Irwin Stelzer

The Limits to Tax:

Efficiency, Equity and International Competition

POLITEIA

A FORUM FOR SOCIAL AND ECONOMIC THINKING

POLITEIA:

A Forum for Social and Economic Thinking

Politeia commissions and publishes discussions by specialists about social and economic ideas and policies. It aims to encourage public discussion on the relationship between the state and the people. Its aim is not to influence people to support any given political party, candidates for election, or position in a referendum, but to inform public discussion of policy.

The forum is independently funded, and the publications do not express a corporate opinion, but the views of their individual authors.

The Limits to Tax:

Efficiency, Equity and International Competition

Irwin Stelzer

POLITEIA

2006

First published in 2006
by
Politeia
22 Charing Cross Road
London WC2H 0QP
Tel: 020 7240 5070 Fax: 020 7240 5095
E-mail: info@politeia.co.uk
Website: www.politeia.co.uk

Policy Series No. 55

Support for this study has been granted by the
Foundation for Social and Economic Thinking

Politeia gratefully acknowledges support towards the tax series from

Ernst & Young LLP

ISBN 1 900 525 87 9

Cover design by John Marenbon

Printed in Great Britain by
4 Print
138 Molesey Avenue
West Molesey
Surrey KT8 2RY

The Author

Dr Irwin Stelzer is Director of Economic Policy Studies at the Hudson Institute in Washington and a columnist both in the US and London where he writes for *The Sunday Times*. His academic career has been mainly in the US, where he has taught at Cornell University, The University of Connecticut and New York University. He has widely written on economic, regulatory and antitrust law subjects. For Politeia he has written, *Good for the Public! Competition, technology and the shrinking state* (February 2006).

CONTENTS

Introduction

I approach this assignment with some trepidation, for three reasons. First, Politeia has already sponsored so much good work on tax policy that I fear I have very little to add.

Second, the various aspects of tax policy are too numerous to address in a brief pamphlet. As Eugene Steuerile has pointed out, tax policy today involves far more than issues of how to collect revenues fairly and efficiently. It has evolved into a major tool for both macro and monetary policy and, more than ever, for expenditure and social policy.[1] We know that tax policy affects economic growth; that it is related to monetary policy, with loose fiscal policy heightening central bankers' fears of inflation sufficiently to affect their decisions on interest rates; and that every decent society accepts the fact that tax policy must be sufficiently humane to permit those disadvantaged by circumstances beyond their control to afford a decent existence.

Third, I do not want to overemphasise the effect of tax policy on economic growth. High-tax jurisdictions with superb transport and other public services can be more attractive to businesses, and to the highly educated employees on whom they increasingly rely, than low-tax jurisdictions with poor transport, rotten schools and polluted air. Worst of all, of course, are high-tax jurisdictions with public services so inefficient that the high level of expenditure does not produce an attractive level of services.

With these caveats, I will try to add something useful to Politeia's extensive discussion of this immensely important subject.

[1] Eugene Steuerle, 'Tax Policy From 1990 to 2001', in *American Economic Policy in the 1990s*, Jeffrey Frankel and Peter Orszag (eds.). Cambridge, Mass., MIT Press, 2002, p.139. Mr Steuerle is a Senior Fellow at the Urban Institute, and has served in the Treasury Department under four different presidents.

I

The Economy and Tax Policy: To cut … or not to cut?

This is a good time to discuss tax policy, since rarely has there been so much nonsense spoken by politicians of all stripes on this subject. The Chancellor of the Exchequer, a man with a complete and deep understanding of the theory of taxation, seems committed to a perpetual increase in the tax burden, despite what he sees before him: the stagnant, high-tax, major European economies; a rapidly growing, low-tax Ireland; and the flight of capital to low-tax Eastern Europe. None of these factors, nor the demonstrated inefficiency with which the state disposes of its taxpayers' hard-earned funds, appears to suggest to the Chancellor that he is steering the British economy from the prosperous condition in which he found it to stagnation at best, and penury at worst.

On the other side of the aisle we have a Tory Party that has managed to insulate itself from the past decade's learning about the relationship between taxation and fiscal stability – what is called in the trade 'dynamic scoring' which counts against revenues foregone those generated by cuts in tax rates. The shadow chancellor would have us believe that our choice is between tax cuts and economic stability. In fact, properly crafted tax cuts contribute to, rather than detract from, economic stability.

Before deciding that tax cuts are dangerous to a nation's economic health, and contribute to the 'black holes' that so worry the City, 'we must carefully think through what happens to the overall economy as well as to individual taxpayers when tax rates are cut.'[2] Larry Lindsey, the economist who crafted the tax cuts that helped President Bush rescue America from a recession, and whom I have just quoted, points out that the direct effect of a tax cut is to reduce revenues, other things remaining equal. But, he quickly adds, in the case of other-than trivial tax cuts, other things do not remain equal: tax rates affect economic behaviour.

For one thing, a reduction in tax rates allows workers and

[2] Lawrence B. Lindsey, *The Growth Experiment: How The New Tax Policy Is Transforming the U.S. Economy*. New York: Basic Books, Inc., 1990, p.57.

entrepreneurs to keep more of what they earn. That increases their incentive to work harder, and to take risks, both of which stimulate economic growth and, with it, tax receipts. A reduction in tax rates also stimulates inbound investment,[3] other things being equal – a phrase I add to make it clear that I doubt that Mr Mugabe could do much to his nation's tax structure to make Zimbabwe attractive to foreign investors.

Whether the increase in receipts will compensate fully, or more, for the revenue loss resulting from a reduction in tax rates will depend on many factors, including the precise nature of the reduction in rates; the stage of the business cycle at the time the reductions become effective; and cultural factors that affect the elasticity of the supply curve of labour and of entrepreneurship. The trade-off between work and leisure, and risk and safety, varies from country to country.

There is another effect of a reduction in tax rates that cannot be ignored. Lowering the tax on corporate profits makes it more attractive to own shares, since a large portion of pre-tax profits flows through to shareholders, and less attractive to incur debt, since the deductible feature of interest payments becomes less valuable. Those who worry about over-leveraging might give this effect of a reduction of tax rates, especially corporate tax rates, some thought. They encourage higher equity: debt ratios.

Finally, in a world in which international competition is becoming more heated, the ability of capital to flow more or less freely across borders (with the possible exception of the borders of France) allows companies to flee high-tax jurisdictions in favour of countries with more benign and welcoming tax regimes, taking jobs with them. This potential for relocation of investment and jobs in response to tax differences is not as great as some industry associations allege: as I have said, tax rates are only one component of any location decision. But neither is it a factor that finance ministers and politicians can ignore, witness the east-bound movement of some segments of German industry, and the desire of France's politicians, including the so-called reformers, to 'harmonise' tax rates throughout the EU in order to eliminate the competitive disadvantage under which France's highly taxed industries operate.

---

[3] 'This study demonstrates with great clarity that countries cutting taxes – especially on business – see more inward investment, higher growth and higher tax revenues.' Charlie Elphicke and William Norton, 'The Case For Reducing Business Taxes', *Centre for Policy Studies*, London, February 2006, p.1.

There are other examples, but I believe I have made my point: tax cuts are not the antithesis of a healthy, growing economy, and do not necessarily result in a shrinkage of revenues flowing to the Treasury. Nor are tax cuts that have net beneficial effects necessarily confined to what some prefer to call 'the rich'. As Lindsey puts it so well, 'The mission for tax reformers … is to apply the lessons and benefits of supply-side economics to the middle and working class….[T]he important job is to eliminate the extra burdens of taxation that do little to raise revenue but discourage thrift and industry'.[4] The pity of today's Britain is that of the three main parties:

- the Liberal Democrats want to raise the marginal rate, probably the change most likely to discourage work and risk-taking, and least likely to generate revenue since, as Harvard economics professor Robert Barro points out, 'upper-income people are very responsive to changes in the tax code; when tax rates rise, the reported amount of taxable income drops sharply.'[5] Perhaps even worse, the economy's best and brightest turn their attention from producing goods and services to devising tax-avoidance schemes, 'a waste of energy and effort which progressive taxation in so many ways leads to', to quote Hayek.[6]
- the Labour Party seems to fit Ronald Reagan's wonderful description, 'The government's view of the economy could be summed up in a few short phrases: "If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidise it,"' and
- the Conservatives, the one grouping that might have fought to reduce the tax burden if for no other reason than to restrain the growth of the state, has ceded that role in its search for what it perceives to be the vote-rich centre ground, and now sees lower taxes as the enemy of economic stability.

There is, in short, no voice for cutting taxes.

Does this matter? After all, the British economy is in pretty good shape, and by the standards of the major continental European economies, in robust good health, thanks largely to the combination of (a) the structural reforms pushed through by Margaret Thatcher, and (b) the current Chancellor's insistence on remaining a foreigner in

---

4 Lindsey, op.cit., p.151.
5 Robert J. Barro, *Getting It Right: Markets and Choices in a Free Society*. Cambridge, Mass. and London: The MIT Press, 1996, p.119.
6 *The Constitution of Liberty*. London, Routledge & Kegan Paul, Ltd. 1960, p.322.

euroland, outside the baleful influence of the accompanying monetary and fiscal policies (the noGrowth and inStability Pact) that have done so much to produce persistent double-digit unemployment in France and Germany, stagnation in Italy, and inflation in Spain.

This satisfactory condition means that the multiple tax increases imposed by Gordon Brown, his tinkering with the tax structure, his retroactive tax increases and other sins have not produced the cataclysm that his critics say waits just around the corner, and if not this corner, then the next one, or the one after that. One reason that these various raids on taxpayers' purses have not triggered a major down-turn might be that the increases were 'stealthy', which my OED defines as 'calculated to elude observation, proceeding by imperceptible degrees'.

Not being noticed, the stealthy increases could not affect behaviour. Contrast that, say, with the proposal to raise the top marginal rate from 40 per cent to 50 per cent, a proposal which, if enacted, would send entrepreneurs scurrying to reduce their exposure to risk, and workers wondering whether the reduced net reward for extra work is sufficient to warrant getting home late of an evening. So, like greed in the movie *Wall Street*, stealth is good.

At least until its cumulative effects become noticeable. At some point the imperceptible becomes perceptible, with effects that are already becoming obvious in the more difficult regions of the North Sea, in which oil companies now express a reluctance to invest, while at the same time they are reacting to the retroactive imposition of taxes on their allegedly obscene profits by reordering the priority ranking of their planned capital avoid higher costs. This is an important point: the theory of retroactive tax increases is that they are a tax on past behaviour, and therefore have the advantage of not affecting the current and future willingness of taxpayers to work and invest. But, as Harvard's Barro points out, 'If the government imposes a levy today, then rational people will worry that the government will impose another in the future'[7]. The present Government has resorted to retroactive taxation at least twice: in the case of the windfall tax on utilities, and, now, by retroactively taxing oil company profits. All, save the most trusting of investors, must be aware that they risk such

[7] Barro, op.cit., p.124.

raids in the future, which may account for the fall-off in new business start-ups and certainly raises the cost of capital.

But, as the man who jumped off the 102-storey-tall Empire State Building said as he passed the 50th floor, 'so far, so good'. Whether Gordon Brown and the UK economy will land with a thump as inevitable as the one in store for the mythical jumper, we do not yet know.

So it is easy to criticise all the players in the tax game – with one exception: the tax avoiders. Let me explain. No one defends those who illegally evade taxes. That is not an issue. But the tax avoiders are those who study the arcane tax code carefully, and find ways to reduce their tax burden without breaking the law. In other words, the avoiders struggle to find ways of rendering unto Gordon that part of what they earn and own that is by law Gordon's, and keeping the rest for themselves. It is, after all, theirs. To stigmatise this process of avoidance is to assume that all of the nation's income belongs to the Treasury, which then benignly allows the public to keep some portion of it, a portion that 'avoiders' attempt unreasonably to enhance by consulting their lawyers and accountants.

II

Tax, Society and the Expanding State

I would be remiss if I confined this essay to a discussion of the effects of high taxes on economic growth, without also mentioning their consequence for civil society. The historian Gertrude Himmelfarb, to whom Gordon Brown loses no opportunity to pay homage, has set forth in great detail the web (no pun intended on the Webbs) of private philanthropic organisations and activities that characterised Victorian Britain,[8] and Charles Murray, the US political scientist, has described just how extensive civic participation once was in pre-welfare-state America: 'Broad networks, engaging people from the top to the bottom of society, spontaneously formed by ordinary citizens, provided sophisticated and effective social insurance and social services of every sort.'[9] Those networks have shrivelled in the face of expanding tax-funded bureaucracies. One serious consequence is that pleas for philanthropic contributions of time and money can now be met by, 'I gave at the office', meaning that 'the tax man had already cometh, I have done my share, so I need not join or support voluntary organisations'. That shift from private organisations to government bureaucracies, from voluntary giving to compulsory extraction, 'ultimately degrades society as a whole', according to Murray.[10]

It is thoughts such as these, combined with the knowledge that there is now no effective force in Britain for reining in the size of the state or its desire to claw a larger and larger portion of the national income for use by its bureaucracy, that I find so depressing. The Liberal Democrats make it quite clear that they favour higher taxes; there is no reason to believe that a Brown-led Labour Party will suddenly decide that higher taxes and further income redistribution are bad ideas; and the Cameron-led Conservative Party has promised to devote half of any growth in national income to a further expansion of the public sector, a process that a simple bit of arithmetic shows will steadily expand the portion of GDP claimed by the state.

---

[8] Gertrude Himmelfarb, *The De-Moralization of Society: From Victorian Virtues to Modern Values*. London: The Institute of Economic Affairs, 1995, espec. pp.143-69.
[9] Charles Murray, *In Our Hands: A Plan to Replace the Welfare State*. Washington, D.C: AEI Press: Washington, D.C., 2006, pp.116-117.
[10] Ibid., p. 122.

We should have predicted this. As liberal (in the American sense) Harvard economist Benjamin Friedman has recently pointed out:

'A potential risk to a country's growth prospects in a democratic system is that the lower-income majority will seek to use the government's tax and spending authority to create jobs on unproductive public works projects…, pad the employment rolls in government-run companies…, and provide overly generous outright welfare programs – in each case using resources that could otherwise go into productive investment.'[11]

A better description of developments in Great Britain could not have been written. The growth of the low-productivity public sector[12] has pulled national productivity growth down to levels that, if not reversed, will seriously reduce living standards – and soon. It has also created a larger constituency for continued growth in spending: public sector employment has risen 13 per cent from its recent low point in 1998 (compared with an increase of less than half that rate in the private sector), and now exceeds 5.8 million, accounting for one in five jobs in Britain.[13] Since many of these public sector jobs are concentrated in various constituencies, the voting power of public sector employees exceeds their numbers, and that power is multiplied further by the dependence of the governing party on contributions from trade unions representing those employees.

Candour compels me to report that a similar expansion of the state is underway in America. Compassionate conservative George W. Bush has expanded the size and reach of government at a rate that would bring smiles to the lips of Franklin D. Roosevelt and Lyndon B. Johnson. Education, once a function reserved for states and localities, is now benefiting from the ministrations of the federal bureaucracy; a blindingly complex and deficit-enhancing prescription drug programme is now available to senior citizens; having failed to react promptly to the devastation caused by Hurricane Katrina, the federal government is now providing trailer homes for its victims, despite high vacancy rates in the rental market.

---

11 Benjamin M. Friedman, *The Moral Consequences of Economic Growth*. New York: Alfred A. Knopf. P. 337.

12 'The concentration of outlays on unproductive labour was observed [by Adam Smith] to lie in the public or government rather than in the private sector of the economy.' (James M. Buchanan, 'Public Goods and Natural Liberty,' in *The Market and the State: Essays in Honour of Adam Smith*. Thomas Wilson and Andrew S. Skinner (eds.). Oxford: Clarendon Press, 1976, p.284.)

13 Office of National Statistics, *Labour Force Survey*, as reported by Stephen Hicks, 'Trends in Public Sector Employment,' December 2005.

Unlike Britain, this expansion of the role of the state has not been accompanied by higher taxes. Indeed, taxes on incomes, dividends, capital gains and inheritance have been reduced. Unfortunately, although *some* cuts in tax rates produce *some* offsetting increases in revenues, *all* cuts in tax rates do not produce *equal* increases in revenues. So we have deficits, not a bad thing when the economy is weak, but less desirable when the economy is growing. After all, few governments would want to find themselves in the position in which Germany's apparently is: so concerned about its fiscal deficit that it has to raise taxes just when the economy seems to be recovering. The phase of the business cycle is not an irrelevance when it comes to setting taxes, another way of saying that we are all Keynesians now, at least up to a point. Still, government in the US is a long way from gobbling up the national income at anything like the rate in the UK.

That bodes well for the prospects of economic growth in America, and badly for the growth prospects of Great Britain, which suffers from a malady additional to the burden of its high and rising taxes. That burden is the mounting complexity of the tax system. Recall Adam Smith's admonition that the timing, manner of payment, and amount of a tax should 'be clear and plain to the contributor, and to every other person' – an admonition not closely followed by Smith's latter-day townsman.

It is often the case that the brightest minds at our respective Treasuries ignore two things. First, as Milton Friedman has pointed out, stability in tax policy is important, often more important than any possible improvement. Second, improvement bought at the cost of increased complexity often is not worth having. One American tax specialist described the work of our National Economic Council (NEC) in terms that are applicable to Gordon Brown.

'The NEC was incredibly effective at creating ideas that sounded like they might work. But the problem was that the new tax incentives would have added great complexity to a system that people already don't understand….[T]he constant flow of complicated proposals tied up Treasury staff and got in the way of necessary improvements … that might have informed future policy development.'[14]

[14] Leonard Burman, *Comments*, in Frankel and Orszag, op.cit., p.182.

III

Competition, a Shrinking State and Economic Growth

Britain, then, faces a situation in which taxes are high, and likely to rise, stealthily or otherwise, retroactively or otherwise; the tax structure is becoming increasingly complex; the relative growth of the public sector is driving down average productivity, which bodes ill for future living standards; the expanded public sector and welfare dependency creates a constituency for the continuation of these trends; and all political parties are agreed that this state of affairs is acceptable – the sort of consensus that last existed when, before Margaret Thatcher began wielding her handbag, all parties agreed that the role of government was to manage decline.

Unfortunately, there is worse. All we need do is look to what might be F.A. Hayek's greatest work, *The Constitution of Liberty*:

'It is questionable whether a society which will recognize no reward other than what appears to its majority as an appropriate income, and which does not regard the acquisition of a fortune in a relatively short time as a legitimate form of remuneration for certain kinds of activities, can in the long run preserve a system of private enterprise.'[15]

But let me conclude on a cheerier note – three cheerier notes, to be exact.

First, even if we are forced to accept the expansion of the state to a point where it is gobbling up over 42 per cent of GDP (and rising), there is room to improve the efficiency with which that money is spent. After all, objections to the massive rise in spending on the NHS would certainly be muted if that money had been, and was being, well spent. We know from experience – experience in the Kremlin and in Whitehall – that centralised setting of targets produces gamesmanship rather than efficient behaviour.

That means that if taxpayers are to get value for the money spent by an increasingly large state, we must develop mechanisms that force public sector employees to do more than serve time until their generous pensions become available. Not all such workers: no disciple of Adam Smith would deny that we wish to appear

[15] Hayek, op.cit., p. 319

admirable in our own eyes and in the eyes of others, and that therefore it is unsurprising that many public sector workers are dedicated, and probably expend huge amounts of energy circumventing rules designed to prevent them from doing a good job in the public interest.

Let me emphasise that I do not believe that the expansion of the state is either inevitable or desirable, for many of the reasons I have already stated, not the least of them being the low productivity of the public sector and the diminishing of the role of the individual. But any realistic observer of the political scene in Britain would be foolish to ignore the possibility — alas, even the probability — that the state will expand in the future in response to voters' fears, however unfounded, of the consequences of its contraction. So it behoves us to plan for the possibility of such expansion by redoubling our efforts to create greater incentives for efficient behaviour. The great economist and Nobel Prize winner R.H. Coase points us in the direction of a solution, which he acknowledges is merely an extension of Adam Smith's earlier argument. He writes, 'Private individuals are constrained in their folly because they personally suffer its consequences…. But…men who bankrupt a city or nation are not necessarily themselves made bankrupt.'[16]

The question, then, is how to remove the insulation that protects public service workers from the consequences of those of their acts that result in the inefficient use of the resources made available to them? The answer is to inject competition into the provision of such services, to – and I hesitate to use this much over-used word – 'empower' the consumers of these services. We have seen from experience that the transformation of the providers of a wide range of services from nationalised monopolies into private sector competitors results in enormous efficiency gains if done properly. Given the blessing and power of choice, consumers forced their gas, electricity, telephone, airline and other companies to improve the quality, value and variety of services on offer.

Therein lies the guide to future policy vis-à-vis the public sector: introduce competition wherever feasible so that poor service will result in an atrophying of inefficient providers that prove unable or unwilling to improve their performance. Parents with education vouchers would

---

[16] R.H. Coase, *Essays on Economics and Economists*, Chicago and London: The University of Chicago Press, 1994, p. 115.

be free to flee bad schools and provide funds for the expansion of good ones, and patients with freedom to choose their doctors and courses of treatment would put unhelpful health care institutions that refuse to upgrade out of business. The idea that 'information asymmetry' — the disparity in knowledge between all-knowing doctors and ignorant patients — makes this impossible is a nonsense. After all, 'information asymmetry' exists in the used car market, with sellers knowing a lot more about the condition of their cars than the buyers, but thousands of transactions are completed every year, with no signs of post-transaction bloodshed. With information about ailments and treatments now widely available on the web, and given the fact that only the patient can make the trade-off between the pain of a damaged hip and the risk and pain of corrective surgery and with parents better informed about the special needs of their children than any bureaucrat can possibly be, we should worry a lot less about information asymmetry than the 'nanny-state knows best crowd' would have us do, and rely more on free choice by consumers of public services. Bad teachers, inattentive doctors and nurses, would be forced by competition, if I might use a nautical phrase, 'to shape up or ship out' in favour of educators and health care providers who best meet parents', pupils' and patients' needs.

No doubt transition will involve pain, but that pain would be transient, and trivial compared to the pain being inflicted by the current system of provision. After the injection of huge sums into the public services, it is no longer reasonable for opponents of submitting public service workers to the refreshing gale of creative destruction to argue that there is insufficient excess capacity to provide meaningful choice. The quality of such capacity will imporve only when the demands of thousands of parents and patients can find expression. The response won't be instantaneous, but it will be noticeable a lot sooner than most who oppose these reforms are willing to concede – which may explain the rabid hostility of some interested parties to such reforms.

So, the first bit of good news is that even an overarching state can be forced to produce services more efficiently if exposed to competition, and policies that would create such competition are well understood, and, I would guess, of broad political appeal.

The second bit of cheer comes from a very rough analysis of the figures. The portion of GDP claimed by the state at the lowest point in recent years was 37 per cent in 1999-2000. It is now about 42 per cent.

So the battle to return to what we can probably use as representing a reasonably satisfactory relationship between Britain's private and public sectors – I, for one, consider that too tilted in favour of the public sector, but then I am an American, and therefore less interested in a safety net than in the opportunity provided individuals by low taxes and rapid economic growth - is a battle over five percentage points. *If* the economy can grow at an annual rate of something like 3 per cent, and the growth in public sector spending can be held to something significantly below that figure, the portion of the wealth produced by workers and entrepreneurs that is absorbed by the public sector will decline – even as the public sector expands.

That, of course, is a rather big 'if'. Which brings us back to where we started. A relative shrinkage of the public sector will require tax policies that contribute to, rather than stifle, economic growth. And it will require a government willing to restrain the rate of growth of the public sector to below that of the private sector, a policy for which no party has expressed any enthusiasm. If a Blair-led Labour Party presided happily over the rapid expansion of the public sector, we can only imagine the glee with which a Brown-led government will step on the gas rather than the brake, without some new thinking by the Prime Minister-in-waiting, new thinking that I believe is already under way. The Liberal Democrats, who do not even have the nodding acquaintance with prudence that the Chancellor has, would probably expand the public sector even faster, with no attention to how such an expansion might be funded, other than by taxing the rich, with consequences I have already discussed. And the new-model Conservatives have promised to share the proceeds of any economic growth equally between the public and private sectors, although that 50:50 promise might be modified if one of the many panels designing Tory policy use the eighteen months allotted to them to come up with a different answer.

Still, despite the current supine attitude of the major parties, the battle for the public's ear is worth fighting. It just might be possible to persuade voters, even the large number now beholden to the state for their jobs and benefits, that their long-run interests are not best served by assigning increasing portions of their incomes, or the incomes of others, to the public sector.

IV

A New Tax Debate

Indeed, we now have a unique opportunity for just such an appraisal – the current belief that global warming is a threat to our future prosperity. Whether or not the earth is warming, as new Hollywood producer Al Gore and long-time public servant Sir Nicholas Stern tell us, and whether or not any such warming is the result of human activity, is no longer relevant. We don't expect *ou*r houses to be burgled, but recognise there is some probability that this might happen and so buy insurance at a cost commensurate with the risk. So even if we are unconvinced that the Gore-Stern-Blair-Cameron combination is certainly right, we should concede that it would be prudent to buy some insurance, especially since its by-product would be a reduction in the flow of funds to oil-producing nations that fund terrorist attacks against the West.

That insurance can be purchased by taxing polluting activity so as to reduce the consumption of goods responsible for such pollution. But beware: such taxes on 'bad' things should not be in addition to existing taxation, but a replacement for taxes on 'good' things, most notably economic growth and job creation. So raise green taxes and lower NICs. It is, of course, true that green taxes are designed to change behaviour, rather than raise revenues, and therefore in the long run should not produce more than a trickle of funds for the Treasury. But given the long life of the capital equipment that would have to be replaced in response to green taxes – the average automobile lasts for about 15 years – and the durability of consumer purchasing habits, there will be a protracted period during which taxes on pollution will produce considerable revenues. The policy must be, therefore, to lower taxes that retard economic growth to make new, environmental taxes revenue-neutral so that, as the receipts from the new taxes decline as behaviour is modified, the revenues from other taxes increases with no increase in the tax rates.

Such calibration cannot, of course, be arranged with precision. But then neither can any other tax policy – witness the wide differences between forecasts of revenues and actual receipts. Nevertheless, it would be worthwhile to set policy moving in this direction, lest the new environmental taxes merely become one more net burden on the private sector.

In short, the new debate on environmental taxation provides an excellent opportunity to reopen a broader debate on tax policy, one that emphasises not only environmental preservation, but the reduction of barriers to economic growth.

Let me conclude with a final bit of cheer. The standard of living in Britain today is probably as high as it has ever been; the country has established itself as a world-class competitor in the globalised market for financial services; it has the advantages of the English language – still spoken in parts of this country – and of a time zone that maximises the ease of doing business around the world which is only one of the many advantages that is allowing London to challenge New York's position as the world's leading financial centre. It has been to the brink of decline before, and pulled back before plunging over the edge. It has in its near-term future a Prime Minister famous for his intelligence and empiricism. There is no reason to believe that Britain cannot face the future with equanimity and even a smile.

The Rule of Parliament
John Hayes £5.00
Caring for the Long term: Financing Provision for
The Elderly
Philip Booth £6.00
What Tories Want
Simon Heffer £5.00
Browned-off: What's Wrong with Gordon Brown's Social Policy?
David Willetts MP£6.00
Comparing Standards: The Report of the Politeia
Education Commission
Sig Prais, Caroline St. John Brooks, Chris Woodhead and others
Edited by Sheila Lawlor £7.50
Reforming Local Government: Accountability,
Finance and Function *
Gillian Shephard £5.00
Britain and Europe: Choices for Change
(joint publication with Global Britain)
Bill Jamieson and Patrick Minford £8.50
EMU and Globalization
Deepak Lal £7.00
Allegiance: The Nation State,
Parliament and Prosperity
Robert Cranborne £3.00
Holding Our Judges to Account
Liam Fox £3.00
Conservative Debates
Oliver Letwin & John Marenbon £7.00
Is European Integration Really the Friend of Free Trade?
James Forder £7.00
European Tax Harmonization and British Taxes
Tim Congdon £7.00
Dilemmas of Decommisioning
Kirsten E. Schulze and M.L.R. Smith £5.00
From Beggars to Choosers: University Funding for the Future
Graham Hills £5.00
The Cost of Caring: The Economics of Providing for the Intellectually Disabled
Shane Kavanagh and Louis Opit £10.00
The End of the Era of Representative Democracy?
Robert Cranborne £3.00
The Coming Constitutional Crisis
Tim Hames £5.00
Beveridge or Brown? Contribution and Redistribution: The Real Social Security Debate
Sheila Lawlor £10.00
Playing at Politics: First-Time Voting in the 1997 UK General Election
Una McCormack £6.00
Funding the Future: Problems in Pension Reform
Christopher Daykin £7.50
A Conservative Future *
Maurice Cowling £3.00
Banking on Change: Independence, Regulation and the Bank of England
David Gowland £7.00

Subscribe to Politeia's Publications!

For £40 a year (£35 by standing order) you will be sent all our pamphlets for the year covered by your subscription and, if you wish, others in print at half the cover price. You will also be notified of Politeia's conferences and events to which, whenever possible, you will be offered admission at reduced rates. More information can be found on our website: www.politeia.co.uk

The Secretary, Politeia, 22 Charing Cross Road, London, WC2H 0QP.
info@pliteia.co,uk

A Selection of Recent and Related Publications

Death of an Illusion? Decline and Fall of High Tax Economies
Vito Tanzi. £5.00
Forever Enslaved? Female Dependency and the State
Sheila Lawlor £5.00
The Challenge of Ageing: Pension Reform, International Trends and Future Imperatives
Chris Daykin £7.00
Aspire Ever Higher: University Policy for the 21st Century
Boris Johnson £5.00
At a Price! The True Cost of Public Spending
A. Heath & D.B. Smith £7.00
Good for the Public! Competition, technology and the shrinking state
Irwin Stelzer £3.00
ABC: A Balanced Constitution for the 21st Century
Martin Howe £5.00
Reforming Public Spending: Great Gain, Little Pain
Ludger Schuknecht and Vito Tanzi £5.00
Policing Matters: Recruitment, Training and Motivation
A. Howlett Bolton, A. Burden, T. Caplin , D. Ramsbotham,
K. Rutherford, C. Woodhead Edited by S Lawlor £7.00
Providing for Pensions: Savings in a Free Society
Tim Congdon £5.00
For Better, or For Worse? The Economic Record of the Labour Government
Warwick Lightfoot £5.00
Let Freedom Prevail!
Liam Fox. £3.00
Working in Harness: Parliamentary Government and the Role of the Lords
Thomas Strathclyde £3.00
Saving Savings: How to Promote Personal Investment
Charles Jackson £5.00
The Pensions Predicament
Paul Thornton £5.00
A Lower Tax Future?
Vito Tanzi £5.00
Voting on the European Constitution
Daniel Hannan £7.00
Comparing Standards: Teaching the Teachers
D.Burghes, S.Lawlor, J.Marenbon, B.Moon, A.Smithers, C.Woodhead £10.00
Mounting Costs: Regulation, Employment and the British Labour Market
Nicholas Boys Smith £7.00
Auditing the New Deal: What Figures for the Future?
Oliver Heald and Mark Waldron £7.00
How Savings Damage Your Retirement
Frank Field £7.00
Incapacity and Disability: Paying for the Consequences
Chris Daykin £5.00
Answer the Question: Prime Ministerial Accountability and

Though there is no political voice for cutting taxes, the subject remains vital to the future. As Dr Irwin Stelzer explains in *The Limits to Tax: Efficiency, Equity and International Competition*, the case for reducing tax as a share of GDP is strong. High tax damages economic growth and society. Besides, change is in the air as green policy sparks a far deeper tax debate. Tax in a growing economy could take a smaller share of GDP. Competition may shrink the state and bring better public services; and vouchers could give patients and parents greater freedom.

POLITEIA

£5.00