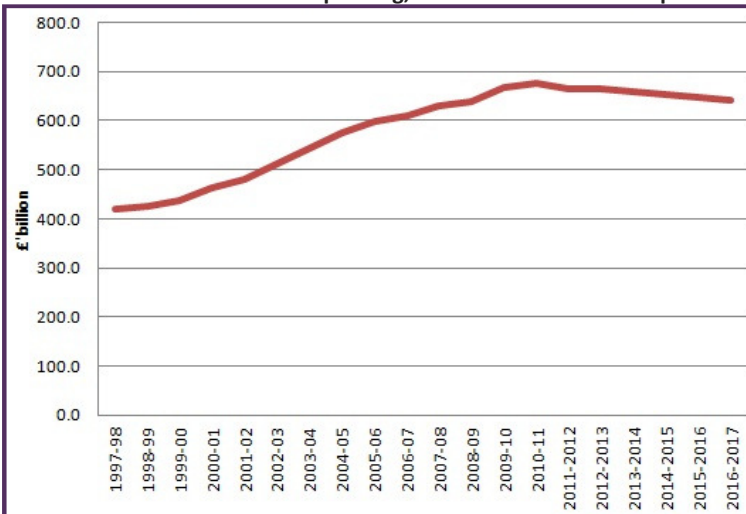
Source: Historical data from HM Treasury, Public Finances Databank: Forecast data from HM Treasury Autumn Statement, December 2012.

However, when this spending is restated to reflect inflation (in the form of CPI) a different picture emerges, as shown in Chart 8.

In real terms it is planned that government expenditure should fall and since much of the actual increase is down to increased borrowing costs and what are called the *automatic multipliers* – that is increase in spending on benefits relating to unemployment – the real fall in the government’s discretionary spending is more marked than these Treasury forecasts suggest. In addition, if government capital expenditure is looked at – where the ability to change economic output is greatest – then a very different picture is seen (Chart 9), again using Budget data.

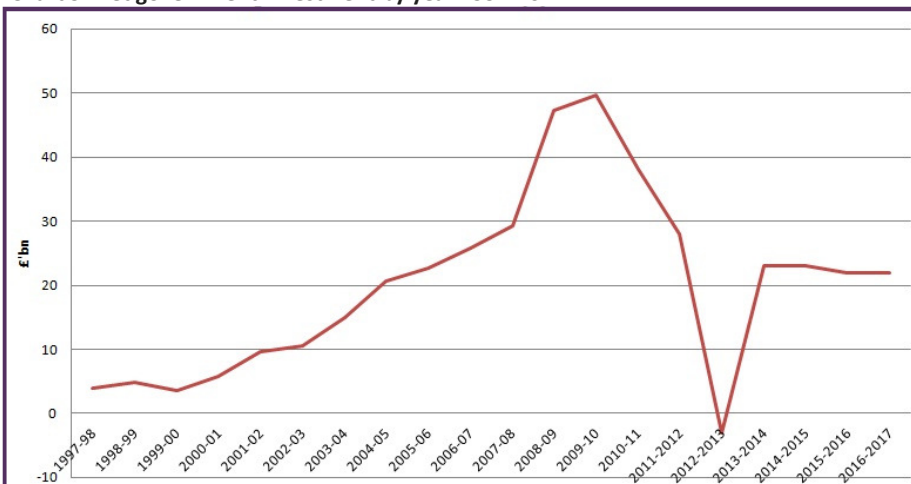
The figures noted are stated net of depreciation, that is the wearing out of government assets each year, and it will be noted that Treasury policy created a

**Chart 8: Current Government Spending, 1997-2017 in 2012-2013 prices.**



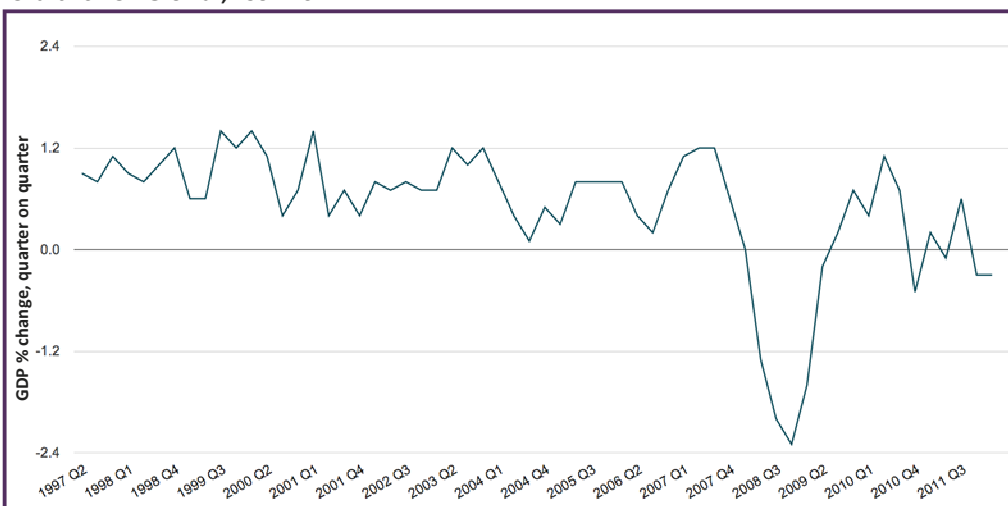
Source: as Chart 7

**Chart 9: Net government investment by year 1997-2017.**



Source: as Chart 7

**Chart 10: UK Growth, 1997-2012.**



Source: as Chart 7

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significant part of the current crisis of idleness by effectively cancelling net investment in 2012-13. This reversed the beneficial impact of Labour's Keynesian stimulus that the graph so clearly shows and which led to there being growth in the economy at the close of its time in office.

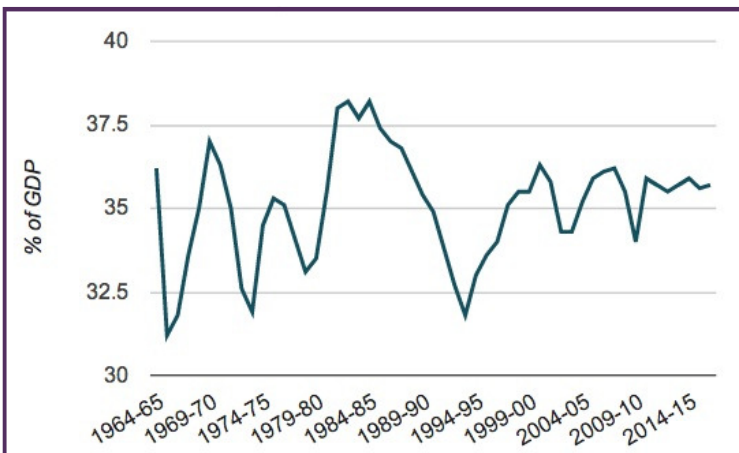
It will be noted that there is some reversal of the earlier cancellation of investment in 2014 onwards, but the impact will take time to clear: idleness has resulted from a policy decision. This is reflected in growth data from 1997 to 2012, shown quarterly in Chart 10.

In the immediate aftermath of the 2008 crash growth collapsed, but the immediate stimulus that government investment created, rapidly reversed this. By 2010 growth was restored. Then investment was reduced based on the belief that the 'multiplier' effect of government spending was limited and that the impact of cutting spending was also limited. The result was that growth collapsed and recession returned. The policy decision to cut was based on what the IMF now admits was a false premise. In fact government investment boosts the economy by much more than the spending that occurs: as the IMF has admitted that boost could be as much as 1.7 times the spend. This reality is obvious from the growth trend data.

If this is true there are several reasons for investing. First, people come off benefits and are no longer idle. That in turn gives rise to social benefits of the sort already noted. There is also an asset created for the long term, and a boost to the remainder of the economy as confidence rises and so people spend more and business invest more, in their own way tackling idleness. Most important though is the impact on borrowing. Even if the funds to invest are borrowed and are not raised from taxation there is a net boost to the economy. And that makes sense when there is idleness: paying for investment by taxation in that situation is like robbing Peter to pay Paul; the increase in investment spending is largely (if not entirely) counterbalanced by a cut in consumer spending in that situation, meaning the two, broadly speaking, negate each other.

An example helps explain this. Overall UK tax receipts are around 36% of GDP at present, a trend that has varied over time, as shown in Chart 11.

Chart 11: UK tax receipts 1964-2015.



Source: HM Treasury via the Guardian <http://www.guardian.co.uk/news/datablog/2010/apr/25/tax-receipts-1963>

Broadly speaking as a result for every £1 spent into the economy 36p is recovered in tax of various sorts.

However, if the multiplier effect is at work then extra government spending of £1 on new investment does not create just £1 of extra GDP: the boost it gives to the economy creates £1.70 of extra GDP in that case. What that then means is that the extra £1 of government spending generates an immediate benefit in terms of additional tax collected of about 61p in tax (i.e. 36 per cent of the £1.70 of extra income).

That is, however, before the impact on the 'automatic multipliers' is taken into account. As Richard Murphy's work has shown<sup>15</sup>, in 2009 a person earning £25,000 at the time did make a net tax contribution of almost exactly 36 per cent of their income to the economy (totalling £9,140 at the time). However, the total cost of supporting such a person when on benefits could easily exceed £12,000. In other words, the impact of benefit payments if they could not work could exceed 45 per cent of income.

The tax contribution was calculated as shown in Table 1. The net contribution to government of £9,140 is 36 per cent of an income of £25,000. The benefit cost, based on a single person renting with one child, was calculated as shown in Table 2. The net cost to government of £12,160 is more than 48 per cent of £25,000. The figure is, of course, representative.

**Table 1: Net tax contribution to government**

	(£)
Income	25,000
Income tax paid	-3,705
National Insurance paid	-2,120
Net pay	19,175
Council tax paid	-700
Income after council tax	18,475
Also:	
Child Benefit	1,040
Child tax credit	1,110
	2,150
Disposable income pre rent	20,625
Rent paid	-6,000
Disposable income after rent	14,625
Tax (VAT, petrol duty, car tax, TV licence, alcohol duty, etc) paid out of disposable income (approximately 15%)	2,300
Income tax paid (as above)	3,705
Council tax	700
National Insurance paid (as above)	2,120
Total tax paid	8,825
Add, National Insurance paid by employer	2,465
Total tax paid as a result	11,290
Less, benefits received (as above)	2,150
Net contribution to government	9,140

**Table 2: Net cost to government. Based on a single person renting with one child.**

	(£)
Job seeker's allowance	3,353
Child tax credits	2,785
Child allowance	1,040
Housing benefit	6,082
Council tax benefit	700
Total income	13,960
Tax paid: council tax	-700
Net income after tax	13,260
Rent paid	-6,000
Net income after rent	7,260
Tax (VAT, petrol duty, car tax, TV licence, alcohol duty, etc) paid out of disposable income (approximately 15%)	1,100
Add council tax paid, as above	700
Total tax paid	1,800
<b>Net cost to government</b>	
Total benefits paid	13,960
Less: tax paid	-1,800
Net cost to government	12,160

In that case the benefit arising from £1 of extra government investment when there is unemployment (as is the case now) then firstly GDP increases by up to £1.70 and secondly the tax benefits resulting from that could be at least 84 per cent (36 per cent + 48 per cent) of the labour element of that £1.70 increase in GDP. It is

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debatable what part of the growth relates to gross wages (because the labour share of wages in GDP is usually stated net of tax) but the ratio is such that the direct, labour related, tax recovery of that growth might entirely plausibly be at least £1, and that is before taking into account the benefit of the new asset the spending has created or the social and private sector benefits arising. The important point is: the spending can pay for itself.

It is fair to warn such figures are, of course, estimates. It is not possible to be sure that such an extrapolation can be made with the accuracy implied. However, that is not a matter of concern. The benefit from £1 of extra spending on government investment is so clearly overall likely to be in excess of the sum expended that it has to be worthwhile. The conclusion then is a simple one, even if it only reiterates what Keynes said in the 1930s: if the aim is to invest to reduce unemployment then the budget will indeed look after itself. Indeed, spending will almost certainly reduce the deficit. It has to do so.

## **How to implement a fiscal policy to tackle idleness**

This then suggests that there is a clear benefit to having a tax and spending policy to tackle idleness, simply because increased activity pays for itself.

As Duncan Weldon has noted<sup>16</sup>, in June 2010 the then new Office for Budget Responsibility assumed that the multipliers in the UK were as follows:

**Change in VAT: 0.35**

**Change in personal tax and NICS: 0.3**

**Change in welfare spend: 0.6**

**Change in departmental spending: 0.6**

**Change in capital spending: 1.0**

These were wrong, as noted above; each being a serious underestimate as the IMF has now appreciated. However, they are worth noting because they show that when it comes to spending to tackle idleness not all spending is equal. Tax cuts are only one third as effective as government investment in new capital spending projects when it comes to stopping idleness. That is because at least part of the impact is exported by boosting imports, and that may increase employment in China or Germany but that is not usually the UK government's aim.

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On the other hand, spending on general projects for immediate benefit is twice as effective as a tax cut. This is unsurprising: most government spending is on employing people (the NHS is the largest employer in the UK, for example). This service-orientated spend stays, at least in the first instance, in the UK, even if those who receive the income will then spend on imports. This though, is why direct government spending, or alternatively, stopping austerity cuts, is a more effective way of decreasing idleness than tax cuts.

What is notable though is that capital spending is by far the most effective way to tackle idleness because the impact per £1 spent is by far the highest within the economy.

In that case a fiscal policy to tackle idleness has, if it is to be evidence based, to have at its core a policy of exploiting the multiplier impact of any spending to the full. This means that:

1. Tax cuts have a low priority: as the evidence of corporation tax cuts in the UK have shown, these appear to have little impact and whilst VAT cuts in 2009 may have delivered short term benefit they should best be seen as an immediate reaction measure, not a long term strategy;
2. Cuts in benefits are harmful: such cuts have a high negative multiplier effect, reducing demand in the economy and so increasing idleness, in the process compounding the impact of idleness for those involuntarily suffering it. Cuts in benefits should therefore be cancelled. That this is the case is intuitively obvious: those in receipt of benefits normally spend all of their income, and largely on essential items, many of which will be purchased in local communities where people live, with a small part going on imported items, which tend to be consumer durables;
3. The greatest impact of a fiscal programme to tackle idleness has to replicate the New Deal of the 1930s and create a programme of rapid and large scale investment in public works. This is not the place to suggest a detailed programme but obvious candidates have to be capable of delivering rapid impact and that means they must be relatively small scale, with low training required and with a good chance of being implemented quickly. This means



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that committing to projects like HS2 may sound good politically, but such policies have very limited immediate impact as their gestation periods are so long. What are required instead are:

- a) Extensive programmes of repairs should be undertaken. By extending asset lives this qualifies as investment for these purposes, and by shifting expenditure from future periods when we might hope markets can deliver fuller employment, to the current period when they cannot, the effective cost is reduced considerably;
- b) Large numbers of small scale investments such as the retro-fitting of double glazing, cavity wall insulation and loft insulation where impact can be large and quick and investment returns are also, conveniently, high;
- c) The building of housing where the impact of investment can be widely diversified.

Other examples can obviously be offered but in each case the policy impact is obvious. By accepting that tax and fiscal policy are related issues, with borrowing and tax being capable of being treated as substitutes one for another, and with the impact of some forms of spending on idleness being much greater than others, it is possible to design fiscal policies that can, and will, end idleness. That is the first stage of a proactive government policy to tackle this issue. Tackling problems within the tax system itself is the next stage.

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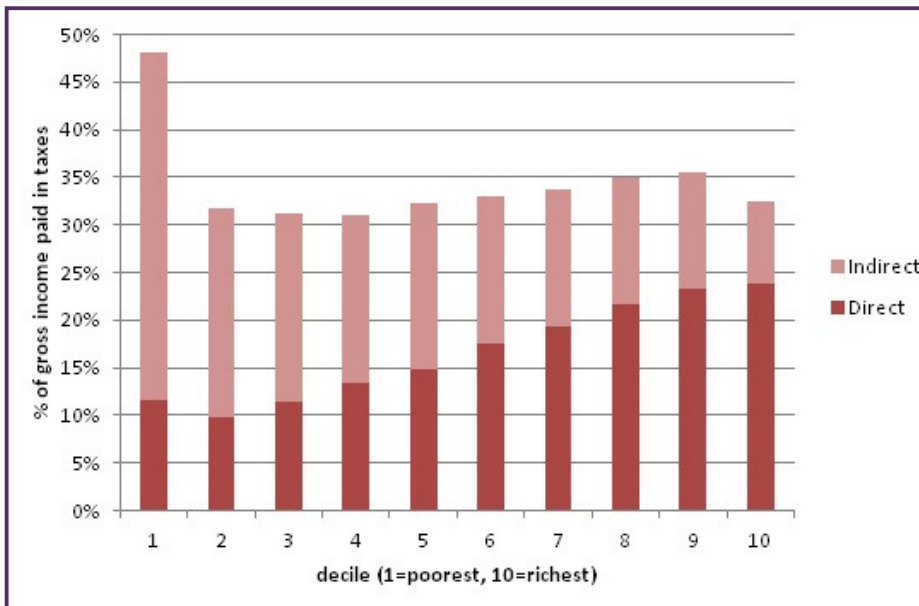
## Part 3: Remedying the disincentive to work within the tax and benefits system

There is a remarkable consensus on the UK tax system. Whilst it clearly suits those well off very well and develops benefits to them that they greatly appreciate, whatever the protestations they might offer, it works very badly indeed for a great many in the UK who are on low income. Since involuntarily idleness and low pay are inevitably related issues, this is a serious problem for those wishing to tackle the problem of involuntary idleness. It is apparent that the tax system can either encourage idleness, or encourage a failure to report income earned which may have much the same effect and is corrosive of society as whole.

Our recommendations here are radical: we are committed to strong, progressive taxation. That means we believe that as income rises the proportion of their total income that a person pays in tax should rise as well. It is a principle of tax justice, usually described as vertical equity, that few would wish to dispute. However, the UK tax system does not deliver vertical equity in a great many cases. Chart 12 presents figures for the proportion of household incomes paid in direct taxes (income tax, national insurance and Council Tax) and indirect taxes (mainly VAT), for households divided into ten equally sized “deciles”, from poorest to richest. Overall, the poorest 10% of households pay substantially more tax as a proportion of their incomes than do any of the other deciles, and tax paid as a percentage of income is reasonably flat (rather than rising as a proportion of income in a progressive manner) across the rest of the income distribution.

The current tax and benefit system produces very high marginal tax rates for low earners who are in receipt of Working Tax Credit (WTC), Housing Benefit (HB) and/or Council Tax Benefit (CTB). Table 3 presents some calculations of marginal rates for people on low incomes in receipt of one or more of these benefits. Anyone on Working Tax Credit with a family gross income of above £6,420 faces a marginal deduction rate (MDR) of 41 pence on each pound of earned income. For people above the national insurance primary threshold (currently £149 per week) and the income tax personal allowance (currently £9,440 per year) this rises to 73%. For people also on in receipt of CTB and HB in addition to WTC, the total marginal

Chart 12: Direct and indirect taxes as a proportion of household income by income decile, 2010-11.



Source: Source: ONS (2012), The Effects of Taxes and Benefits on Household Income 2010-11. Methodology used to produce results is an updated version of D. Byrne and S. Ruane (2008), "The UK Tax Burden: Can Labour be called the "party of fairness", Compass Thinkpiece.

Table 3: The impact of the interaction of tax and benefits.

Benefit/tax combination	Working Tax Credit	Employee NICs	Income tax	Council Tax Benefit	Housing Benefit	Total (excluding employer NICs)	Employer NICs	Total
On Working Tax Credit taper, below NICs threshold	41%					41%	0.0%	41%
On Working Tax Credit taper, above NICs threshold, below income tax threshold	41%	12%				53%	12.1%	65%
On Working Tax Credit taper, above income tax personal allowance	41%	12%	20%			73%	12.1%	85%
As above and on Council Tax Benefit	41%	12%	20%	5.4%		78%	12.1%	91%
As above and on Housing Benefit	41%	12%	20%	5.4%	17.6%	96%	12.1%	108%
Not on Working Tax Credit, on Council Tax Benefit, above income tax personal allowance	0%	12%	20%	13.6%		46%	12.1%	58%
Not on Working Tax Credit, on Council Tax Benefit and Housing Benefit, above income tax personal allowance	0%	12%	20%	13.6%	44.2%	90%	12.1%	102%

Note: employer NICs marginal rate calculated as  $(13.8/113.8) = 12.1\%$

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deduction rate rises to a staggering 96% - i.e. these people keep only 4 pence of each additional pound they earn. Even for low earners not claiming WTC (for example, most childless people on low earnings) the marginal deduction rate for people on HB and CTB and above the Income Tax personal allowance is 90%.

The Coalition Government has claimed that the replacement of the current tax credit and means-tested benefit system with Universal Credit (UC) – which is scheduled to begin in autumn 2013 – will mean that no-one on low earnings faces a Marginal Deduction Rate (MDR) of more than 73%. This is because Universal Credit operates with a taper of 65% on income after income tax and national insurance, so the combined marginal rate is equal to 73%. This is calculated as 20% income tax plus 12% employee national insurance plus 65% of income after tax and national insurance, which then equals 73%. However, notwithstanding the fact that 73% is still a very high withdrawal rate, the Government's analysis is in any case incomplete; it ignores the fact that many low earners in receipt of Universal Credit will also be in receipt of Council Tax Support (CTS) – the localised replacement for Council Tax Benefit.

As recent research by the New Policy Institute shows<sup>17</sup>, most councils are planning to incorporate the current income taper rules for Council Tax Benefit (tapered at 20% for each £1 of increase in income after tax and national insurances) into their new Council Tax Support rules, which would mean that the MDR for people in receipt of Council Tax Support rises from 73 percent to 78.4%. Some councils are also planning to increase the taper rate to 25 or 30% of net income which would mean MDRs as high as 81%. So, while the introduction of Universal Credit eliminates the MDRs of 90% or more that many households currently claiming Housing Benefit face, it still results in a large number of low-income households with MDRs in the region of 80%. MDRs at this level offer very poor incentives for low-income workers to increase their hours of work or find better-paid employment.

## **Causes of vertical inequality in the tax system creating disincentives to work**

There are a number of causes for vertical inequality of the sorts just noted. At higher income levels the restricted tax allowances, that are now often subject to seemingly arbitrary limits, coupled with some recent changes such as reducing the personal

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allowance for those earning more than £100,000 a year, produce some highly erratic tax rates for those in these income brackets. These are not, however, the focus for attention when considering the issue of idleness. At lower income levels there are fundamentally three problems that create considerable problems with the tax and benefits system that can result in considerable and entirely reasonable disincentives to work.

The first is the interaction between the Income Tax and National Insurance system: National Insurance is operated on much lower levels of income than Income Tax but is crude in its impact, being assessed each time a person is paid with little consideration of cumulative impact over a period of time and multiple payments. This can produce anomalous and unfair results for those undertaking a number of employments, for example with both too high and too low a level of charge being possible, especially if some payment is from employment and another part from self employment. National Insurance is a problem in other words.

Secondly, as noted above, the withdrawal of benefits is a massive issue of concern.

Lastly, and maybe for many people rather strangely, increasing personal allowances that provide increasing levels of tax free income also create problems for those suffering involuntary idleness. This is because whenever there is a shift from one status to another (in this case not being taxed to being taxed) then a transition problem occurs which in itself may look surmountable but which if not coordinated with other similar transitions (losing benefits, for example) creates substantial marginal tax rates that create a massive disincentive to work for those on low pay, as noted above.

These issues are all significant, and all are now inherent in the design of our tax and benefits system. Well meaning changes to address one issue can give rise to problems elsewhere. It is our opinion that this is best addressed by a complete redesign of the Income Tax, National Insurance and benefits systems: nothing less will do if we are to tackle institutional impediments to idleness.

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## Redesigning tax and benefits for the 21st century

The Coalition government has tried to redesign benefits whilst in many ways making the problems they are tackling harder by increasing taxation allowances and National Insurance rates. We reject this approach to tackling the problems of reducing the barriers to work that the present system creates. We do instead suggest a much more radical solution to the problem of tax reinforcing patterns of voluntary idleness. Our proposal is radical but, we think, essential.

It is our belief that if the problems we have outlined are to be addressed we need to do three things.

The first is to make a universal benefits payment in the UK to all families. This is often described as a Citizen's Income. The level we are suggesting is based on the Minimum Income Standards developed by researchers at the Centre for Research on Social Policy at Loughborough University<sup>18</sup>. This level is set sufficiently high to completely eliminate poverty (using a poverty line of 60 per cent of median earnings) for working age families<sup>19</sup>. Thus the system we are suggesting eradicates another of Beveridge's five Giant Evils, 'want' – at least to the extent that 'want' consists of low income.

Next, we would suggest the merger of tax and National Insurance. The contributory principle was sound when Beveridge first proposed it but it has outlived its usefulness, and is largely a fiction in the present system in any case, given that many of the families most vulnerable to poverty are those with the fewest previous contributions under the National Insurance system. In addition, for all practical purposes National Insurance is now a tax, and a not very good one at that, not least because it is deeply regressive since most incomes of much over about £42,000 a year are subject to very low rates of tax whereas lower levels of income are subject to higher rates. This is perverse in a progressive tax system.

Most of all though, having a separate system creates complexity and that is one of the inherent flaws in our current arrangements. Merging all National Insurance into income taxation would simplify and clarify the current system of personal taxation as well as creating parity between employees and the self-employed. Several governments, including the current Coalition Government, have proposed merging

income tax and National Insurance: in this paper we show that it can be done, and reasonably straightforwardly.

We are aware that if such a merger does take place then pensioners could lose since they do not now pay National Insurance. We would seek to protect those on modest incomes under our proposal. Those enjoying higher levels of income in retirement do not, however, we think need protection. The principles of progressive taxation should apply even in retirement in our opinion.

Our proposed system is based around two simple components:

### **1. Basic income payment – Minimum Income Standard**

All families would receive an unconditional, tax-free basic income payment that would be set at levels sufficient to alleviate poverty. We suggest using the Minimum Income Standard (MIS) developed by researchers at the Centre for Research in Social Policy at Loughborough University in 2008, and revised and updated in 2012 using funding from the Joseph Rowntree Foundation. Table 4 shows the weekly levels of payment required using the MIS data for families of different sizes.

We stress, these payments would be aid, irrespective of a person's other income in the arrangement we propose: these are universal entitlements.

**Table 4: Minimum Income Standards for families of different sizes.**

Family type	Minimum Income Standard (£/week)
Single, no children	192.59
Couple, no children	301.74
Lone parent, 1 child	275.59
Lone parent, 2 children	361.99
Lone parent, 3 children	457.66
Couple, 1 child	374.17
Couple, 2 children	454.52
Couple, 3 children	554.55
Couple, 4 children	605.80
Single pensioner	158.74
Couple pensioner	231.48

Source: [www.minimumincomestandard.org/2012\\_update.htm](http://www.minimumincomestandard.org/2012_update.htm)

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## **2. Unified Income Tax (UIT)**

The current Income Tax system and the entire National Insurance Contributions system (employer, employee and self-employed contributions) would be replaced by a single Income Tax structure. This would have a clear and progressive structure, but would have a basic rate of around 50 per cent (for people of working age) over most of the earnings distribution. This would apply to all income (including earnings, investments, property and private pension income) as well as capital gains. To ensure that the tax structure is progressive, low earners would pay income tax at rates well below 40 per cent - we envisage a small tax-free personal allowance (maybe £2,000 or so, but remember everyone gets the Minimum Income Standard payment noted above instead) followed by a 25 per cent band and then the main 50 per cent band. At the other end of the income scale, incomes above £100,000 would pay tax at higher rates ranging from 60 per cent to a maximum of 70 per cent for incomes above £150,000 - which sounds much higher than the current (until April 2013) rate of 50 per cent, but in fact, taking employee and employer National Insurance Contributions (NICs) into account, is actually not much higher than the current system. We call this the Unified Income Tax system.

## **Overall costings**

This section presents some basic costings for the system. The rate of average Unified Income Tax (UIS) required to pay for a tax-free Minimum Income Standard (MIS) to all households is calculated as follows:

- 1) The cost of paying Minimum Income Standard to all households is compared with the current costs of benefits and tax credits (excluding CTB and HB, which we discuss later on). Comparing these two numbers gives the additional revenue required to pay for MIS relative to the current benefit and tax credit system.
- 2) We assume that the rate of Universal Income Tax has to be set in order to raise an amount equal to the current revenue yield from Income Tax and NICs plus the additional revenue required to pay for MIS. In other words we assume that all the additional revenue required to pay for MIS comes from UIT.



Table 5 shows that Universal Income Tax would need to be set at about 45 per cent to meet the costs of universal basic income at Minimum Income Standards levels if applied equally at all income levels (which is not our intention). However, in practice we suggest it should be possible to meet some of the costs of MIS through other taxes (e.g. wealth taxes) and reforms to the current system that reduce tax avoidance and evasion. If we assume that (say) £55 billion per year can be raised through a combination of wealth taxation and reduced avoidance/evasion (a process that would be greatly assisted by the UIT simplification), this would reduce the required UIT rate to around 40 per cent, which is below the current effective marginal deduction rate for most employees from a combination of basic rate Income Tax, employee NICs and employer NICs (assuming that employer NICs are actually incident on the employee in the final instance as almost everyone does).

**Table 5: Calculation of average UIT rate required to pay for universal family MIS<sup>20</sup>.**

	Amount (annual, £bn)
Current cost of benefits and tax credits (excluding HB & CTB)	173
Cost of paying MIS to all households	467
Additional tax revenue required	294
Current revenue from income tax & NICs	260
Required total revenue from UIT	554
Household taxable income (estimated)	1228
Average UIT rate required	45%

### ***Marginal rates of UIT***

This analysis suggests an average rate of UIT of 45 per cent to balance the books (in practice, the rate would hopefully be lower than this, as explained above). However, we are not proposing a ‘flat tax’ at a fixed rate on all income. Rather, the structure of UIT would be progressive: as indicated above, we suggest a series of rates ranging from a small personal allowance for the lowest earners, through a 25 per cent starting rate, 45 per cent basic rate, and then higher rates on incomes above £100,000 per year up to 70% above £150,000 or £200,000 per year. When National Insurance is taken into account these rates are only a little above those now in operation for those on PAYE in these income brackets. In addition, because they would apply to all income, earned and unearned as well as capital gains, the

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opportunities for tax avoidance would be reduced, although to ensure this was the case measures to stop income shifting into companies would be needed.

### ***Replacing Housing Benefit***

The system described above does not include an allowance for housing costs in the MIS as this would make the costs of the basic income scheme impractical. We suggest providing a means-tested support scheme for housing costs along the lines of the current HB scheme but with lower marginal withdrawal rates of housing support – say, no more than a 60 per cent combined taper for housing support plus UIT at any point in the income distribution. This means that MDRs for most families receiving housing support would be much lower than those created by the current HB system or the Universal Credit system scheduled to be introduced later this year. Large-scale construction of new social housing is also crucial to provide additional low-cost rental housing for low income families which would reduce the HB bill<sup>21</sup>, as would rent controls in the private sector to discourage profiteering by landlords.

### ***Replacing Council Tax Benefit***

The interaction of CTB (and its successor, Council Tax Support) with the withdrawal taper for other means-tested benefits is currently one of the factors meaning that MDRs for low-income households are extremely high both under the current tax-benefit system and Universal Credit. We suggest replacing Council Tax with a tax on land values, shifting the tax base from income to wealth, to circumvent this problem. The tax would be payable by landowners rather than tenants.

## **Advantages of the reformed tax-benefit system**

The reforms we are suggesting to the UK tax and benefit system have the following advantages compared with the current system:

- The Citizen's Income scheme we are proposing means the effective eradication of poverty (on the Households Below Average Income “*below 60% of median income*” definition) – and immediately, rather than having to wait until 2020 or some indeterminately distant point in the future.

- MDRs for families on low incomes are much lower under this system – a maximum of 60 per cent for those in receipt of housing support and 45 per cent for those not on housing support.
- The system would be hugely simplified, with only one direct tax and two benefits – the universal citizen’s income and a means-tested benefit to assist with housing costs. There would be no need to maintain National Insurance contributions records anymore, and it would be much easier for people to understand how much better off they would be in work than out of work.

### **Areas where further research is necessary**

- Disabled people in the UK face additional costs that (we would argue) should be reflected in the level of citizen’s income available to them, or via some other kind of additional payment. Thus there would continue to be a need for something along the lines of Disability Living Allowance to make the system fairer for disabled people vis-à-vis non-disabled people.
- There is an unresolved question (which we do not attempt to address in the limited space available here) about how much work conditionality should be attached to receipt of citizen’s income. Because of the substantial increase in non-means-tested income transfer payments compared to the existing system, the system may create an incentive not to work at all compared with the current system. There is a case for having a job search requirement for unemployed people (excepting the disabled, carers and those with young children) along the lines envisaged by Beveridge. The precise extent of conditionality is a matter for further debate, but is an issue we acknowledge to be of significance, as did Beveridge.
- The citizen’s incomes payable to families do not include an allowance for childcare costs in the version of the system we could set out here. Childcare subsidies could be included in the system (at extra cost), or alternatively childcare providers could be subsidised directly by the government to create provision which is low-cost or free at source. The question of what system works best is a matter for further study drawing on international best practice.

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# Conclusion

This paper has sought to address a complex issue. It is our belief that people who wish to work for a wage should be able to do so. That is, after all, why idleness is an issue. If it were voluntary then we need not be troubled by it: the fact is that it is not.

At a macroeconomic level what involuntary idleness represents is a massive waste of economic resources for this country. We have sought to show that the policy of austerity that has increased idleness, and which has now given rise to the additional problem of disguised under-employment, makes no economic sense now we know that in the current state of the economy spending on investment by the government does, at the very least, pay for itself in the short term whilst in the longer term it can generate the revenues needed to deliver deficit reduction. In doing so we suggest nothing more than Keynes made clear was the case eighty years ago, which is that if the issue of unemployment is addressed then the budget looks after itself.

What we also address is the fact that at a microeconomic level the barriers to work are very real. When many on low levels of income face MDRs (a measure that we use to combine the impact of tax and National Insurance payments and benefit withdrawals) of in excess of 90 per cent over relatively wide ranges of their available income then the disincentive to work is, understandably, high. The government says that Universal Credit will reduce this to a maximum 73 per cent, but we show this is not true: in making their claim they ignore, for example, Council Tax Benefits.

We conclude that we face a conundrum. People want to work and it is clear that it makes sound economic sense for the government to invest to get people back into work. However, there are sound and wholly economically rational reasons deep-rooted in the current tax and benefits system why for some people work quite literally cannot pay, even before their additional costs arising from being out of their homes (such as travel costs and paying for childcare) are taken into account. If idleness is to be tackled, there is then what we think to be an irrefutable case for broader reform of the tax, National Insurance and benefits system, than this government, or any since the current structure was created has been willing to undertake.

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We are not, of course, the first to suggest the merger of the tax and National Insurance systems, and that is what we do. What we also, however, do is integrate that reform with a suggestion for a radical reform of the benefits system. Our proposal embraces the idea of a 'citizen's income'. This is a universal payment to all families (including those made up of a single person), without exception, of a weekly sum meant to ensure that they have at least 60% of UK average earnings on which to subsist each week. On current definitions of poverty this would, at a stroke, eliminate want from the UK economy.

The design of the payment we propose is important: it is simple, which saves enormously in its cost of management. It is universal, so that it is paid irrespective of the level of the recipient's income, so that problems created by the withdrawal of benefits are avoided. And because it is universal, it has the merit of not dividing society in the way that so much recent political debate has sought to do.

Such a payment would, however, be expensive. We estimate a total cost of approximately £467 billion a year. To put this in context, the current total benefits budget is £173 billion a year, including the old age pension that this payment would also replace. Taxes would therefore, very obviously, have to change to pay for this universal benefit, paid without questions being asked to all families in the UK. To achieve this we suggest a new Universal Income Tax to replace the current Income Tax, National Insurance and Capital Gains Tax system (although separate rules for the calculation of gains would still be needed).

This new tax would have a different logic to some parts of the existing tax system. For example, because there would be a universal payment to all families (including single people) every week, the need for a significant personal tax allowance would largely be eliminated: almost all income could, as a result, be taxed.

We would, of course, propose that the tax be progressive and admit that at present we have not completed calculations on an appropriate scale of such progression, but we would expect the tax to start at a rate of at least 25 per cent, have a standard rate of maybe 45 per cent and to have higher rates of up to 70 per cent on incomes in excess of £150,000.

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These rates sound high, but it has to be borne in mind that a family of two adults and two children enjoying an income of £30,000 would have an overall tax rate of less than 45 per cent, meaning they would pay less than £12,500 in tax, but would also receive an annual income of not less than £23,600 under our proposal. In other words, they would enjoy their earned income effectively tax-free.

No one can pretend that keeping a family on this level of income is easy, and measures to support rental costs would still be needed, but the essential point is that under this system work always pays, and the rate of tax paid by those undertaking it will always be lower than most on low incomes now suffer. The impediments to work would be eliminated, real incomes would rise because employer's National Insurance would be abolished which should give rise to significant increases in pay, and those on high incomes would face marginal tax rates on earned income little different from those now paid when National Insurance is taken into account, albeit that those living off unearned income would pay somewhat more.

The system does, therefore have the merit of unambiguously encouraging work. It does at the same time have the merit of massively simplifying the benefits and pension system. It will remove means testing from much of it. It also has the merit of massively simplifying the tax system, not least by removing the current incentives to abuse the differences between earned and unearned income, self-employed and employment status and income and capital gains to avoid tax. We suspect that when such factors are taken into account the overall rates of tax required to fund our proposal will be lower than we expect but nor are we embarrassed by the tax rates that we propose. As we have shown, the UK tax system is not progressive at present. It is unambiguously the case that our proposal would make it so. We make no apology for that. We have for years had a tax system that claims to be progressive when it is not, and which has actually imposed, as we show, by far the highest marginal tax rates (which are the greatest disincentive to work) on those who are low paid. Our proposal corrects that.

As a result what we propose tackles impediments to idleness: if the government were to invest to create new jobs, anyone taking one would always benefit as a result. That has to be appropriate. But equally, what we propose tackles want. And in the process tax abuse is tackled by simplifying the tax system whilst the outcome

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is a tax system that accords with the natural justice and economic logic of progressive taxation. Half measures will not work when tackling the current crisis. In 1942 Beveridge said the war provided a revolutionary moment and as he noted “*A revolutionary moment in the world’s history is a time for revolutions, not for patching*”<sup>22</sup>. We agree: the global recession is now providing another revolutionary moment in which new thinking is required. That is what we have sought to offer here.

# Notes

<sup>1</sup> William Beveridge (1942) *Social Insurance and Allied Services Cmd 6404*.

<sup>2</sup> William Beveridge (1942) *Social Insurance and Allied Services Cmd 6404*.

<sup>3</sup> Radio interview, 1933, Keynes, Complete Works XXI, p. 150.

<sup>4</sup> Draft chapter, 1933, Keynes, Complete Works XXIX, p. 80-1.

<sup>5</sup> Duncan Weldon (2012), <http://touchstoneblog.org.uk/2012/10/fiscal-multipliers-the-imf-the-obr/>

<sup>6</sup> Anjum Klair (2013), <http://touchstoneblog.org.uk/2013/01/the-rise-in-job-levels-since-the-recession-are-driven-by-surge-in-self-employment/>

<sup>7</sup> Ha-Joon Chang (2013) The Guardian: <http://www.guardian.co.uk/commentisfree/2013/jan/29/myth-lazy-mob-hands-rich>

<sup>8</sup> See <https://www.gov.uk/national-minimum-wage-rates>

<sup>9</sup> Resolution Foundation (2011) Low Pay Britain: [http://www.resolutionfoundation.org/media/media/downloads/Low\\_Pay\\_Britain.pdf](http://www.resolutionfoundation.org/media/media/downloads/Low_Pay_Britain.pdf)

<sup>10</sup> See, for example, Dickens, R., R. Riley and D. Wilkinson (2009). The Employment and Hours of Work Effects of the Changing National Minimum Wage. Research Report for the Low Pay Commission; Bryan, M, A Salvatori and M Taylor (2012), The Impact of the National Minimum Wage on Earnings, Employment and Hours through the Recession, Research Report for the Low Pay Commission.

<sup>11</sup> See <http://www.iea.org.uk/blog/expansionary-fiscal-contraction>

<sup>12</sup> Aditya Chakraborty (2012) The Guardian: <http://www.guardian.co.uk/commentisfree/2012/dec/03/osborne-plan-families-more-debt>

<sup>13</sup> See: [http://www.ey.com/GL/en/Newsroom/News-releases/News\\_Cash-is-a-challenge-for-cash-rich-and-cash-poor-CFOs](http://www.ey.com/GL/en/Newsroom/News-releases/News_Cash-is-a-challenge-for-cash-rich-and-cash-poor-CFOs).

<sup>14</sup> See <http://www.bbc.co.uk/news/business-20926609>

<sup>15</sup> See <http://www.taxresearch.org.uk/Blog/2010/05/17/the-only-way-to-cut-government-debt-is-to-increase-government-spending-2/>

<sup>16</sup> Duncan Weldon (2012) <http://touchstoneblog.org.uk/2012/10/fiscal-multipliers-the-imf-the-obr/>.

<sup>17</sup> P Kenway and S Popper (2012), "Localising Council Tax Support: A Briefing Note on Local Authorities' Plans", New Policy Institute. <http://www.npi.org.uk/files/New%20Policy%20Institute/LocalisingCouncilTaxSupport.pdf>

<sup>18</sup> See [http://www.minimumincomestandard.org/2012\\_update.htm](http://www.minimumincomestandard.org/2012_update.htm)

<sup>19</sup> Note that for pensioner families, their income needs to be slightly higher than the suggested Minimum Income Standard level to escape poverty. See [http://www.minimumincomestandard.org/downloads/2012\\_launch/mis\\_report\\_2012.pdf](http://www.minimumincomestandard.org/downloads/2012_launch/mis_report_2012.pdf), Table 5 p31. To alleviate this problem we have set Citizen's Income payments for pensioners equal to the equivalent (slightly higher) amount for working age adults.

<sup>20</sup> Sources: Income tax and national insurance yield – OBR Economic and Fiscal Outlook December 2012. Benefit expenditure: Institute for Fiscal Studies Fiscal Facts. Cost of paying MIS: authors' own calculations based on 2010-11 Family Resources Survey. Household taxable income: authors' calculations using HMRC Personal Incomes Statistics 2010-11, Table 3.5 (for taxable income above income tax personal allowance) combined with 2010-11 Family Resources Survey (to estimate taxable income below current personal allowance).

<sup>21</sup> See Duncan Bowie (2013) Tackling squalor: the pivotal role of social housing, Centre for Labour and Social Studies.

<sup>22</sup> William Beveridge (1942) *Social Insurance and Allied Services Cmd 6404*.



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