

redesigning *the state*

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Citizens and Taxes

Selina Chen

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The Fabian Society

The Fabian Society is Britain's senior think tank. Concerned since its foundation with evolutionary political and economic reform and progressive social change, the Fabian Society has played a central role for more than a century in the development of political ideas and public policy on the left of centre. The Society is affiliated to the Labour Party but is editorially and organisationally independent. In recent years the Society's work on the modernisation of the Labour Party's constitution and its analysis of changing political attitudes have played a significant part in the renewal of the party's public appeal.

Today the Fabian Society seeks to help shape the agenda for the medium and long term of the new Labour Government. Analysing the key challenges facing the UK and the rest of the industrialised world in a changing society and global economy, the Society's programme aims to explore the political ideas and the policy reforms which will define the left-of-centre in the new century. Through its pamphlets, discussion papers, seminars and conferences, the Society provides an arena for open-minded public debate.

The Fabian Society is unique among think tanks in being a democratically-constituted membership organisation. Its five and a half thousand members engage in political education and argument through the Society's publications, conferences and other events, its quarterly journal *Fabian Review* and a network of local societies and meetings.

Redesigning the State

The Fabian Society's programme on 'Redesigning the State' seeks to examine the role and form of a state appropriate to 21st century Britain. In recent years the role of the state has come under multiple challenge: its ability to tax adequately and to deliver public services efficiently has been widely doubted, while 'globalisation' has apparently raised questions of its economic competence. Public confidence in the institutions of government is in long term decline.

The Fabian Society's programme aims to reassess the purpose and critical functions of the state in a changing social and economic context. Central to this are the questions of the levels at which the state should operate, from the local to the supra-national, and to the maintenance of an appropriately funded public sphere. It hopes to contribute to the renewal of democratic legitimacy by exploring ways of improving the relationships between citizens and their governments, including constitutional reforms. And it seeks to identify how the state can improve the delivery of public services for both customers and citizens.

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Foreword

Raymond Plant

Taxation is central to politics. Taxes pay for government and for public services. Debate about the level and structure of taxation is therefore a crucial part of the democratic process in modern societies. Yet over the last twenty years reasoned debate about taxation has almost disappeared from British public life. Politicians seem willing to talk about taxes only if they can promise to cut them. Media coverage of Budgets is obsessed with the headline basic rate of income tax to the exclusion of almost all else.

This is of course the result of a conscious political project embarked upon by the Conservative Governments of the 1980s and early 1990s. For the Tories cutting tax – and in particular, income tax – was the totemic policy which symbolised the rolling back of the frontiers of the state. In terms of policy this project failed: when the Conservatives left office the overall level of tax and public spending was higher than when they entered it. But at an ideological level, and in terms of public debate, their redefinition of the tax question along these restricted lines still dominates the political landscape.

This is deeply unhealthy. It is particularly damaging for the new Labour Government, which believes in active government and seeks to deliver high quality public services, and which therefore depends on a basic public understanding and acceptance of taxation. But it is bad for democracy more generally. Taxation is essentially a relationship between the citizen and the state – at an everyday level, indeed, a rather more significant one to the average citizen than voting. Lack of proper public debate about taxation therefore reinforces the loss of trust in politics and political institutions which has become so marked in recent years.

It is for this reason that the Fabian Society established, in September 1998, its independent Commission on Taxation and Citizenship. Comprising fifteen eminent individuals from a variety of walks of life, the Commission's aim is to examine the purpose and structure of the tax system and make recommendations for reform. Above all the Commission seeks to restore taxation policy to a legitimate place in political argument, establishing a new terrain for debate beyond the narrow ground of the Conservative legacy. Starting from the concept of citizenship – the notion of a civic community connecting individuals to one another and to their government – the Commission hopes to contribute not merely to a more mature political debate on taxation itself, but to the wider renewal of democratic politics and civic purpose in British society today.

This pamphlet by Selina Chen, one of the Commission's Research Fellows, arises from and is informed by the Commission's deliberations. But it should not be taken as representing either the Commission's views or those of any individual Commissioner. Its publication by the Fabian Society, in advance of the Commission's final report, is intended rather as a contribution to the general debate which the Commission seeks to promote. We hope it fulfils this purpose.

Raymond Plant is Chair of the Commission on Taxation and Citizenship

on taxation owes much to its experience in the 1992 election, when John Smith's shadow budget – proposing modest tax increases for the better off – provided the pretext for a vicious Tory advertising campaign attacking 'Labour's tax bombshell'. It is accepted wisdom in new Labour circles that voters' perceptions of Labour's tax policies were a major reason for its defeat. Fears about the personal cost of voting Labour were compounded by more deeply-seated suspicions about the party's economic competence.⁴ The lesson learned from this episode was not simply that Labour must never again be tarred with the 'high taxation' brush, but that the party had to neutralise the subject of taxation in voters' minds. It had to be taken out of play altogether as a political issue. New Labour's tax pledge in the 1997 election – that there would be no rises in income tax rates in the lifetime of its first Parliament – was one obvious consequence of this new strategy. The party's general reluctance to talk about tax policy at all has been the other.

In view of its experience this strategy has been perfectly understandable. But it surely cannot be sustained forever. New Labour seeks not merely to remain in power, but to establish a long-term public consensus around the values and ideas of the centre-left. In its ambition to make the 21st century a 'progressive century' in the same way that the 20th has been predominantly conservative, Labour seeks an ideological as well as electoral hegemony, a shift in the accepted common sense of the age. But it cannot then allow one of the most important areas of public policy to pass by default. Taxation is not just central to the management of public policy; with its twin, public spending, it helps to define the very nature of government. Labour's goal is to demonstrate to the British public that government can be good: that it can help to create a fairer and more cohesive society through active policy and high quality public services. But then its approach to taxation must surely be a part of this – explained and justified, not somehow hidden away or disguised. Solid and long-lasting support for the values of the centre-left must ultimately include an acceptance, not simply of how they are delivered in practice, but of how they are paid for.

This is all the more important given that the present state of debate about taxation is the deliberate product of the previous era of ideological domination. The view that taxes are inherently bad and should be cut wherever possible, and that income tax is the worst of all, were deliberately fostered during the period of neo-liberal Conservative rule. They were part of a sustained attack upon the legitimacy of government, carried out both in practice and at an ideological level, and underpinned by a powerful neo-liberal philosophy. For new Labour it is this attack above all which must be reversed. It is through reclaiming the need for and effectiveness of public action to achieve social and economic progress that the centre-left is defined. But then changing the terms of debate about taxation which underpinned the neo-liberal era must surely be a central part of its mission.

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2. Tax challenges

A new debate about taxation is needed; but it must then reflect the new context in which it is conducted. Over recent years three major challenges in the politics of taxation have emerged: we might call these the fiscal, the electoral and the civic.

The fiscal challenge

The fiscal question is simply enough stated. Will governments in the future have enough money to pay for public services? The challenge arises from both the revenue and spending sides of the fiscal equation: indeed, it is based on the claim that these are now embarked on fundamentally divergent paths.

Globalisation and e-commerce

On the revenue side, the claim now frequently heard is that in the modern world there is an inexorable downward pressure on the ability of governments to levy taxes. Two related trends are at work here, it is argued. On the one hand is globalisation. In the highly competitive international economy in which we live today, the growing mobility both of capital and of top executives and professionals will make it increasingly difficult for national governments to raise taxes. Firms will locate where taxes are lowest; governments will inevitably start competing to offer more favourable tax environments, both to firms and higher income earners; public revenues will consequently be at risk. The recent protests by UK road hauliers at the difference between fuel duties in Britain and France were harbingers of the pressures to come. Where tax differences remain, ever larger multinational corporations will simply manipulate their prices and accounts to disguise the location of their activities and so avoid tax. Executive pay will increasingly take the form of share options and other forms of capital wealth which allow tax to be avoided.

All this, it is claimed, will be made worse by the parallel growth of electronic commerce. Predictions of the rapid growth of e-commerce – some estimates suggest a global turnover of \$2 trillion by 2002 – have led certain commentators to issue dire warnings that nation states will witness a drastic reduction in their powers of taxation.⁵ Because e-commerce transactions cannot be located in any geographic territory and may leave no audit trail, it is argued, tax evasion will become relatively easy, and governments will find their revenues from sales taxes hugely reduced.

Some caution is necessary here, however. While there is no question that there are real forces at work in these areas, their impact on tax options is by no means predetermined. In the first place, the globalisation argument places too much weight on tax differentials as the determinant of firm location. The evidence in fact suggests that taxes have a rather marginal effect, with other factors – wage

levels, skills, geography, communication infrastructures - far more important.⁶ It also assumes that nation states are incapable of co-ordinating tax policy where this might prove necessary to prevent downward tax competition. In the European Union there is already a degree of tax harmonisation on VAT, and strong pressures to extend this to corporate and savings taxes. Against the alleged 'inevitability' of downward pressure on national tax rates must be set the political will to avoid this.

And the same is true with respect to electronic commerce. If inspection is lax, there may be risks of easy avoidance. But it is in all nations' – certainly all developed nations' – interests to prevent this, and co-ordinated international efforts are already being made to ensure that easy avoidance is minimised. The mere fact that a sales transaction is conducted electronically does not of itself make its financial audit trail invisible; and, except for those few products (such as music and software) which can themselves be delivered digitally, electronic commerce no more eliminates physical goods than telephone sales do. There is a risk of exaggeration here, born of newness, which may hinder calm policy making.

And of course even if there did turn out to be significant downward pressure on certain taxes there always remains the possibility of levying others. Taxes on mobile factors of production can be substituted by taxes on less mobile ones – as indeed the new taxes on energy, wastes and land being introduced in many industrialised countries, including the UK, already reveal.

The demand for public services

If downward pressure is the concern on the revenue side, the opposite pressure is felt in relation to spending. The alleged trend here is that the demand for certain public services is rising faster than national income. A number of public policy analysts argue that health, education and social services (and possibly some others, such as public transport and environmental services) are what economists call 'superior goods'; as the public grows richer, its demand for these services rises faster than the growth of national income.⁷ There is therefore a constant upward constant pressure on the tax burden as a proportion of GDP.

This is a function, such analysts claim, of several forces. One is inherent in the nature of such services: education and health are simply the public's preferred choice for spending higher incomes. Moreover in the new 'knowledge economy', education is the key resource: modern societies will inevitably require more and more of their young people – and increasingly older people as well – to go through higher education and training. In part it results from technological innovation. In health care in particular new medical technologies and drug treatments may create both a steeply rising cost curve and simultaneously rising expectations of what constitutes acceptable treatment. (The exorbitant cost of meeting the demand for Viagra on the NHS provides just the most public herald

of future pressures.) These forces are exacerbated by demographic trends, particularly of an ageing population, which are driving up expected costs in health care, personal social services and pensions. Increased private provision may not be sufficient to bridge this gap.

Added to this claim of rising demand for public revenues are further doubts about diminishing supply. It is pointed out that the public accounts have been kept afloat over the last twenty years by a series of one-off measures and short-term injections of funds: notably North Sea Oil receipts, privatisation proceeds and the windfall tax on privatised utilities. These sources are all now close to exhaustion, with no obvious substitutes. Meanwhile the drastic cuts which the Tories made to certain areas of public expenditure – notably capital spending and defence – have been reversed by the new government.

Of course, none of these pressures in themselves project a shortfall in government budgets. It is always an option to cut spending in other areas. Significant new efficiency gains may achieve better service outcomes for less spending. Faster rates of economic growth may yield substantial additional revenues which can bridge the gap (at least in the short term) between expectations and available resources. As the present Chancellor has already shown, the complexity of the public accounts allows for a dose of fiscal imagination to open up considerable new sources of revenue. The evidence from the Treasury's own 'generational accounts' suggests that at present levels of spending there is indeed no structural gap – though they also show that such a gap would appear if the growth rates of health and education expenditure rose without compensating reductions in other areas.⁸

The electoral challenge

The missing element in these arguments, of course, is public opinion. It is assumed that a rising generalised demand for public services will translate into concrete electoral pressures on governments and parties to raise spending levels. But this is by no means certain; indeed the opposite view – that governments face constant electoral pressure to cut tax – is more widely believed. The second key question of current tax politics is therefore electoral: exactly how much are the public prepared to pay – and to vote for?

There is a longstanding puzzle here. Among politicians and media commentators it is almost universally believed that the public will not support parties which promise tax increases. Indeed it is the public's alleged 'tax resistance' that is the basis of the inertia in the terms of debate in this field. Promising to cut taxes, or at least being committed not to raising them, is regarded as unvaryingly politically popular.

And yet this does not appear to be supported by the evidence of public opinion. The annual British Social Attitudes reports have been tracking opinion on this

question since 1983. For two kinds of spending, health and education, consistent, large and increasing majorities of the British public say they support higher taxes for higher spending: 77 per cent for health and 66 per cent for education in 1995 (compared, incidentally, with 63 per cent and 50 per cent in 1983). When it is pointed out to respondents that this would mean an increase in their own taxes, not simply those of other people's, these numbers decline, but they remain well over 50 per cent for both areas of spending. Moreover, when asked to choose between income tax and other forms of tax, including VAT, as a means of raising the necessary revenue, most people, even those on high incomes, opt for progressive taxes.⁹

But of course public opinion as expressed in surveys is not the same as voting intention. Critics argue cynically that what is said to a researcher is belied by what is done in the privacy of the polling booth. Do the results of the last four general elections not show precisely that the British public will only vote for low tax parties?

In fact they don't. In the elections of 1983, 1987 and 1992 a majority of the public voted for parties (Labour and the SDP / Liberal Democrats) promising to raise taxes or keep them as they were: the Tories never received more than 44 per cent of the popular vote. It was the electoral system which generated the apparently opposite results in terms of seats won and governments formed. Moreover, detailed analyses of voters' reasons for voting for the different parties in these elections and in 1997 do not reveal that tax policies played anything like the central role which political mythology suggests. Neither John Smith's Shadow Budget in 1992 nor new Labour's tax policy announced in 1997 had discernible effects on stated voting intentions.¹⁰

What accounts then for the received wisdom that the public are highly resistant to tax increases? Three explanations offer themselves. The first is that though taxation policy per se is not a determinant of voting intention, it acts as a proxy for economic competence, which is. Parties associated with high taxes – particularly the pre-1997 Labour Party – are also associated with economic incompetence, and economic credibility is the single most important ingredient of electoral success. There is indeed evidence of this – Labour and the Conservatives swapped places as being the 'best party on taxation' at exactly the same time (late 1992) as they reversed positions on having 'the best policies on managing the economy'.¹¹ But the causation here is not clear: since at this time Labour had only announced a general abandonment of its 1992 election programme rather than any specific pledges on tax it may be that its general image of growing economic competence led to consequent approval for its tax policies rather than the other way round. On the other hand it is equally plausible that the party's subsequent 'low tax' policy reinforced its rising economic credibility. (It should be noted, incidentally, that if this relationship applies it suggests that the Government's strong current reputation for managing the

economy may give it more room for manoeuvre on taxation than it has previously been allowed.)

The second explanation is that overall majorities of public opinion are more or less irrelevant when it comes to winning elections. In Britain's first past the post electoral system, it is the views only of swing voters in marginal seats which really matter. And the evidence is that these voters are indeed resistant to tax increases. Survey evidence following the 1992 election showed that 'high taxes' were among the first things which C1 and C2 voters in the Midlands and South East of England identified with Labour.¹² The party's own private focus groups over the 1992-97 period powerfully reinforced the leadership's view that to these 'aspirational' target voters tax policy was indeed a central factor in voting intention. (Whether it remains so, of course, is another matter.)

The third possible explanation is that generalised public support for higher taxes to pay for higher spending is not sufficient to lead to concrete electoral support. People must also be confident that the money will be spent – and spent wisely – on the services they desire. And it is this confidence, it may be argued, which is absent. The public simply do not believe in governments' ability to deliver.

The civic challenge

This leads directly to the third question in the new politics of taxation. The 'civic challenge' asks about the relationship between citizens and their government. Does the present state of debate about taxation reflect not simply a lack of faith in particular governments' abilities to deliver better services, but a more profound erosion of the notion of citizenship itself?

The loss of public trust in government over the last two decades has been widely remarked upon. Public attitude surveys show declining confidence in politicians and political institutions.¹³ Voter turnouts in elections are in long-term decline. The public's faith in the ability of governments to deliver better outcomes certainly seems to have been damaged. Yet it is important to distinguish here between two different possible problems.

If by 'trust' is meant a blind confidence that governments are always efficient and wise, its loss is surely not something to be regretted. Increasing incomes, the rise of individualism and the widening sense of personal autonomy experienced over the last two decades have simultaneously made the public less deferential to authority and more conscious of themselves as consumers. As choice and customer service have improved in the private sector, so people have come to expect and demand more of public services. But this is surely to the good. It can hardly be denied that parts of the public sector have not been raging successes. Many public services do need to be of higher quality, more customer-focused and better adapted to diverse individual circumstances. Gov-

ernment certainly does need to be more responsive and efficient. If a certain level of 'tax resistance' arises from a lack of confidence that the government will spend taxpayers' money wisely it is not without some justification. And there is an obvious remedy – at least in principle – at hand. Governments need to improve. They need to become more efficient, delivering better services; and they need to demonstrate to the public that this is happening.

But the deeper anxiety is that this may not be enough. For beyond the relatively simple decline in 'customer' confidence may lie a more profound decline in the very notion of citizenship itself. Loss of faith in political institutions appears to be more than a disgruntlement with the quality of public services. It reflects a disengagement with the entire political process, a weakening of the democratic link which attaches individuals to their government – and to each other. This is surely the phenomenon behind low election turnouts. But if this is the case the implications for taxation are more severe. For taxation is in itself a relationship between citizen and state: to the average citizen, and on an everyday basis, a rather more significant one than voting. If this relationship is weakened the legitimacy of taxation is weakened too. It seems likely that people feeling only a weak democratic connection to their government will feel resistant to paying taxes too.

In this sense the civic challenge goes well beyond taxation. It is the rejuvenation of the ideal of political citizenship more generally. The broad implications can be glibly stated: governments must become more accountable, democratic processes must become more open and participatory. These are easier said than done. But it seems at least indisputable that a part of this process must be the promotion of open and accessible public debate. And this must be particularly important in the field of taxation, where a lack of public understanding of how taxes are spent and the social benefits generated by them can only serve to undermine the sense of disconnection between the citizen and her government.

The politics of taxation is therefore intimately bound up with the wider politics of democratic renewal. And in turn it depends upon the restoration of proper public debate about what taxes are for, who pays them, and how much of them are needed.

3. Citizenship And taxation

Acknowledging that taxation is an important element in the relationship between citizen and state leads to an important observation. This is that arguments about taxation policy are almost always based on prior and more deep-rooted arguments about the nature of citizenship. Political attitudes towards taxation reflect underlying attitudes towards the kind of society we live in: the bonds (or lack of them) connecting individuals to one another in the 'civic community', and the rights and responsibilities which define the relationship between individuals and their government.

This can be seen most clearly in the Conservative era whose legacy we continue to confront. The dominant terms of political debate about taxation are founded on the neo-liberal conception of citizenship which underpinned the politics of the new right in the 1980s and 90s. By the same token, if the centre-left is to renew the legitimacy of taxation it must articulate afresh its own notion of citizenship in the modern world.

The neo-liberal view

The neo-liberal conception of citizenship, founded upon libertarian political philosophy, asserts the fundamentalism of individual freedom. Freedom is the capacity to act autonomously and to own property: its principal enemy is government. The state, neo-liberals assert, can do very little of benefit for its citizens except protect their basic rights to property and to physical security. Above all the state should do as little as possible to infringe the individual's right to keep what she has earned in the marketplace. The neo-liberal view that unfettered markets are the most efficient way of running an economy then happily coincides with its philosophical commitment to individual freedom.

The neo-liberal view of taxation follows. Taxation for any purpose other than the protection of these basic individual rights is essentially confiscation. In the philosopher Robert Nozick's phrase, taxation for collective purposes is "on a par with forced labour", since it appropriates private earnings for purposes determined not by the individual but by government. Hence the proponents of 'Tax Freedom Day', a neo-liberal campaign first promulgated in the USA but recently imported to the UK, describe the time spent earning the amount paid in taxes each year as days spent in slavery to an avaricious and overweening state.

Of course in real life Conservative governments cannot actually reduce taxation to the levels envisaged in libertarian theory. But they have used it to provide philosophical justification for the view that taxes are a priori too high and should be cut simply as of principle. The recent Conservative pledge that a Tory

government would reduce the level of taxation as a proportion of GDP whatever the prevailing economic and social circumstances is a classic manifestation of this view which has animated Tory thinking for the last quarter century. Even for Conservatives who do not share the fundamental neo-liberal hostility to the state which underpins it, this has proved a difficult view to dissent from.

One obvious weakness of the neo-liberal view, even on its own terms, is an inadequate understanding of the practicalities of individual freedom. Neo-liberals assert the validity only of 'negative' rights (to protection against threats to life, liberty and property) and minimal civic rights such as the rights to free speech and to vote. They present these as relatively costless; hence the necessity only for minimal taxes. But in fact protecting even negative rights is expensive; they require the state to exercise considerable law-enforcement powers and judicial sway, which require supporting by social expenditures. In a scenario where market forces are allowed free rein, the costs of law-enforcement could be considerable, given the likely rise in crime and disorder. The minimal state turns out, in other words, to require rather more taxing and spending than originally envisaged.¹⁴ The present case of Russia is particularly instructive in this regard: the chronic crisis of a state unable either to collect its taxes or to enforce the rule of law.¹⁵

But of course this is not the principal objection to the neo-liberal view of citizenship. For most people the principal problem will be its stunted view of the person: an atomised individual principally defined through his or her exchanges in the market. Mrs Thatcher's famous declaration that "there is no such thing as society, there are only individuals and their families" demonstrated graphically the rejection of any wider notion that the individual might be located in a community of mutual dependence.

The social democratic view

This is the starting place for what might be termed the traditional social democratic view of citizenship. In the classic formulation offered by T. H. Marshall forty years ago, the crucial recognition was that the successful exercise of negative rights requires a parallel account of social and economic rights.¹⁶ For democracy to function there must be universal education. Individuals can participate fully in society only if freed from the constant constraints of poverty and ill-health. Civic equality, both in politics and before the law, is undermined by wide economic and social disparities.

And so from this basis in rights emerges the concept of a civic community. In the social democratic conception individuals are not atoms, entirely responsible for the satisfaction of their own needs. We are mutually interdependent, reliant not just on the civility and cooperation of the strangers with whom we share the same geographic space, but on their participation in the provision of collective goods. The money we earn does not come simply from our own

efforts, but from the education and culture we have acquired in society, from the benefits of the social institutions and networks in which we are inescapably embedded. We are surrounded by the shared public goods we need to live and for which we therefore depend on others: roads, policing, clean air, refuse collection, cultural life. And we also have moral obligations to others with whom we may not share such mutual dependence.

For recognition of mutual interdependence comes with an understanding that the outcomes of market processes are not socially just. Those born with wealth and talent will have access to opportunities and incomes not available to those dealt a less fortunate hand. Such inequalities will be amplified as the market rewards success. In the social democratic view, the fundamental equality of worth of citizens cannot be maintained if social and economic inequalities grow too great. Citizenship therefore implies social justice, requiring the state to mitigate undeserved inequalities by redistributing opportunities and resources towards the disadvantaged.

Taxation has therefore been viewed very differently in the social democratic tradition from the neo-liberal one. Taxation is not confiscation: the state does not take away the individual's 'own money'. Part of each of our incomes is owed to the community already in payment of shared benefits. We could not be who we are without these. Taxation is not punishment, but an expression of mutual solidarity. As Keynes remarked, it is the membership fee we pay for living in a decent society.

And as such it is a central element of the democratic process. For the social democratic conception of citizenship depends crucially upon fair collective decision making. If citizenship requires both universal public services and redistribution, the form these take, their level and quality, must be decided democratically. So ensuring that the level and form of taxation is subject to democratic process and decision is vital.

Citizenship in new times

The social democratic view of citizenship is a familiar and longstanding one. Yet it has become more important than ever for us to renew and revisit it. This is not just because we have emerged from a long period dominated by the contrary neo-liberal ideology. It is because some of the assumptions and values embodied in the social democratic tradition of the postwar period can no longer be taken for granted.

In the heyday of social democracy the notion of 'community' needed little theorising. British society was constructed around communities – local communities, trade-based and industrial ones and the larger collectivities of class. Most people's outlook on life, and certainly on politics, was coloured by these social identities. The decline of 'ascribed' communities of this sort over the last

two decades, and the rise of more individualised perspectives on life, mean that today, the notion of a civic community cannot be assumed. The 'elective' communities which people tend to belong to now – self-chosen communities of friends, interests and identities – do not provide the basis for a generalised sense of belonging to a geographic and political community, many of whose other members are strangers. Yet it is upon this that the social democratic conception of citizenship depends. The idea of a civic community must today therefore be deliberately reconstructed anew and constantly reinforced.

The growth of individualisation has been accompanied – and influenced - by rising and widening prosperity. As disposable income has increased, people have become more conscious of themselves as consumers. The choice of private goods available has hugely expanded for most people, making the opportunity cost of taxation – what is foregone to pay for it – seem greater. As inequality in incomes has grown, and people have become more aware of others' consumption patterns (both through greater social mixing, and through television, magazines and advertising) the pressures to consume have become larger. Social comparison based on consumption levels has become sharper as people's 'reference groups' (those with whom they compare themselves) have widened.¹⁷ It is surely then not surprising that the social and political forces pressing down on taxation have become greater.

Moreover some goods which for many people were formerly only available in the public sector have now become largely or partly private – housing, transport, pensions, welfare insurance, health care. As prosperity has widened, so many people's perception of their dependence on public services has fallen. This is surely particularly true of the social security system. A safety net which did not seem very far below for a majority of citizens now seems very distant for many. The welfare budget takes up more than a quarter of public spending, but the original sense that taxes paid directly for the benefits on which one relied or were likely to rely has surely declined.

Perhaps most importantly, political experience has chastened the old social democratic confidence in the capacities of the state. The ascendancy of neo-liberalism during the 1980s and 90s was not based, after all, on widespread popular belief in libertarian political theory. It reflected a much more practical dissatisfaction with the workings of the postwar state. Where social democrats had assumed governments could correct market failures, it became apparent by the end of the 1970s that 'state failures' were as likely to replace them. Whether it was the challenge to Keynesian economic management posed by stagflation and rising unemployment, the apparently limitless subsidies swallowed by inefficient nationalised industries, or the perception that public services were monolithic, bureaucratic and producer-dominated, the very agent of change by which postwar social democracy intended to transform society came to appear seriously discredited. Today we accept a rather more limited view of the state's

role; but comparisons with the private sector have simultaneously raised expectations of its performance. The question of whether it can deliver still remains.

So the re-legitimising of taxation in the public mind cannot rely simply on a restatement of the old social democratic concept of citizenship. The centre-left must find new ways of articulating its values, explaining again, and to a new generation, why taxation is central to a decent and modern society.

Validating taxation

This need surely not be that hard a task. The pressures against may be stronger than they were, but they are by no means overwhelming.

The first and most important argument that must be made is that taxation can make you better off. Public spending – on health, education, public transport, the environment, the arts – contributes to our living standards. Indeed at the margin, where taxes are levied, it can contribute more than the private spending which it replaces. The issue of transport, which has suddenly leapt to the top of public spending priorities, illustrates this well. Extra private income, spent on more private car use, will make the problem of road congestion worse. Extra public income, spent on public transport and infrastructure, will make it better.

The crucial recognition here is that public spending, financed through taxation, can achieve some of an individual's objectives better than his or her own private spending. The neo-liberal argument assumes that this can never be the case: individuals are always best placed to satisfy their own needs, the state can never know better. But this is simply not true. My desire for safe streets and a low crime rate cannot be satisfied through my own private spending: I need the community to pay for policing and for social expenditures which reduce the problem at source. I cannot buy clean air (and only a minority can buy their way into the diminishing number of neighbourhoods which have more of it): this must be secured collectively, through reductions in road transport emissions. I can pay out of private income for my health care; but this will never cover all my health needs, and for the system as a whole private funding is much less efficient than a publicly financed NHS. Americans pay far more for their health insurance than Britons pay for the NHS in tax. For most people, paying for private education is out of the question.

What is needed here is a new language to embed the idea that living standards are not only about private consumption, but about public spending too. One of the more pernicious results of the neo-liberal agenda is the way in which Budget statements are reported by the media. The question is always whether tax changes have made the typical person 'better off' or 'worse off'. But tax changes alone can never measure this. It depends on what is done with the money: on the spending side of the equation as well as the revenue raising. Integrating a spending analysis into the Budget might help here. A new way of articulating

and measuring 'overall living standards' or quality of life, encompassing public goods as well as private ones, almost certainly would.

The argument for taxation is not simply about the collective nature of public services. For many could be financed at least partly through an expansion of charging. Taxation also depends on the principle of equity: that public services should be available to all, and therefore should be paid for according to ability to pay rather than use. In fact this principle is not absolute: partial charging for public services is commonplace, whether for swimming pools, prescriptions or, less formally, through school fundraising events. There are legitimate arguments to be had about where lines should be drawn – as witnessed, for example, over national museum charges. But the general principle is important, and its widespread public acceptance evidence that the idea of community has not yet collapsed as far as some have claimed.

The value of taxation-funded public services, which are therefore universally available, lies not simply in their efficiency but in their contribution to social cohesion. Public services, commonly experienced, act as a sort of social glue. We all have an interest in them; and it is in using them (schools, hospitals, public transport) that we meet our fellow citizens. The deep public support for the NHS, despite all its faults, is surely an expression of this sense of commonality: it is one of those institutions that binds the nation together. One of the results of rising inequality is precisely the sense that some citizens are opting out of this common experience, using private education, health care, transport and even in some cases – as in the US – barricading themselves behind gated residential communities. Retaining high-quality, tax-funded public services is therefore an essential bulwark against the 'social exclusion of the rich' as well as that of the poor.

This inchoate but keenly felt concept of 'social cohesion' is crucial to the argument for taxation in another way. For the argument that 'taxes make you better off' applies directly only to those public services used by all, or nearly all, citizens – health, education, public transport. (Even those who do not use public transport almost always need others to do so.) But a considerable proportion of public spending, both on social security and on anti-social exclusion programmes such as the New Deal for Communities, Sure Start and so on, appears to the majority of taxpayers essentially as transfers to other people. Electorally this has therefore been the more difficult area of spending and taxation to defend. Indeed, an ideological attack on welfare spending has long provided the underpinning for the Conservatives' tax-cutting agenda – though in government they had little success in actually reducing it.

But the legacy of Conservative governments has made the need for such spending larger than ever. Over the last twenty years poverty has grown hugely. One in three children now lives in poverty, up from one in ten in 1979.¹⁸ The government's poverty report *Opportunities for All* paints a disturbing picture of

Britain: a hugely rich society in which around a fifth of its citizens are excluded because they have insufficient means or opportunity to maintain a decent condition of life.

There are a number of ways in which spending on the poor can be justified to the better off. One can appeal to their self-interest: no one likes stepping over beggars in town centres. Poverty and unemployment almost certainly increase crime, which hurts the middle classes (though much less than it hurts the poor, who are its main victims). Social exclusion is economically counter-productive in an economy in which human capital is the crucial resource: Britain's record of under-achievement in education and training is part of the reason its overall economic productivity is lower than those of competitor countries. The importance of 'social capital' in generating economic growth has now been well documented.¹⁹ But at root the moral obligation to eliminate poverty arises directly from the social democratic notion of citizenship; not just for the Marshallian reason that poverty undermines the principle of equal worth and makes equal participation in civic society impossible, but because huge inequalities of wealth and income sever the bonds which tie people together in a civic community. This is the real political force of social exclusion: the fracturing of the sense we have of living in a single society, of being responsible for one another. Hearteningly, despite twenty years of the official promotion of neo-liberal individualism, the evidence remains strongly that most people in Britain, including most of the comfortably off, do not want to live in such conditions. The 1999 British Social Attitudes survey asked its respondents if the Government 'should increase taxes on the better-off to spend on the poor'. 53 per cent said yes, 17 per cent no; there were majorities in favour among all income households including the top quarter.²⁰

Tackling poverty – and the Government is committed to eliminating child poverty in twenty years – means redistributing money from rich to poor through the tax and welfare systems. The methods of doing this have changed: the emphasis is less now on simple benefits and more on active assistance to help people get into work. Tax credits – the Working Families Tax Credit, the childcare credit, in time perhaps a new general low-wage credit – provide a new method of delivering transfers, giving additional incentives to work and a shallower poverty trap. But the fundamental principle remains intact. And it is not cheap. The various New Deals for the young and older unemployed, lone parents and disabled people, are expensive; their absolute cost has fallen as economic growth has created new jobs, but any future economic downturn will once again lead to a rising welfare bill.

Redistribution has become more or less a taboo word in new Labour circles: one of the reminders, it is believed, of 'Old Labour'. But redistribution is an essential corollary of citizenship. It already occurs, of course: the combined system of taxation and public spending is extremely redistributive, with those

on higher incomes paying far more than the poor for the public services they use. The tax system alone is highly progressive: the top 10 per cent of income earners already contribute 48 per cent of tax revenues.²¹ But this is merely a reflection of income inequality: the gap between higher earnings and those at the bottom has grown enormously. Income inequality in the UK has been rising rapidly over the last two decades, and economic pressures seem sure to maintain the trend. In the new global economy scarce skills attract huge salary premiums, while low skills are in fierce competition in more flexible labour markets.

These circumstances make it even more appropriate for the tax system to be used as an instrument of redistribution. Helping to damp down rising income inequalities is a legitimate goal of public policy based on citizenship. To some extent this can be done through changes to the distribution of the tax burden itself: Labour's first three budgets have carefully redirected monies to low-income families with children and away from the childless on higher incomes. Several other adjustments to the tax system can take this process further. But more widely the need is to ensure that resources are directed to the poor through spending programmes, and that the revenues for these are taken predominantly from the better off. If redistribution has for presentational reasons to be given a different name, the importance of doing it should not be hidden.

Reforming government

These arguments are of course theoretical: they do not in themselves determine whether taxes now should rise or fall. Their aim is to articulate a modern centre-left idea of citizenship and to show how this can help to re-legitimise taxation in general. When a priori tax-cutting remains the dominant political argument in this field, this is important enough.

But in fact making the citizenship case is not enough to restore a sense of civic community. For, as outlined so far, it still rests on a public confidence in government which can no longer be assumed. However philosophically justified, public support for taxation will only be secured if government can be made more effective and more accountable.

Responding to this challenge is of particular concern to the centre-left at this time. Whereas neo-liberals can base their anti-state, tax-cutting agenda on the acquiescent assumption that government simply isn't, and never can be, efficient, the centre-left must actively demonstrate the opposite. Belief in the value of public services must today be matched by proof that the quality of those services can be significantly improved. In this way the project of 'modernising' the public sector becomes central to any centre-left debate about taxation; only if government works, and is seen to work, can it expect to re-legitimise the taxes which citizens pay for it.

There are two fundamental challenges for a centre-left government. The first is

actually improving the processes of government and its delivery of services. The second issue is the more direct one for citizenship: how do citizens know what their taxes pay for, and whether they have been well spent? Can the public, that is, feel more 'connection' with their taxes? It is to this that we now turn.

Taxes and trust: rewriting the civic contract

The argument made, then, is that any new centre-left project of re-legitimising taxation must first restore public confidence that taxes will be spent well by government. But this is not simply about ensuring that they *are* better spent. It will also be crucial to address the *perception* of the gap between the taxes people pay and the spending for which they are used; what might be called the 'fiscal disconnection' between citizens and their taxes.²²

In essence what is required is a new draft of the civic contract which specifies the tax relationship between citizens and their government. Taxes and spending must become more transparent: what taxes pay for must become clearer to the public, and Governments must become more open to scrutiny about the benefits which its spending delivers. In turn the processes of decision making about taxation and spending need to become more accessible to public debate and involvement. Three different approaches to achieving these ends may be offered.

Transparency and scrutiny

The first requirement must surely be to make the facts about taxing and spending more transparent to the public. The Government's reforms in the presentation of the public accounts – such as the establishment of clear fiscal rules and the Comprehensive Spending Review – are definite improvements, but it could still hardly be said that the presentation of Budgets themselves are models of clarity. Post-budget confusion about where exactly certain revenues have come from and how the tax burden has changed is still common.

Few would dispute that for the ordinary citizen greater education and more information generally about the tax system and government spending would be useful. Even simple pie charts setting out how much tax is collected from different sources and how much money is spent on different departments would do much to clarify many popular misconceptions. It is commonly done by local authorities; it is surely not beyond the capacity of Government to provide similar information in accessible form. The media and the popular press in particular could do rather more than currently to assist public understanding. The existence of independent research organisations commenting on government budgetary policies remains an important resource.

One reform that has been canvassed to make individuals more aware of their own taxes would be the requirement for all taxpayers to fill in annual tax returns, as happens in many other countries. But the administrative costs of an expanded system of self-assessment would be considerable, and its chief result would more likely be an expanded tax accountancy industry than the widespread reconnection of citizens with their taxes.

Accompanying more information about where taxes are spent is the need for better assessment of how successful such spending is. The accountable state needs to be open to public scrutiny of its performance. Again there have been important innovations already in this area. The use of performance targets in particular can help to ensure that the objectives of spending are clear – though as the example of health waiting lists has shown, the risk of poorly chosen indicators is that spending is skewed to meet them and away from more pressing priorities. The response here must be to ensure proper public debate about the choice of indicators.

The Treasury now makes Public Service Agreements with spending departments based on negotiated outcome measures. But getting clear information to the public on the performance of departments against these targets is still fraught with difficulty. There are too many of them; they are not always easily understood and the meaningful presentation of results is complex. As is well known with school league tables, indicators can be misleading. The Government's annual reports are intended as a more general mechanism of reporting back to the public. But they lack specific objectives and the assessment is of a very general nature (in the second report, 98 per cent of manifesto promises were described as being 'met' or 'on course'²³). Most important, the self-assessed basis of these reports provides little confidence in the result. What is needed perhaps is an independent body scrutinising government performance: something perhaps between the National Audit Office and the Audit Commission (which scrutinises local government). Publication of an authoritative, independent performance review of central government might do much to raise public confidence in the quality of public services - and hence in the value of taxation.

Hypothecation

One reason often noted for the 'fiscal disconnection' between citizens and their taxes is that the sums collected are unconnected in their amount and source from the areas in which they are spent. With the important exception of the National Insurance Fund, there is a central Treasury pool into which all taxes are poured, and from which all spending is taken. The 'hypothecation' or earmarking of taxes for a particular spending purpose – the setting aside of a certain revenue stream, or a certain proportion of tax revenues - is therefore often proposed as a way of reconnecting taxation more clearly to its spending objectives.

Hypothecation originally emerged as a proposal from the right of the political spectrum. For advocates of a minimal state it was conceived as a way of controlling public expenditure by restricting the discretionary power of government. If a tax could only be spent on a specific purpose, the ability of government to spend in new areas would be limited. But it is precisely for this reason that hypothecation has long been opposed by most economic commentators and politicians in Britain. Strictly applied, it introduces serious rigidities into bud-

get making. The level of spending in a particular area becomes determined not by the need for it but by the quite independent ability of a particular tax to raise revenue – which might be too much or too little. It is for this reason that the National Insurance Fund is not in fact a fully hypothecated tax mechanism: it is topped up from the Treasury when social security spending exceeds revenues, and (in principle) makes contributions back again when the reverse is the case.

There are clearly many advantages to the pooling of taxes and to preserving the Treasury's flexibility to spend as it chooses across different areas without being limited by the yield of any given revenue stream. There are obvious dangers that hypothecating popular budgets (health or education) could undermine less popular ones (social security). Nevertheless, the possibility of reconnecting citizens and their taxes by this method makes hypothecation attractive if these objections can be overcome.

There would appear to be particular opportunities where specific taxes are levied for reasons other than simple revenue raising. Environmental and transport taxes, for example, are designed to change behaviour, reducing activities (energy use or private car use) which cause environmental damage and encouraging more benign alternatives (energy conservation, use of public transport). Hypothecation of the revenues to spending in the same field can then have two benefits. First, it can help win public acceptance for the tax: it will be easier to claim that improving the environment is the genuine motive if the revenues are spent in this way than if they go simply into the general Treasury pot. Second, the revenues can be spent in such a way as to improve the environmental impact further: on subsidies for energy efficiency measures, for example, or to funds for public transport. Flexibility can be maintained: there is no need for the spending to be limited to the revenues from the tax.

Given the history of Treasury opposition to hypothecation in the past, it is surprising that this principle has now been accepted by the Government without much fanfare. The present Transport Bill allows local authorities to levy urban congestion and workplace car parking charges so long as the revenues are earmarked for transport spending. In the 1999 pre-Budget report the Chancellor announced that any future real increases in road fuel duty would also be earmarked for transport spending; and that similar increases in tobacco duty would add to the existing health budget. It will be interesting to note if, when implemented, these promises do indeed help win public acceptance by making people feel more 'connected'.

A looser form of hypothecation might be usable for major areas in the budget as a whole. In circumstances where taxes need to be increased to finance spending programmes, it is no longer possible for government to do this without explanation. The general principle of hypothecation may then offer a way of explaining to citizens why the extra spending or tax is needed, and where it will be spent. This might effectively take the form of a 'tax promise', in which a government

seeks extra revenue, and promises in return that it will be used to achieve specified spending objectives – health spending, lower class sizes or whatever.

However, there is a risk here, and it is a serious one. The danger is that hypothecated tax promises could prove to be merely presentational – and therefore actively deceptive. If they are to increase public trust, hypothecated revenues must generate additional funding over and above what would have been spent anyway. If for example local authorities use the revenues from their new transport charges for transport spending, but then reduce their existing transport budgets to compensate, with the result being no overall increase in spending in that area, hypothecation would be exposed as a sham. Once exposed, this would be deeply destructive of public trust – achieving precisely the opposite end to that intended. For this reason, it is vital to establish conclusively that government has spent more than it would otherwise have done. Since future spending levels are not known, this remains a challenge which advocates of hypothecation must meet.

Participation and civic involvement

The third approach to reconnecting citizens and their taxes is the possibility of increasing civic involvement in taxing and spending decisions. The scope for direct involvement in such decisions would seem to be greater at the local than at the national level.

There are two routes available here. One is to increase the ability of local authorities to raise their own revenues. At present the balance between local and central funding (only around 25 per cent of local authorities' revenue comes from Council Tax; the rest is given in central government grants) makes it difficult for local authorities to raise its own funds. For any given spending increase, Council Tax rates need to rise disproportionately. Increasing the power of local authorities to raise their own taxes (by introducing a local income tax or other locally-based levies) would increase the democratic accountability of local government to its citizens. It would surely then encourage local residents to take a greater interest in local decision-making.

A second and more direct way of increasing civic involvement in taxing and spending decisions is by use of referendums. The recent example of the referendum held by Milton Keynes Council on its tax and spending options showed how such a method can not only generate lively local debate, but win public acceptance for tax increases. The referendum approved the Council's plans for a ten per cent increase in both Council tax and targeted spending.

Taxpaying and the civic contract

The restoration of civic trust will manifest itself in a citizenry that is willing to carry out its responsibility to pay taxes in return for the benefits that it receives. It is now commonplace to assert that rights carry with them responsibilities: the

duty to pay one's taxes is one of the first duties that come to mind when people are asked about citizenship.²⁴

Taxpaying is not often thought of as a voluntary expression of 'civic virtue' since tax is legally owed to the state and most taxes are deducted at source from the payslip or on the sales receipt. Ultimately though, even passive duties can be successfully enforced only if there is a widespread willingness to comply. Civic virtue is unavoidably reflected in the extent to which people think it acceptable to engage in tax evasion. Research has shown that attitudes towards government and perceptions of the fairness of the tax burden are significant factors in explaining tax compliance.²⁵ Considerations of citizenship do seem to matter to people when it comes to paying taxes. So taxes are not simply the price that is paid for living in a civilised society; it would also appear that the civilised society is one in which its citizens pay their taxes.

5. Conclusion: the time is now

The aim of this pamphlet has been to re-establish the general legitimacy of taxation rather than to argue for a specific overall level. Whether taxes need to rise depends on many factors. No-one could doubt the need for higher public spending in the UK today: to raise educational standards (the UK still spends a lower percentage of national income on education than its major competitors), to meet the pressing needs of the health service, to invest in public transport, to provide decent care for the elderly, for the regeneration of our poorest neighbourhoods, to eliminate poverty. The list of demands is long. But at the same time current revenues are buoyant: even allowing for cyclical adjustment, higher than expected economic growth has provided the Treasury with considerable extra funds over the next few years. And the scope of further efficiency savings is unknown.

What can be said is that the UK's tax burden as a share of GDP remains at the low end of the international league table, and that those countries with higher proportions of public spending to national income appear to suffer no adverse economic consequences. A public debate about the appropriate level of taxation and spending is therefore perfectly legitimate. There should be no *in principle* objection to modest tax increases – perhaps up to 2 per cent of GDP – if the need and public support warrants it. The taboo on tax rises is unhealthy and should end.

Of course the very existence of budget surpluses reduces the need for tax rises. But this makes the present a particularly appropriate time to have an open public debate on this subject. A period of relative prosperity reduces the temptation for tax cuts to make people 'feel good'. And the buoyancy of Treasury receipts means that the prospect of actual tax rises is slim. In these propitious circumstances we have a rare opportunity for government both to engage in programmes of much needed social spending and investment and simultaneously to stimulate a wider debate about the appropriate long term levels of taxation and spending. The present moment offers a golden opportunity for government to reconnect itself with its citizens, justifying and explaining its tax and spending policies to fashion a new political consensus.

A healthy civic relationship will be one that has moved beyond the impoverished politics of *a priori* tax cutting introduced by previous governments. It is one that exhibits mature debate about what taxes are for, when they are fair, when they penalise unfairly, and how as a society we should finance the objectives and programmes that make us all better off. How far we will have succeeded in building a strong society of citizens capable of dealing with the challenges of the future will depend on how far the debate on taxation has transcended the current stalemate.







Notes

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Citizens and Taxes

Taxation lies at the very heart of the relationship between citizen and state – taxes pay for the services that government provides. However, this element in the civic relationship is in urgent need of repair.

The politics of tax over the last twenty years has been dominated by the Tories' tax-cutting platform. Political debate over taxation has become almost taboo. A lack of open and informed discussion fosters public distrust of the state and constrains what government can do for its citizens.

Citizens and Taxes aims to provide the basis for a new civic language of taxation. Drawing on a new discussion of the meaning of citizenship, it argues that a more democratic and accountable state requires governments to justify its taxing and spending decisions more clearly to its citizens. It sets out various ways in which citizens' taxes could be better connected with the spending they fund. It seeks to encourage an open and much needed debate on taxation in advance of the report by the Fabian Society's Commission on Taxation and Citizenship.

This pamphlet is part of the Fabian Society's Redesigning the State programme, which seeks to examine the role and form of a state appropriate to twenty-first century Britain. Previous publications include *Information Age Government* by Liam Byrne, *Modernising Criminal Justice* by Neil Addison and *Reforming the Lords* by John Osmond.

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