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22 Charing Cross Road, WC2H 0QP

E mail: info@politeia.co.uk Telephone: 0207 240 5070

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Death of an Illusion? Decline and Fall of High Tax Economies Can Britain's high tax levels survive?

As Gordon Brown prepares to become prime minister he will have to re-consider UK tax levels. For, across the world, patterns of public spending and tax are changing. Politeia's new pamphlet, *Death of an Illusion? Decline and Fall of High Tax Economies*, considers these patterns and what the future holds. The author, Professor Vito Tanzi, shows how tax levels as a share of GDP rose throughout the 20th century, affected by supply and demand. From around 10-12 per cent of national income in the 1900s, they rose to 40-50 per cent by the 1980s. But since the 1980s they have, in many countries, fallen

- Initially demand for spending was low as the state's role was modest. Supply was difficult: the rich were few and powerful, the poor un-taxable. Besides the difficulties of collection were considerable, and wage earners were too few in number.
- However, universal suffrage, more middle class earners and PAYE were to change this. During and after the two world wars tax levels rose as economic structures changed. Nonetheless tax was around 30 % of GDP in most industrial countries until the 1960s.
- By the 1960's the political and intellectual climate changed with the belief that Government 'could efficiently improve people's lives'.
- In the 1965-85 period tax as a percentage of GDP rose by around 15 % for the European countries. The increase came from VAT, social security contributions and the increase in real incomes and prices (fiscal drag). Public spending rose too.

By the 1980s, the economic damage caused by high tax and public spending was under scrutiny and the status quo under attack. Popular – and specialist -opinion changed. So too did the political climate under Thatcher and Reagan. Supply side reform began to replace Keynesian thinking. Since the 1980s several countries have reduced tax as a share of GDP with average tax levels falling. The average tax level (2004) was around 2.2 percentage points below the average of highest levels reached, (more in the US, Japan, Finland, Sweden, New Zealand and The Netherlands).

The forces for the future, says Tanzi, are in the balance. The demand for higher spending – to pay for pensions, demographic change or better public services – may not win the day. Policies are changing to provide the social goods people in industrial countries want in different ways. Attitudes to income tax are changing while the move to flat taxes has become popular in some transition economies. Above all, global forces are at work. The supply of tax revenue may become problematic: foreign competition, globalization and technological change, 'fiscal termites', are changing fiscal systems. Competition from low tax countries – China, India, Vietnam – may force change on high tax countries who must compete. Financial (and human) capital may go to places where tax rates are lower. As the author concludes, there is now the prospect for the future 'of a world in which the level of tax is lower, the taxes are simpler and the state plays a less intrusive and more efficient role in the economy...'

Professor Vito Tanzi was Director of the Fiscal Affairs Department of the International Monetary Fund (1981-2000).

Death of an Illusion? Decline and Fall of High Tax Economies, by Vito Tanzi, is published by Politeia, 22 Charing Cross Rd, WC2H 0QP at £5.00. Enquiries to Daniel Griffiths, Press Officer on 0207 240 5070/ 07952205036, e-mail, info@politeia.co.uk.

Professor Vito Tanzi will be in London from Washington to discuss his study on Thursday 23rd and Friday 24th November. If you would like to come to interview Vito Tanzi then, please contact Daniel Griffiths at Politeia on 0207 240 5070 or at secretary@politeia.co.uk or Vito Tanzi at vito.tanzi@msn.com