

Caesar's trap: How England Plunders Scotland

"Render therefore unto Caesar the things which are Caesar's; and unto God the things that are God's."

Matthew: 22(21)

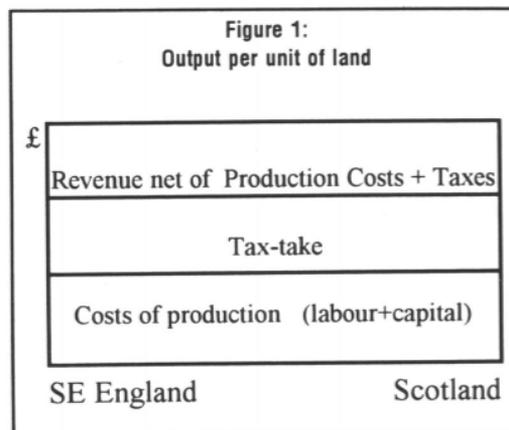
THE SUN was supposed to have set on colonial exploitation as a social artform when the imperial powers retreated to their home territories. In 1945 there were 62 politically independent nations. Today there are 193.

But the end of imperialism did not terminate the exploitation that drove the colonial conquest of other people's land. It lived on - back home. Governments discriminated between their own citizens.

Covert colonialism is now close to being exposed by the widening fissures within European nations, with demands for secession from the Belgians to the Basques. It is also a problem for the global community. From Canada's Quebec in the West to China's Xinjiang province in the East, discontent with arrested cultural development is exposing material deprivation to scrutiny as part of the demand for a new phase of secessionism.

But if secessionist leaders are to bring improvements they need to understand how citizens in a democratic country are exploited by the government which they elect. Otherwise, they will import the pathological practices of the past into the "post-modern" world. Scotland is our case study.

TAXATION produces profoundly negative costs on people, but the impact is not spread equally within an economy. The tribes north of Hadrian's Wall



remained beyond the reach of the Roman Legions, but they fell under the thrall of Westminster. Ironically, the treaty of Union (1707) was supposed to secure Scotland equality and freedom of commerce and preservation of national institutions (law, education, church); it did. But fiscal policy would be determined in London. That was the catch which the Scots did not see coming...

The Union is now at risk of unraveling: Scotland never lost its suspicion that it was not one of equals. Taxation is on the agenda (see Box 1). But if the Nationalists (SNP) get their way, will the people of Scotland be better off?

The SNP, like secessionists around the world, claim that sovereignty would provide

the chance for a fresh start. Among other things, they would control the tax system in favour of efficiency in the use of their home territory and the production of wealth. True or false? The answer depends on what system of public finance they chose.

As it is structured today, taxation is the primary cause of social disharmony. It divides a nation: there is a dynamic spatial separation of the central regions - the seats of government and corporate HQs - from the peripheral regions. One consequence is that the richer central regions falsely believe they subsidise the periphery. This is certainly true of views held in London.

S.E. England is a £100bn economy of 8m people which, if it were an independent country, would be the world's 19th largest - and the 10th largest in Europe, according to Allan Willett, Chairman designate of the proposed Regional Development Agency. In the centre of the SE is London. A report produced for the London Chamber of Commerce and Industry in August claimed that the capital's tax subsidy to the rest of the UK may be about £14bn a year, or £2,000 for each Londoner.

Some politicians who want to be elected as London's first mayor have called for £2bn to be taken from the Scottish Office budget. According to the National Institute of Economic and Social Research, if that "subsidy" to Scotland was spent on the capital's

TAX POLICY will be at the centre of the campaign to determine who controls Scotland's new Parliament.

Tony Blair is fighting to cut back the Nationalists' opinion poll lead. They want to control the Parliament which convenes in Edinburgh next May. The Premier has set the tone by accusing the SNP of proposing policies that could raise taxes for some families by an extra £1,500 per year. He says: "Their goal is to wreck the Scottish parliament and use the chaos to wrench Scotland out of the UK, no matter what the damage to Scots' jobs and investment". He has appointed former Treasury minister Helen Liddell to lead the charge against the SNP. She accused them of planning to raise taxation by 15p in the pound.

Box 1 Scotland: the taxing issue

The Nationalists were angered, but the implications of tax policies need to be closely scrutinised by voters before they endorse any party. In picking tax policy as a field for battle, the Prime Minister has exposed his government to severe criticism. For when he travelled to Scotland on July 17 and rounded on the ghost of Old Labour, he informed his critics within his party that the people of Scotland wanted "fairness and efficiency".

But during Mr Blair's first year of stewardship, the UK economy under-performed by more than £430 billion because his govern-

ment raised revenue with taxes that damage people's incentives to work. In July, Mr Blair published an audit of New Labour's first-year (*The Government's Annual Report 97/98*, London: Stationery Office). This ignored the estimated losses inflicted on Britain by the government's choice of public finance. On a per capita basis, the loss to Scotland was about £37 bn every year (see *Land & Liberty*, Summer 1998, p.3).

SNP plans to develop a distinctive tax policy also came under attack from Tory party chairman Raymond Robertson, who claims that separation of Scotland from England "would impact on the level playing field which exists between the two nations". In fact the "level playing field" is a myth.

transport infrastructure, 25,000 jobs would be created.

Can the SNP refute the claim that Scotland is a client of London? Precise calculations are not possible, because not all government receipts and expenditures are broken down by region. Economic theory, however, comes to the rescue.

IF THE value of wealth produced was uniform across the economy, tax policies would not be biased against any particular region. This is represented graphically in Figure 1, which assumes a cross-section drawn from London to the Isle of Lewis. It also assumes that, for each unit of land, there is an identical value of output.

After deducting the costs of production, there is a net income - or taxable surplus - from which government can draw its revenue. The tax slice - assuming a uniform rate is applied cross the territory (say: 50% of the taxable surplus) - would take the same amount of revenue from all areas. No region would be unfairly disadvantaged. Every region would lose as much as the other regions, as a result of the distortions introduced by taxation (see *Land & Liberty*, Summer 1998, p.3).

But output is not equal across the economy. A French statesman, Anne-Robert Turgot (1727-81), was the first to describe what is now called the law of diminishing returns. That law applies to a particular enterprise: there is a decrease in output with each additional productive input. This idea also holds good on a geographical basis. As a general statement, it is true to say that the further away you go from the centre of economic activity, the lower the output of total product. The lower output means that the taxable income diminishes. (For a description of lower taxable surplus in Scotland than in SE England, see Box 2.)

This means that rendering Caesar his due is more complicated than the advice offered in the Bible. For what really matters is *how* that revenue is rendered. Under the regime prevailing today, taxes draw a greater proportion of the taxable income of the outlying areas compared with the inner regions: in doing so, they enrich the advantaged centres at the expense of the disadvantaged regions.

TO UNRAVEL the architecture of fiscal exploitation we have to trace the dynamics of the economy.

Discriminatory taxes impose an additional burden on outlying regions. Tax rates may appear to be fair to everyone: they are the same, wherever people live. *The social effect, however, is to claw a larger portion of the taxable income from Scotland compared with the taxable surplus in London.* Progressive rates that fall on some incomes conceal the arbitrary burden that is inflicted on Scotland, for other tax rates - such as those that fall on firms, or on consumers (VAT) - are uniform across the country. They slice off a larger proportion of the taxable surplus in the regions.

This is graphically illustrated by Fig. 2. To

Box 2

Regional variations in the tax base

IF OUTPUT was similar throughout an economy - for the same volume of inputs (land, labour and capital) - taxation would not discriminate arbitrarily between the regions.

This is not the case. The theory of rent - which enables us to measure the surplus after paying all production costs - was built on the realisation that the further out you go from the centre of activity, the lower the output. David Ricardo (1772 -1823) relied on variations in soil fertility for his formulation. The Prussian agricultural economist Johann von Thunen (1783 - 1850) reached the same conclusion by analysing differences in transport costs.

Competition levels the costs of labour (wages) and capital (interest). The excess - the net surplus, after financing the inputs - was claimed by the third factor, land.

If you cut a cross-section through a country - say, from south-east England up to Scotland along the east coast railway track - you would end up with a downward sloping curve. Output for a unit of land would be greatest at the "centre" and lowest at the periphery. According to theory, the taxable capacity of the south-east is higher than in Scotland.

Examine the data on land prices. This is one indicator of variations in the surplus. The spatial trend in farmland prices is revealing.

Average price (£ per hectare): sales to individuals (1996/97)

South East	5,147
Eastern	5,774
East Midlands	5,688
Yorks/Humberside	4,578
North East	2,225
Scotland	1,515*

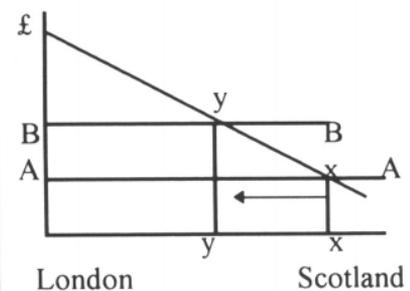
□ The 1997 figure provided by the Scottish Office is based on incomplete data. The 1996 figure is £2,022.

A similar profile is found in housing land values, but with the peak in London. Ditto for commercial and industrial sites.

We can view residential land prices from a dynamic perspective. The data on the rate of change in "house" (buildings+land) prices reveals that in the 12 months to March 1998, prices increased by 12.8% in London, and were negative in Scotland (minus 0.8%). Variations in the labour cost of construction, and in bricks and mortar, do not account for the difference. Anyway, bricks and mortar depreciate in value. So what was rising fastest in London and slowest in Scotland? Land prices - with regional differences that imply a diminishing taxable surplus across the country.

start with, government cannot take part of the costs of production (the amount below the line AA). It has to slice some (or all) of the cream off the top of the national "cake", which is the net income of the economy. And that "cream" is a lower proportion of total output, the further you go from the economic centre (hence the downward sloping curve, which represents the outer limit of production). If government tax-take is represented by the value below BB, note how it takes a larger part - or all - of the surplus in the outer regions. (What happens to the "cream" above the line BB? It is converted into the rental claims of owners of land and natural resources.) This is the key: *the marginal impact is greatest in the outlying region than at the administrative centre.*

Figure 2: Cross-section of UK:
the Decline in Output



The critical point of social and economic stress is that location - and economic condition - called the "margin" (xx). Here, a firm or worker could just cover costs, if free of taxation. Adding taxes to the necessary costs of production, however, drives total costs above revenue. That is the recipe for bankruptcy - caused, note, not by economic inefficiency, but by fiscal penalty. This explains why, in the peripheral regions

- more people are unemployed, even though they are productive enough to pay their way (net of taxes);
- more firms are bankrupted, even though they are sufficiently competitive to provide goods or services at prices that customers are willing to pay;
- more communities are driven into the state of dependency, and are forced to lobby for state handouts from parliament.

One expression of this tax effect: land is driven out of use, rendered uneconomic by the tax burden (the active economic margin shifts inwards from xx to yy). For at point x, a firm or worker cannot cover costs and meet the government's tax demands. The government drives the firm or employee out of business.

There is ample sociological and economic data (crime, drug addiction, family crises, etc) to elaborate this profile of fiscal prejudice against Scotland in human terms.

Evidence of the pathology of taxation can be seen throughout Europe. A disproportionate part of the taxable income is sucked out of an arc that runs from Southern Italy through

Spain and Portugal, up through Ireland and into the highlands of Scotland. The winners - who are subsidised by the outlying regions - are the populations in the banana-shaped belt that runs from the Rhineland through greater Paris to Lombardy and Catalonia.

THUS do governments systematically exploit citizens from northern Scotland to southern Italy, with tax policies which are unprincipled, abusive and discriminatory. This offends the philosophy that underpins liberal democratic society, in which everyone is supposed to be treated equally.

Taxes appear to be even-handed; appear to treat everyone equally before the law. In fact, they skim the taxable income lightly in the rich regions and heavily in the relatively poorer regions. The result is conspicuous consumption in the social centres and the pockets of cultural implosion in the outer regions.

The process does not stop there. Much of Scotland's income channelled into SE England is transformed back into rent and much of it sluices into private pockets.

- Public investment financed by the Treasury increases land prices which are privately appropriated.
- Wages paid to employees in both the public and private sectors are partly channelled into the residential land sector.
- A large part of Scottish revenue ends up in the financial sector as "interest" on mortgages (when people buy their houses with the aid of loans, they pay the rental value of their land to finan-

cial institutions, but they change the name from rent to interest).

The centre is not yet finished with the periphery. For an economic mechanism is at work which, fuelled by the lop-sided distribu-

tion of income in favour of rents/taxes in the SE, gradually grinds the economy into crisis. This is foreshadowed by "asset price inflation". In response, government raises the rate of interest. Notice the effect on the periphery.

The same rate of interest is imposed on everyone, equally, across the country. This additional cost imposed on producers, however, skims relatively more from the net income produced in the peripheral regions than in the centre. If we treat the line BB in Fig.2 as the measure of the added cost of borrowing money, we see the same effect as an increase in tax burden: many of Scotland's otherwise viable firms, operating at the "margin", are bankrupted: revenue is not sufficient to cover all the necessary costs of production plus the artificially increased cost of financing loans from banks.

The same negative consequences are imposed on "marginal" firms in SE England. That is why many areas of inner cities in rich regions are afflicted with dereliction. But from the regional point of view, the aggregate injury is greater in Scotland than SE England. Thus, as government tries to crush escalating increases in "house" (= land) prices in London, it inflicts even greater pain on the Scots.

THE economic exploitation provokes a democratic reaction, which is then spun into good news. For doesn't Scotland receive a disproportionate share of public spending? But this dependency is further evidence of discrimination against Scotland, for which parliament compensates with subsidies.

Box 3

The tax Base: $Q - W + I = R + T$

THERE IS no mystery about a nation's taxable income. Philosophers in France and Scotland cracked the code in the 18th century.

When we subtract the cost of employing people (W), and the user-cost of capital (I - interest and depreciation) from the value of total output (Q), net of taxes, we are left with the pure surplus (R - the rent of land and natural resources) plus the share of output that is captured as taxes (T).

This equation ought to be applied every time a government raises or lowers taxes. Such an audit identifies the winners and losers.

As a general rule, the following is true.

When government raises taxes on wages or interest (W+I), it triggers a chain reaction of multiple disincentives. People cannot live on less than W. So, to preserve the value of take-home pay, they force employers to pass T on to final consumers. The same happens with capital - owners protect the value of I by threatening to relocate elsewhere. Taxes are shifted forward to consumers.

But consumers are the producers. When prices (P) are raised by T, people are obliged to protect the real value of their disposable income. How? They reduce the amount paid for the use of land and natural resources. So taxes ultimately fall on Rent. Adam Smith and the other classical economists acknowledged this long ago.

Neat; except that the costs inflicted by this complex struggle for control over the taxable surplus are enormous.¹ People and firms expend energy deflecting taxes onto the natural tax base: resource rents (R).

What would happen if government simplified its task by taking its revenue direct from rent? Society would be enriched by obviating the mind-boggling losses inflicted by conventional taxation.

Question: Couldn't landowners merely pass the tax on to consumers? Obviously not - if the above reasoning is correct. It is. Just about the only principle upon which economists have remained consistent, for two centuries, is the one that says a public charge levied direct on rent cannot be shifted onto W or I. Prof. Paul Samuelson repeated this in his textbook:

"Pure land rent is in the nature of a 'surplus' that can be taxed heavily without distort-

ing production incentives or impairing productive efficiency." A direct public charge on the rent of land and natural resources would stick on rent. The charge would be on R after deducting income imputed to undepreciated investments in and on the land, which is interest [I] on capital. Prof. Samuelson notes: "The landowners will not like this. But under competition there is nothing they can do about it, since they cannot alter the total supply and the land must work for whatever it can get".²

Does it matter that landowners would not like it? Not really - no-one can buck an iron law. And landowners don't buck this one: T already comes out of R! But in that case, why don't governments take T direct from R, rather than trying to take it indirectly via W+I? Answer: an anti-social history.

Conclusion. R+T yields more than sufficient revenue for government. If conventional taxes were eliminated, the value of T, as a general rule, would merge into R. Why wouldn't it go into the pockets of employees or capital owners? For the same reason that taxes are shifted off W+I in the first place - competition.

Hence the finding by Dr Mason Gaffney, professor of economics at the University of California (Riverside): "It seems reasonable to conclude that aggregate resource rents, in a tax-free economy, would be adequate to replace all present taxes".³ Gaffney's main reservation is that this fiscal directness might raise the demand for labour and capital and so raise wage rates, and returns to capital, at the expense of rent. This would shrink the tax base. This effect, however, would also diminish the "socially necessary" spending demands on government (people would not be dependent on welfare handouts), thereby reducing the need to maintain government revenues at current levels.

- 1 Fred Harrison, "The Systemic Crisis", in *The Losses of Nations* (ed: F. Harrison), London: Othila Press, 1998.
- 2 Paul Samuelson and William Nordhaus, *Economics*, New York: McGraw-Hill, 1985, 12th edn., p.605.
- 3 M. Gaffney, "An Inventory of Rent-yielding Resources", in Harrison, *op. cit.*, p.231.

When Scotland's Parliament is elected in May, these "subsidies" are likely to be cut. Pressure on government will come from Labour MPs in English regions, who resent the apparent favouritism directed to the Scots. This will add even greater negative pressures on Scotland.

The problem will be further exacerbated by Chancellor Gordon Brown's determination to cut regional aid to businesses as part of the three-year spending review. Selective assistance to the peripheral regions help to offset the damage inflicted by taxes, but the Chancellor's priorities will raise even further the government-induced barriers to creating jobs and attracting capital to Scotland.

The government claims that inward investors are planning to create more jobs in Scotland than at any time in nearly 20 years. The value of such investment schemes agreed in the year to March 1998 was £1 billion, but these have been bought at a price. The "incentives" include "free" land and tax privileges which are not available to local entrepreneurs. Without the distortions introduced by taxation, entrepreneurs would not need these "incentives", which increase the costs of bureaucracy and state management of markets.

THE BLAIR government is seeking strategies to help the peripheral regions.

- Proposals being studied by the Treasury and Department of Trade and Industry would enable small companies to offset start up losses against their payroll tax - officially called the employers' national insurance contributions. Why not just reduce or abolish the disincentive payroll tax? And why arbitrarily favour small businesses which have just started up?
- England's Northwest and Northeast suffer above average unemployment and lower than average GDP per head of the population. Regeneration is supposed to be driven by regional development agencies which are due to start work next April. Regional chambers are being created which will add to the bureaucratic infrastructure, but so far it appears that the work has been limited to defining a wish list. Under the Chancellor's budgetary plans, there will be cuts in funding. This would not be a problem if government was reforming taxation to give the regions a fair deal from public finance. This is not the case.
- In Wales, the government wishes to raise wages and employment levels, but its Pathway to Prosperity strategy offers little hope of achieving its target of equalling the EU average for GDP. The current level is 80%. The new Welsh National Assembly will not have the power to reform taxation to animate the entrepreneurial spirit.

Wages in Wales have been falling and unemployment rising. The principality's GDP is the lowest of any region in Britain, and weekly earnings are 89% of the UK average. But the thrust of the government's plans is

biased largely in favour of providing advice to foreign would-be investors, rather than untaxing the productive efforts of Welsh entrepreneurs. The government hopes that greater co-ordination of existing efforts will work where the infusion of taxpayers money in the past has failed. It won't.

SCOTLAND could serve as a symbol for people who need to be emancipated from the last great social injustice in history.

The public's attempt at confiscation of privately earned incomes (taxes on people's wages and the interest on their savings) and the private confiscation of the public value which is created in our communities (the privatisation of resource rents) needs to become the central theme for democratic debate, if a just settlement is to be reached that would unify nations in the global society.

Without that reform, the sincerely-held wish of Tony Blair - reported in *Scotland on Sunday* (July 5) - that the Scottish Parliament should "deliver improvements in the lives of the Scottish people - in the health service, in education, in creating a vibrant economy" - cannot be realised. There is no reason to expect that a Scottish Parliament could succeed where Westminster failed. Scotland's Parliament will not have the right to alter the character of the tax system.

How can this vicious fiscal knot be untangled? The tax issue has been dramatically forced onto the political agenda by Standard Life, Scotland's largest company which manages £60bn of people's money. It is investigating the fiscal consequences of separation from Britain. Scottish Widows, Scotland's second largest financial house, also fears the risks of fiscal disadvantage arising from secession.

How can the SNP address the need for a viable fiscal policy rather than retreat under the onslaught of a myth that claims Scotland is treated equally under the present tax regime?

The answer is to be found in a reform that would enhance the incentives of people who work and save. Politicians who want the language of fiscal reform could do no better than read the speeches that Winston Churchill delivered at the hustings in 1910. The promise would be a constitutional guarantee that each region would pay an identical proportion of its taxable surplus to government (see Box 3).

To achieve this, revenue has to be drawn *direct* from the taxable surplus, or resource rents. This would generate a dynamic harmony: the model embraces competition, but is fair to every individual, firm and region. It lays the foundations for optimum economic growth, and it frees a community to choose its preferred path of cultural development.

By detaxing wages and savings, people's choices are enlarged. Production spontaneously increases because the disincentives of conventional taxation are removed. This

means people may choose to live at current levels of income and increase their leisure time. How could this happen? The productivity of land, labour and capital inputs is increased. And government could fulfil all its obligations. For without the distortions inflicted by taxes, productivity would be sufficient for everyone to earn a living without state handouts.

This fiscal model conforms to the philosophy of property rights in which everyone is entitled to an equal share of nature's resources; while preserving the rights of individuals to enjoy the exclusive possession of their land.

The benefits would germinate globally. Today, many nations and ethnic groups feel disadvantaged, and some fundamentalists use the language from the colonial era to disparage "imperialist" nations.

The USA is the main target for the violence - which includes bombs in embassies - of those who feel socially deprived. Analysts predict that terroristic tactics will increase as the mode of warfare in the 21st century. So, therefore, the US has a vested interest in uncovering the benign philosophy that would unite the world behind the highest moral standards of individual and social behaviour.

The prerequisite is the elimination of colonial exploitation by taxation.

Belfast □ Peace Dividend

Asset strippers beat taxpayers

THE PROSPECT of a settlement in Northern Ireland has aroused expectations of renewed prosperity for the province. But the profits from peace are not being shared equally.

In the residential sector the owners of properties have seen prices escalate in the past 12 months. But their capital gains are small change compared with the windfall profits that have flowed from the public sector even during the height of the conflict.

In 1994 the Belfast International Airport was sold to a management employee consortium for £32.75 million. Two years later the airport was sold to a property development company for £107 million. The three principal directors of the consortium reportedly made a return of £6 million each on investments of £50,000.

Last June the House of Commons Public Accounts Committee "severely criticised" the Northern Ireland Office for "inadequacies" in its handling of the privatisation. The MPs declared that it was "outrageous that the purchasers of the airport should have been able to acquire an asset belonging to the taxpayer and sell it at such an immense profit in just two years without any obligation to return some of that profit to the taxpayer".