7. Land value tax and overall tax policy

Nobody likes paying taxes. But, leaving aside imperialistic wars of aggression dressed up as defence, and provided the tax system is fair and is seen to be so, people generally accept the need for governments to collect revenue for the provision of services and amenities from which everyone benefits – and which otherwise might scarcely exist. However, different taxes have different economic impacts, some tending to enhance economic activity, thus extending employment and raising earnings, and therefore help to improve social welfare, while others may have the opposite effect.

Pros and cons of different taxes

A famous historical example of a bad tax was the tax on date palms introduced by Muhammad Ali, the Ottoman ruler of Egypt, from 1805 to 1848. The peasant farmers responded by uprooting their trees to avoid paying the tax. But when this tax was replaced by a tax on land, this gave farmers the incentive to grow more palms in order to raise the revenue to pay the tax. This resulted in a bigger crop of dates, which benefited the economy of Egypt and its people.

In today's terms, it is the difference between imposing a tax on the development of land – as proposed in the Barker Review on housing supply, and as put into practice by previous labour governments – and a tax on the land itself. Whereas a development land tax acts as a disincentive to build houses or invest in other productive activities on the land, an annual tax on land according to its value would encourage such investments, because not making optimal use of the land is penalised.

Income tax, which accounts for just over a quarter of government revenue in Britain, should also be regarded as a bad tax because it tends to penalise enterprise and economic activity – the more one works, the more tax one has to pay.

Here, it should be noted that the incidence or burden of a tax does not necessarily fall on those nominally paying it. In the case of income tax, it will depend on workers' relative bargaining positions, which, among other things, is determined by the overall level of unemployment, how much in demand are particular skills, and how well organised workers are. When workers are in a weak bargaining position, more of the tax burden will fall on workers. This would reduce the incentive to work beyond a certain amount because of the higher effective tax rates on additional earnings.

However, when workers are in a strong bargaining position, the tax burden will fall more on the employer, because for a given take-home pay, they will have to spend more on wages than they would if there were no income tax. This will reduce the incentive to employ more workers, and would be at the expense of investment.

Of course, employers, as far as possible, will seek to pass on to consumers the extra amount that they have to spend on wages, in the form of higher prices. How far they will be able to do that will depend on the level of competition for the particular product or service being produced or supplied, as well as overall economic demand. If employers do succeed, it will mean that the income tax burden would have been passed on to consumers. As a result, consumers would have less to spend, which would reduce overall economic demand, and therefore the incentive to invest in new economic activities and jobs, thus having a negative impact on economic growth. It would also weaken workers' bargaining positions, so that more of the tax burden would fall on workers.

Similar arguments apply to other taxes on incomes, including corporation tax, as well as taxes on consumption (which, in effect, is the same as people having to pay out more tax on their incomes), such as value added tax, excise duties, and council tax.

Deadweight losses due to tax

The extent to which a tax acts as a disincentive for people or society to work, invest or consume, and therefore has an adverse impact on welfare, is called a deadweight loss by economists. It is the element or fraction of the tax in which the social cost of the tax exceeds the social benefit – or, in other words, that which prevents mutually beneficial transactions from occurring, such as an employer offering a job, or a consumer or business purchasing some item. The larger the number of transactions impeded by a tax, the higher the deadweight loss.

In the early 1990s, Nicolaus Tideman and Florenz Plassmann, economists at the Virginia Polytechnic Institute and State University, estimated that the British economy was achieving only 55 per cent of its potential due to such deadweight losses (see'Taxed out of Work and Wealth: The Costs of Taxing Labor and Capital' in Fred Harrison (ed.), *The Losses of Nations*, Othila Press, 1998). It was on this basis, updating the figures to 2001, that Ronald Banks, in his book, *Double-cross* (Centre for Land Policy Studies, 2002), calculated that every year, Gordon Brown (then the Chancellor of the Exchequer), 'deprives each man, woman and child in Britain of £15,000 … on TOP of the taxes he collects from us'.

However, neither of these studies took into account the offsetting knock-on effects derived from governments spending the tax revenues. Thus, whether spent on wages or on capital goods for the public sector, new economic demand is created. This stimulates investment and employment in the production and supply of goods and services to meet that demand, leading to further growth of economic demand, and so on.

Furthermore, they disregard the extent to which some people and businesses strive to work longer hours in order to compensate for the tax that they have to pay, which, if invested intelligently by governments, would lead to higher growth and improved welfare. And they ignore the welfare gains arising from the existence of public services and social security that should be part of any civilised society, and which depends on government revenues from taxation.

Nevertheless, the studies do beg the question of how to raise revenue and at the same time minimise deadweight losses.

This could be achieved by biasing taxation towards those activities or commodities for which supply or demand is least affected by variations in price or cost – or, in economists' parlance, those whose supply or demand is least elastic.

The most obvious examples used by mainstream economists are those commodities that are most highly taxed in Britain, namely tobacco, alcohol and petrol. Their effective tax rates range from 50 to 90 per cent. Another candidate would be food, but this is regarded as too important for people's welfare to tax, especially as so many people at the moment are paid so badly that they can barely afford the foods that they need even without tax.

But the best example of a commodity whose supply is almost wholly inelastic, and therefore a good candidate for tax, is almost entirely ignored by mainstream economists – namely land. If land is taxed according to its value – which is mainly determined by the demand for land in particular localities – there would be no deadweight loss. Based on this argument, land should be the most heavily taxed item of all.

The advantages of a tax on land value

Apart from the fact that a land value tax carries virtually no deadweight loss, its revenue earning potential is huge. Thus, various studies, including that of Banks mentioned above, have estimated that introducing LVT into Britain could raise at least £200 billion a year in 2002 prices. That was more than the combined revenue of £174 billion from income tax, corporation tax, capital gains tax, inheritance tax, stamp duties, insurance premium tax and all council taxes and national non-domestic rates, in that year, corresponding to around half of all government revenue.

Moreover, as discussed, because LVT would stimulate investment and economic activity, which would raise the demand for land, and therefore land values, the amount of revenue that could be collected through LVT would tend to increase considerably over time.

In addition, a land value tax is inherently a fair tax, because the value of a site upon which the tax would be based is determined not by the owner or occupier, but by its location, and the social and economic activities of society as a whole, and by what nature has provided, which should be shared by all. And unlike other taxes, LVT does not take anything away from landowners that they themselves might have created. In fact, LVT provides automatic compensation for those sites that are disadvantaged in some way as a result of other developments, such as proximity to a busy road, a rubbish dump, or whatever.

Also, LVT is fairer because it is practically impossible to avoid. People do not end up having to pay more tax to compensate for those who evade it. In the case of income tax and taxes on business, there is a flourishing 'shadow economy' and a whole army of tax avoidance experts totally geared to helping people and businesses evade tax, making extensive use of the various offshore tax havens. But you cannot siphon out land into an offshore tax haven!

A further advantage of LVT is that it has a built-in counter-cyclical mechanism. When there is an economic downturn for whatever reason, land values tend to fall so that for a given rate of tax the amount of LVT due would also fall. This would mean that people would have more to spend, thus helping to boost economic demand, and therefore investment and employment, and businesses would have more to invest, all of which would help to offset any economic downturn.

The government, of course, would get less revenue, but this could be compensated by the government accumulating the higher revenues obtained from LVT when the economy was expanding, which would tend to raise land values. This counter-cyclical effect of LVT, of course, would depend on the regular updating of land values.

Proposals for a fairer and economically more beneficial tax system

The economic benefits of LVT – and the fact that it is practically impossible to avoid – has led some enthusiasts to advocate abolishing all other taxes and replacing them entirely with LVT. However, LVT is unlikely to provide enough revenue to finance all the needs of a modern state – especially if governments became more actively involved in pre-empting market failures and economic downturns, which it is becoming increasingly obvious is needed now that prevailing neo-liberal economic policies are running into the sand.

In short, other taxes will continue to be required, albeit at lower rates. In addition, such taxes can frequently play an important role in achieving other policy objectives.

For example, a progressive income tax in a highly unequal society such as Britain's helps the tax burden to fall more heavily on those who can afford to pay. Once society became less unequal, income tax would become less important in this respect. It is therefore proposed that income tax should be gradually phased out as LVT was extended.

The only exception would be tax on very high incomes – such as the earnings of footballers, pop stars, actors, opera singers, high court judges, and top managers, whose situation is analogous to land in that their skills are practically unique, yet are in high demand. Supply, therefore, cannot be increased in line with demand. In other words, a large part of the value of their skills, which is reflected in their high earnings, is created by society, so that it is only fair that society should get back a proportion of that value in the form of tax. It is therefore proposed that income tax – perhaps re-named surtax – be retained for very high incomes, and at a higher rate than now, especially as the tax would carry no deadweight loss.

Meanwhile, it is proposed that recurrent expenditure on pensions and healthcare should continue to be financed through contributions out of people's earnings, perhaps topped up by employers' contributions. As argued elsewhere, this is by far the most cost-effective and the fairest way of providing these services (see Jerry Jones, *The future of pensions – how to ensure a decent retirement for all*, CPB, 2006). It is recommended that these contributions be ring-fenced, and paid into a National Pension Fund, and National Health Fund, respectively, managed by statutory authorities, under democratic control, independent of the government of the day. People could then be sure that the money that they were paying out is actually going into those areas. The contributions should be seen as a part of people's wages or salaries that are deferred until they retire, giving an assured income until death, or as an insurance premium to cover healthcare when people or their families are in need of it.

If these payments were clearly earmarked for the purposes intended, and kept quite separate from the government budget, they would be widely accepted, and would carry no deadweight loss.

Next, it is proposed that a corporation tax (that is a tax on profits) be retained and, beyond a certain threshold, the rate raised in steps to 50 per cent (which is what it was in most countries in the 1960s and 1970s). The argument in favour is that some productive activities are inherently more profitable than others, yet are dependent on less profitable or unprofitable activities. Such a tax on profits would help finance those less profitable, but nonetheless essential, activities, especially public services and infrastructure, upon which all productive activities depend.

A further argument for such a tax is the fact that, under capitalism, the bulk of company profits derives from surplus labour appropriated from employees and from customers and suppliers. In effect, therefore, the higher profits of the more profitable activities are derived from the rest of society, and it is therefore only fair that they be taxed.

In addition, it is proposed that all exemptions and allowances, which companies can use to set against tax, and which are subject to so much abuse, should be abolished. A recent investigation by the *Financial Times*, for example, found that several major corporations in Britain, including some foreign banks, are currently paying almost no tax. They achieve this by arranging for most of the profits to be made by foreign subsidiaries, often based in offshore tax havens – such as by taking out large loans from their subsidiaries and setting the interest payments off against tax, or through transfer pricing.

A problem with raising the rate of corporation tax under the current neo-liberal regime is that some businesses might seek to relocate in order to avoid the tax, thus putting people out of work. Thus, it would probably be impractical to follow through with this policy immediately. It will have to await for the folly of current neo-liberal polices to become more universally recognised, which will happen as they get into increasing difficulties, so that it becomes acceptable once again for governments to make use of capital controls and other types of interventions (such as taking over businesses threatening to relocate and turning them into worker-owned enterprises).

Such a policy would also depend on the abolition of offshore tax havens – or making dealings with affiliates based in offshore tax havens illegal. It was precisely the mushrooming of transactions through offshore tax havens that undermined such policies previously.

Furthermore, it is proposed that taxes on consumption, including value added tax and excise duties, which currently account for almost a third of government revenue, be retained – or preferably turned into a simple sales tax at different rates for different products (though, at present, this would contravene EU commitments). In addition to raising revenue, the object here would be to encourage restraint on the excessive consumption of natural resources, and, by varying the rates, to favour economic activities that have a smaller environmental impact, and generally shift the economy towards a more sustainable basis.

Along with land value tax, therefore, such a tax can be regarded essentially as a 'green tax'. Like land value tax, a sales tax also has the advantage that it is hard to avoid, even in this increasingly mobile world, since residents and visitors alike would have to pay it. Its regressive characteristics could be drastically reduced by making incomes much more equitable than they are now. Over time, the rates of tax could be reduced by raising the rate of land value tax, thus reducing the disincentive effect of such a sales tax.

In addition, it is suggested that other environmental taxes be retained, or extended, to stimulate investment in measures to reduce or recycle waste, to reduce carbon dioxide emissions, and to combat the adverse effects of climate change.

Finally, it is recommended that certain other taxes that do not necessarily raise much revenue, but are important mechanisms for preventing the avoidance of other taxes, and are in the interests of fairness, be retained.

For example, other things being equal, it would be possible to avoid income tax or corporation tax by reclassifying income from earnings or profits as capital gains. Hence the need for a capital gains tax. Similarly, the inheritance tax, among other things, helps to combat individuals transferring profits or income to heirs in order to avoid tax.

It should also be pointed out that having a broad range of taxes allows revenue to be raised at a lower rate for each tax than otherwise, thus lessening their burden, and reducing the incentive to find ways of evading the particular tax.

To sum up, it is proposed that LVT should become the core source of funding for public expenditure, which would be topped up by other taxes that also benefit society in various ways.