Funding the Future

The Financial Times does not understand what tax is for

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The Financial Times has published a lengthy article entitled Britain's 1,000-year-old tax travails, examining the history of taxation in the UK and the complexity of the tax system that we now have.

There is useful material in the article. It explains how we have accumulated around 90 different taxes, a tax code exceeding 23,000 pages, and a bewildering range of exemptions, allowances and anomalies, many of which make little economic sense.

It also explains how politicians have contributed to this situation by promising not to increase headline tax rates whilst finding increasingly obscure ways to raise additional revenue.

All of that is about reasonable criticism and analysis.

But, that said, there is something fundamentally wrong with the article. Despite its length and its quotes from numerous supposed tax experts, it never seriously asks the most important question of all, which is, what is tax for?

That omission matters because, without understanding the purpose of taxation, it is impossible to design a coherent tax system, and the FT and its chosen experts clearly lack that ability because they did not ask that question, let alone try to answer it.

The missing understanding of taxation

The FT article adopts the conventional assumption that governments tax to pay for public spending. It consequently concludes that Britain must either increase taxes or cut public spending, and probably do both if it continues in its current economic trajectory. That conclusion is presented as an unavoidable economic fact, but it is not. It instead reflects a deep economic misunderstanding.

That is because modern monetary theory (MMT) offers a fundamentally different understanding of taxation. It recognises that a government issuing its own sovereign currency does not need to collect that currency from taxpayers before it can spend. In

fact, what happens in the real economy is that government spending creates money, whilst taxation withdraws it from circulation.

This does not mean taxation is unnecessary. Quite the opposite. Taxation is essential to the functioning of a modern economy, but for reasons that extend far beyond supposedly financing government expenditure.

The contrast between an MMT-informed understanding of taxation and the assumptions made in the Financial Times article is so striking that I summarise them as follows:

MMT understanding of taxation	Financial Times treatment
Government spending creates money; taxation withdraws it.	Taxation is presented as a means of financing government expenditure.
Taxation helps control aggregate demand and inflation.	Not discussed.
Taxation creates demand for the currency in which liabilities must be settled.	Not discussed.
Taxation redistributes income and wealth.	Inequality is mentioned, but redistribution is not developed as a central purpose.
Taxation can discourage socially harmful activities.	Tax-induced behavioural changes are overwhelmingly treated as economic distortions.
Taxation can address concentrations of economic power.	Not discussed.
The appropriate level of taxation depends partly on inflation, resource availability and economic conditions.	Taxation is presented principally as a response to spending requirements and fiscal pressures.

These differences are not minor matters of interpretation. They represent fundamentally different understandings of how the economy works.

The questions that should have been asked

If we want to understand Britain's tax system, we should begin by asking what sort of

society and economy we want to create. That means the following questions must be addressed first.

* What public services do we need?

* What resources are required to provide them?

* Are those resources available, or could they be developed?

* What would be the inflationary consequences of the government spending needed to deliver those services?

* How much taxation is required to manage demand and release resources for public use?

* How should taxation redistribute income and wealth? And

* How can taxation discourage harmful economic activity whilst encouraging behaviour that benefits society?

These questions should underpin tax policy.

Instead, the Financial Times largely treats taxation as a revenue-raising exercise, with the principal challenge being how to extract sufficient money from the population without provoking political opposition.

As a result, the article devotes much of its attention to the problems faced by people earning more than £100,000 a year, the peculiarities of VAT, and the consequences of freezing income tax allowances. These things matter, but they are also staggering examples of missing the point of tax policy debate.

Also notable is that the article barely considers the fundamental distinction between income earned from work and income derived from wealth, and that matters enormously.

We have a tax system that frequently taxes income from work more heavily than income from wealth. National insurance contributions reinforce that discrimination. Capital gains receive preferential treatment. Significant forms of investment income escape charges imposed on employment income. These are not peripheral problems. They are central to understanding why inequality persists, why wealth accumulates, and why the tax system fails to deliver economic justice, but despite that they receive remarkably little attention.

Why this matters

The Financial Times argues that Britain must accept higher taxes, lower public spending, or both. That conclusion does, however, follow from its assumptions, and not from any serious examination of the economic choices available to us.

A government with monetary sovereignty faces real constraints. It cannot command resources that do not exist. It cannot ignore inflation. It cannot assume that every desirable activity can be undertaken simultaneously.

But those constraints arise from the availability of labour, skills, technology, natural resources, and productive capacity. They are not the same as the financial constraints faced by a household.

Taxation has a vital role in managing those constraints.

It also has a vital role in shaping the distribution of income, wealth and power within society.

And that means the starting point for tax reform should not be the question of how much money the government needs to raise. It should be the question of what economic and social outcomes taxation is intended to achieve.

The Financial Times has produced an interesting history of Britain's tax system. But it has confused three different questions: how taxes should be administered, who should pay them, and why governments need taxation at all.

It concentrates on the first, pays inadequate attention to the second, and almost entirely ignores the third, and that is why its analysis fails. Unless we understand what tax is for, we cannot possibly design a tax system fit for purpose. And the absence of that understanding is the real problem with Britain's taxation debate.