If people are going to propose tax reforms, might we t...

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I have already written about deeply depressing economic thinking finding opportunity for expression in the pages of the FT this morning. Now let me do so again.

The FT also features this gem this morning, under the headline "A truly progressive VAT would solve a lot of UK tax problems":

In the tortured public conversation about UK tax policy, income and wealth receive outsized attention. Consumption tax is far less discussed although it is the second-largest source of revenue to the Treasury.

Reforming the UK’s value added tax — making it more comprehensive and progressive simultaneously — would hit the sweet spot, raising much-needed revenue while boosting both economic efficiency and equity.

Let me run through the arguments of the author of this piece, who is Joel Suss, who is apparently an FT employee.

The suggestion is that, to increase the UK tax take, we should seriously expand the range of goods and services on which VAT is currently not charged. I presume this is thought necessary because, although it is not stated, I suspect the author believes in both the household analogy and the need for the UK government to comply with its own fiscal rules.

At present, only about half of sales in the UK are, in broad terms, subject to VAT, with major exemptions or zero-rated bands applying to the supply of things like houses, rents, most food, children’s clothes, water supplies, healthcare, education, books, funerals, domestic energy, financial services and a host of other items, all of them considered to be necessities in one way or another.

It has long been argued by neoliberal economists that this is inefficient, and that a level playing field should be created in the marketplace where tax cannot have a distortionary effect on the decisions that people make as to what they wish to consume, even though the creation of that distortionary effect is, in fact, one of the primary purposes of taxation.

What would the consequence of this change be? Very obviously, the cost of many things we buy would go up by at least 20%, and the cost of living would, for many people, go through the roof. The Bank of England would then deem it necessary to significantly increase interest rates to tackle the resulting inflation and to supposedly tackle the risk that people would seek long-term adjustments to their wages as a consequence because, quite clearly, most would not be able to afford these increased costs.

Joel Suss ignores all these unfortunate factors in his analysis, as did the academic authors on whose thinking he relies, but does instead suggest that every household whose income is below an agreed threshold should be allowed to reclaim the VAT that they pay to ensure that the poor are not penalised by this change.

The threshold he suggests is 60% of median UK household income, or household income of about £20,000 a year, which is where the UK poverty threshold is set. For these households, he suggests a system where they should collect receipts recording their VAT expenditure and submit them to the tax authority to receive a refund, which he argues would guarantee that the VAT system would become more progressive as a consequence.

To describe this view as naive is to be polite to Joel Suss.

Firstly, that is because VAT can never be progressive, as it is a tax on expenditure. By definition, those with the highest levels of income and wealth in the UK do not spend all their income, which is precisely how they become wealthy. Their expenditure as a proportion of their income is, then, always smaller than that of lower-income households. VAT can never be progressive as a result. To ignore this obvious fact is to deny reality and even distort the truth.

The second point is that this proposal creates a massive threshold issue. Those with household income just below the reclaim threshold will, if this proposal were adopted, end up being significantly better off because of their capacity to reclaim VAT than those with incomes just above the reclaim threshold, who will not be able to do so. This proposal does, therefore, have a massive regressive element built into it by design.

There is also a third fact to consider. It is well known that billions of pounds of benefits are not paid in the UK each year because of the practical and administrative difficulties faced by those on low incomes when making claims for those benefits to which they are entitled. Exactly the same issue would arise with regard to these VAT claims.

The assumption made is that every household under the required income threshold would, first of all, know that it should register for this purpose and be able to prove that it remained under that threshold at all times, presumably with significant penalties being attached to errors that were made. Secondly, it is presumed that these people have the time and resources available to make the VAT reclaims to which they would be entitled. Both assumptions are profoundly flawed.

As a consequence, many people in deep poverty would, in fact, end up paying more VAT as a consequence of this proposal, and that would create massive tax, economic and social injustice.

As tax proposals go, this has to be one of the most callous, ill-thought-through, deeply regressive, profoundly neoliberal and socially unjust that exists. It is yet another tax reform that sits in the same category as Gabriel Zucman's wealth tax. It looks great in an academic paper, but is truly terrible when the practical consequences are thought through, including those for the macroeconomy, which it appears all those proposing it have completely ignored.

A better alternative

Let me then suggest a better tax, if we do want a progressive consumption tax, which I happen to think might be desirable.

I've described this alternative on a number of occasions. It is a financial transactions tax on all financial flows through UK-based bank accounts, making separate charges for receipts and payments, and making the charge progressive based upon the aggregate flow through the account, having eliminated bank transfers and intra-family (or, in the case of companies, intra-company) payments.

Such a tax could be truly progressive. Anyone with financial flows through their bank account indicating that they were on around median income or lower might be exempt from the tax. The tax rate could then rise significantly as income flows rise. Alternative bands could be applied to businesses, with smaller companies paying lower rates than larger companies. If appropriate rates were applied to those with wealth, the need for other discussions on wealth taxation might be entirely eliminated.

This tax would be genuinely progressive because it would be based upon income flow and active expenditure, whatever payments were made for. In other words, it could be applied to the purchase of financial assets as much as it could be applied to anything else, meaning that the wealthy would not obtain the benefits that they do under the VAT system.

If applied to companies, at appropriate rates, it could be used to eliminate employers' national insurance charges, which are at present seen as a serious impediment to the growth of employment in the UK. This is why variable rates on companies would be necessary. Smaller employers should not pay the same rate as larger employers, but the advantage would be that those companies that currently pay very little national insurance because they have very high financial throughput but very low levels of employment creation would, as a consequence, make a proper contribution to the economy, which they do not at present.

Some will argue that this tax could be easily avoided by using cash, alternative currencies, Bitcoin and offshore accounts. As a result, I have proposed mechanisms to deal with all these issues, including the option of permitting HMRC to raise estimated assessments on those individuals and companies who appear to underpay in proportion to their obvious economic activities, with the burden of proof resting on the taxpayer to suggest that the assessment raised was wrong.

The consequence would be a genuinely progressive indirect tax in the UK that could certainly eliminate employers' national insurance charges over time, with a phased transition from one system to the other, and which could also potentially eliminate national insurance charges on employees over time if rates could be calibrated appropriately, which I suspect experience over time would permit. Both would be significant gains for atx justice

I also make the point that there would be no cliff edges in this system, and the reporting would be incredibly simple and not at all onerous. All the data necessary to prepare these tax returns already exists. If a bank can calculate the charges it imposes on the basis of activity through a bank account, it could just as easily calculate the amount of this tax to be paid on the same basis and pay the sum over every month, with it potentially being permitted to make an annual adjustment to ensure that an overall fair rate of tax reflecting activity over a 12-month period was paid by each person in the country.

My point is a simple one. If we want to discuss tax reform in the UK, can we do so intelligently, taking into consideration all the impacts of a proposal, and do so in a way that integrates tax into the needs of our society? So many proposals I see fail to do that, and that is why I put forward this idea instead.