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Does the Economic Recession Create Opportunities for Wealth Taxation?

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Abstract

The economic recession has slowed efforts to weaken inheritance tax in the UK. Political debates about cuts in government spending mean that cutting inheritance tax is not seen as a priority. However, can present conditions create a positive case for wealth taxes? I examine the ways that the recession might provide arguments for wealth taxation. A house price bubble is usually seen as one of the root causes of the crisis. This might support arguments about a form of land tax. Wealth taxes might also fit into a revival of interest in Keynesian economic ideas.

Introduction

One impact of the recent financial crisis in the UK has been to slow efforts to weaken inheritance tax. In 2007, the Conservative shadow chancellor George Osborne promised at their party conference that a future Conservative government would raise the threshold of paying inheritance tax to £1 million. This move was widely seen as reviving the fortunes of the Conservative party and deterring Prime Minister Gordon Brown from calling a snap general election in October (Prabhakar, Rowlingson and White 2008).

Since Osborne's statement, the UK has experienced a financial crisis that involved government bailouts for banks such as Northern Rock and Royal Bank of Scotland as well as experiencing a period of recession. Debates between the political parties in the run-up to the 2010 general election now focuses on ways of reducing the public sector deficit. Although questions can be asked about whether the size of public borrowing in the UK is a problem when compared to other countries as well as the UK's economic history (Arestis and Sawyer

2009), the focus nevertheless between the main parties has been on cuts in public spending as well as possible tax rises.

Conservative plans take a different hue in this changed climate. Initially, the Labour government reacted to the Conservative plans by rushing through their own proposals to weaken inheritance tax by allowing the transfer of nil band allowances (Prabhakar 2009). Since then Labour politicians have been more critical of the Conservative promise (Rawnsley 2009). The charge is that in the recession it is perverse that the Conservative party should be offering a tax cut that will only benefit the very wealthiest in society. At Prime Minister's questions in the House of Commons on 2 December 2009, Gordon Brown quipped that the Conservative inheritance tax policy: 'seems to have been dreamed up on the playing fields of Eton' (reported in Treneman 2009). Although there are no signs that the Conservatives will drop this pledge (especially after Conservative leader David Cameron has already retreated over a promise to offer a UK referendum on the Lisbon treaty), the inheritance tax pledge is unlikely to be an immediate priority for an incoming Conservative government. Commenting in December 2009 on Labour's pre-budget report on the BBC show Newsnight, the Conservative shadow chief secretary to the Treasury Philip Hammond noted that the Conservatives would first reverse Labour's national insurance increase rather than raise the inheritance tax threshold

The recession has thus offered a reprieve for inheritance tax. In this paper I examine the ways that the recession might make a more positive case for a wealth tax. Given the bailouts for the banks, could the recession be used to make the case to spread wealth more evenly? A house price bubble is often seen as one of the chief culprits of the recession. Some commentators suggest that a failure to address problems in housing is one of the systematic failures of the

UK economy (Watson 2008; Crawshaw 2009). A form of land tax might address this by dampening housing demand as well as being part of arguments about fair taxation. More widely, the recession has revived interest in Keynesian economic ideas. Keynes (1936) advanced a case for wealth taxes as part of his *General Theory of Employment, Interest and Money*. Wealth taxes could be part of a renewed Keynesian approach to the economy.

This paper is organised as follows. First, I note the role of a house price bubble in provoking the current recession. I look at how such a bubble might shape debates about reform and how this feeds into current reform proposals originating from bodies such as the housing charity Shelter. Second, I broaden this out and note how wealth taxes can fit into a Keynesian approach to the economy. Third, I sketch out some of the prospects for reform, looking for example at recent interest in 'progressive conservatism'. A conclusion briefly reviews the ground covered in this paper.

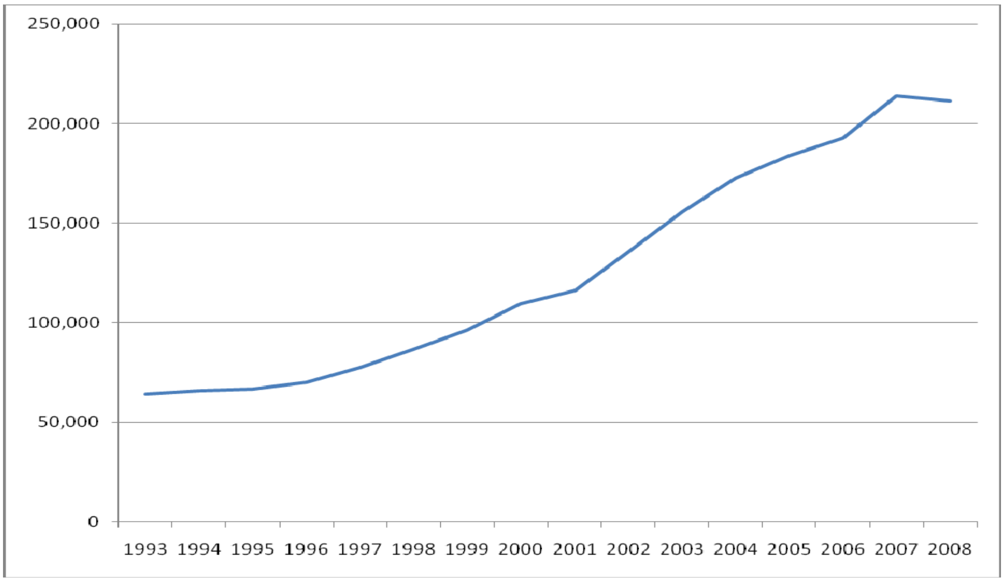
Housing taxation

Problems in the US housing market are usually identified as one of the main causes of the recent global economic and financial crisis. In particular, mortgages were made easily available in the 'subprime' or 'ninja' (no income, no jobs) housing market. While a boom could be sustained while house prices were rising, problems arose once this bubble burst. Individuals found it difficult to make mortgage repayments and financial institutions with substantial holdings of such mortgages suffered heavy losses. These problems fed into and were mirrored in the UK. For example, the Northern Rock bank pursued an aggressive mortgage policy and suffered significant losses. Fears of a run on this bank as savers and depositors began to withdraw money prompted the UK government to intervene to nationalise the bank. The taxpayer thus had to bailout Northern Rock and other banks to protect the financial system.

Some commentators see the recent financial crisis as part of a wider failure of the UK government to tackle systematic problems in the housing market (Watson 2008). However, one might use recent events as a way of opening up debates about the taxation of housing as well as wealth more generally. Crawshaw notes that: ‘the economic downturn has exposed serious failures at the heart of Britain’s housing system ... As housing and economic policies are now being reassessed in the light of the economic downturn, it is vital that we take the opportunity to consider housing taxation as one of the key ways to tackle these systematic failures (Crawshaw 2009, 6). As well as being relevant for the housing market, housing taxation is also important for wealth taxation more generally. Property is an important part of household wealth. In 2009, the Office for National Statistics published the results of its first wave of its Wealth and Assets survey, which reported household wealth between July 2006 to June 2008. This survey notes that property is the joint biggest contributor to total wealth in Great Britain, alongside private personal wealth. Property wealth is £3.5 trillion which is 39% of total wealth in Great Britain between 2006/08 (Daffin 2009). A housing tax is thus an important form of wealth tax. Property also impacts on other types of wealth tax. For example, in the UK part of the public’s concern with inheritance tax is that rising property prices will tip increasing numbers of estates over the inheritance tax threshold (Prabhakar 2009).

One way that recent events might be used to open up debates is by discussing the fairness of taxing property price rises. Of course, while distinctions can be drawn between housing taxation and land taxation, there is nevertheless likely to be a close relation between land and house values. Taxing housing might act as a reasonable proxy for taxing the value of land. House prices have risen substantially over the recent past. The following chart draws on data as the Department for Communities and Local Government to show how the 'mix-adjusted' house price has changed in the UK over the past 15 years. The mix-adjusted figure takes account of the fact that houses may be sold at different parts of the year.

Figure: Average mix-adjusted house price in the UK



Source: Department for Communities and Local Government, at

http://www.communities.gov.uk/housing/housingresearch/housingstatistics/housingstatisticsby/housingmarket/livetables/housepricestables/simpleaveragestables/

House prices have risen over threefold over the 15 years, from £64,874 in 1993 to £211,388 in 2008. More recently, there have been signs of a bubble in the house price market (Watson

2008). Against this background, it is plausible to suggest that home-owners have enjoyed a windfall gain to the value of their homes. House prices have risen in significantly from factors beyond their control. Although personal investment and home improvements may have increased the value of their homes, it is unlikely to have led to a tripling of house prices over a 15 year period.

During the nineteenth century, Henry George outlined arguments that prefigure some of the debates today in his book *Progress and Poverty*. George argues that land is the most important factor of production and that the bulk of material progress comes from rents for land rather than returns to labour or capital. He argues that it is unnecessary to remove private property to address inequality emerging from the unequal ownership of land. He supports instead a tax on the rents as well as value of land (George 1932). More recently, various commentators outline why a land tax is a fair tax (Maxwell and Vigor 2005; McLean 2006a; 2006b). For example, McLean argues that land values are based on three main sources: its scarcity value; the value created by the owner of the land; and the value added by the actions of public authorities. He argues that much of the value of land derives from the first and third of these sources. For example, a land values may rise because local authorities make an investment in local transport networks such as faster trains. He says the fact that much of the rise in land values come from communal rather than individual actions justifies taxing the value of land (McLean 2006b).

Another way that property taxation can be linked to recent events is by considering how taxes might help manage demand for housing. Crawshaw (2009) provides an example of this in a policy report published for the housing charity Shelter. He says that the focus of his paper is how the: ‘taxation system affects access to, and demand for, housing’ (Crawshaw 2009, 8).

Crawshaw considers a range of tax reforms that might be used to manage demand and dampen the possibility of a future bubble. These ideas cover council tax, stamp duty, capital gains tax, taxation of rental income, inheritance tax and housing tax credits. He identifies two immediate reforms. First, abolishing council tax discounts to owners of second and long-term empty houses. Second, raising the threshold of rent-a-room relief to home-owners to boost the supply of low-cost rental accommodation. The aim of both of these proposals is to reduce the demand for housing.

Keynes and wealth taxation

Housing taxation is one form of wealth taxation. One might also use the recession to try and widen the debate out to consider other forms of wealth taxation. One way this might be done is by linking this to a revival of interest in the idea of J.M. Keynes. Recent events have underlined the importance of Keynesian ideas (Hutton 2008; Clarke 2009; Skidelsky 2009).

Keynes criticised both income and wealth inequality in his *General Theory of Employment, Interest and Money*: ‘The outstanding faults of the economic society in which we live are its failure to provide for full employment and inequitable distribution of wealth and income’ (Keynes 1936, 372). Keynes sought to show how income and wealth inequality hamper economic growth and development. Classical economic theory assumed that the level of savings determine the amount of investment in an economy, which is known as ‘Say’s law’ (Skidelsky 2009). Keynes said one consequence of this view was that people were deterred from taxing wealth. In particular, taxing wealth was judged to be harmful because it would reduce the level of savings and so reduce investment and growth. However, Keynes challenged Say’s law. He argued that savings did not determine investment and that unless an economy is at full employment, a propensity to consume is more important for growth.

Redistributing wealth and income helps boost the propensity to consume by transferring wealth and income to those who lack both.

Keynes said that his argument overturned received wisdom about wealth taxation. He writes that the: ‘confusion of the public mind on the matter is well illustrated by the very common belief that the death duties are responsible for a reduction in the capital wealth of the country ... But inasmuch as an increase in the habitual propensity to consume will in general (*i.e.* except in conditions of full employment) serve to increase at the same time the inducement to invest, the inference commonly drawn is the exact opposite of the truth’ (Keynes 1936, 373).

Although Keynes accepted some level of income and wealth inequality could be permitted to provide a spur for making money, he criticised levels of inequality that existed at the time in Great Britain. He continued that his position was supported by his theory of the rate of interest. He noted that traditionally a high rate of interest was thought to provide an incentive to save. However, he said that he had shown that investment determined saving, and that a low rate of interest was generally needed to induce investment. Paying large amounts of interest was simply an economic rent and did not induce investment. He calls for the: ‘euthanasia of the rentier, and, consequently, the euthanasia of the capitalist to exploit the scarcity-value of capital’ (Keynes 1936, 376).

Economics has developed substantially since Keynes wrote his *General Theory*. One should perhaps not accept his arguments uncritically. Nevertheless, one virtue of his approach is the way he linked wealth taxation with economic growth. This is part of a broader tradition emphasising the importance of equality for economic growth. Wilkinson and Pickett (2009) provide a recent example of this in their book *The Spirit Level*. Wilkinson and Pickett marshal a wide array of statistics from across the world to show how more equal societies are also more economically and socially successful. One implication of this review is to imply steps to promote equality. Wilkinson and Pickett have helped create an organisation The Equality Trust, which is designed to promote equality in policy discussions, (http://www.equalitytrust.org.uk/about/history). At present, The Equality Trust contains more work on identifying the cost of inequality rather than on practical solutions to tackle inequality. Discussions of wealth taxation in The Equality Trust are fairly limited as yet and could be developed. Such discussions might exploit opportunities for wider public debate, such as the European Union's plan in 2010 to have a series of activities focusing on Poverty and Social Exclusion.

Prospects for reform

Public opinion is one of the most obvious things that need to be addressed if the case for reform is to be successful. It is a commonplace to say that the public shows hostility towards all forms of wealth taxation, especially inheritance taxes. Although such opposition should not be dismissed, focus group research I have conducted suggests that there may be more prospects for shaping public opinion. Opposition to wealth taxation appears to be moderated when people are asked to view wealth taxes as part of the wider tax system. Any tax discussed in isolation from other taxes or spending decisions is likely to provoke public opposition. Wealth taxes here are no different from other taxes, such as petrol duties, cigarette taxes or value added tax. Presenting people with choices over the trade-offs between different taxes, or the appropriate mix of tax and spending policies appears important for changing public opinion (Prabhakar 2009). Indeed, Labour appears more confident of making a case for inheritance tax today because of the way it links inheritance tax with spending decisions, that is, it is unjustified to offer tax cuts that will benefit the very wealthiest in an era of recession and spending cuts.

Such arguments could be developed as my focus group research suggests that certain taxes may be easier to generate support. In particular, linking the case for housing taxes to a windfall rise in house prices appears to create wider support than focusing on taxing the transfer of wealth across generations. House price rises owing to public investment does not seem to prompt the emotional arguments involved with taxing inheritances. Of course, while positive arguments may be offered for inheritance tax, part of the debate should look at which particular taxes to prioritise. The suggestion here is that housing or land taxes may be a good place to start.

There are early signs that wealth taxation is appearing on the political agenda. For example, the Liberal Democrats have announced plans for housing taxation in the approach to the 2010 general election. However, the way this policy unfolded also highlights some of the challenges facing this agenda. At the party's conference on 21 September 2009, shadow chancellor Vince Cable stated that the Liberal Democrats would impose a 0.5% levy on all houses worth over £1 million (Cable 2009). This 'mansion tax' proposal appeared to stoke opposition in Liberal Democrat circles, with rumours that Cable had not properly consulted with colleagues prior this statement as well as concerns that this would create problems for those Liberal Democrat MPs defending marginal constituencies in the south-east of England with a high proportion of properties worth over £1 million (Sparrow 2009; Coates and Jagger 2009). These criticisms appear to have fed a change of policy. On 30 November 2009, party leader Nick Clegg said that there would now be a 1% levy on properties worth over £2 million (BBC News 2009; Liberal Democrats 2009). Practical proposals therefore have to negotiate a series of hurdles. Although the ‘mansion tax’ proposal highlights that this can be a tricky process, it also suggests that it can be done if suitably framed.

What of the right of the political spectrum? In the UK, there has been much attention recently to the idea of ‘progressive conservatism’. Commentators such as Philip Blond (2009a; 2009b) argue that conservative means are best placed to advance progressive goals. Part of this focuses on ‘re-capitalising the poor’. Blond argues that under the ‘market state’, which adopts a free market approach to the polity and economy, wealth inequality has increased. He records that in 1976, the bottom half of the population owned 12% of the country’s liquid wealth, but this had dropped to 1% in 2003. If wealth is extended to include property, then the share held by the bottom half of the population is only 7%. Blond says that combating this is to allow for an extension of real opportunity, and doing this means a: ‘new popular philosophy of asset extension and stakeholder equity capitalism is required’ (Blond 2009a, 6). Some suggestion that these ideas might gather political weight is indicated by the fact that David Cameron (2009a) referred to re-capitalising the poor at a speech at at the World Economic Forum at Davos on 30 January 2009. He also appeared at the launch of Blond’s new think-tank ResPublica on 26 November 2009 (Hoggart 2009), and also referred to Wilkinson’s and Pickett’s book *The Spirit Level* in the Hugo Young memorial speech on poverty on 10 November 2009 (Cameron 2009b).

However, questions can be asked about progressive conservatism. It is often unclear what progressive conservatism means in concrete terms. Where details do exist, this often avoids the topic of wealth taxation. For example, perhaps the most detailed account to date of what progressive conservatism means in practice fails to mention wealth taxation at all (Wind-Cowie 2009). At a political level, it is also difficult to reconcile progressive conservatism with a continuing Conservative party commitment to weaken inheritance tax. The suspicion here is that progressive conservatism is a convenient label with which to woo floating voters rather than a real attempt to develop innovative ways of addressing wealth inequality.

Conclusion

The financial crisis and the economic recession have altered the terms of the political debate. In the UK, debate between the main political parties focus on a new 'age of austerity' as the political parties discuss the appropriate package of taxes and spending commitments to cope with the crisis. A key feature of these debates is the discussion between party leaders of the depth and extent of cuts needed to control the public finances. This suggests that government is entering a period of retrenchment in which services will be cut.

Although public spending cuts are perhaps the most obvious impact of the recession on the public finances, it is possible that the recession creates opportunities as well as threats. Government-led bailouts of the banks and the financial system arguably expose some of the flaws associated with a free market approach to the economy. This creates a space in which one can debate different ways of governing the economy and society. Part of this might focus on the case for greater wealth equality and a need for wealth taxation. The above has highlighted two ways this might be done, namely by linking this to housing taxation as well as a renewed Keynesian approach to the economy.

Any such programme needs an organisation or network to make a case for reform. This is needed to help build public support and backing for wealth taxation. There are signs that centre left networks and parties are beginning to play such a role. There is less certainty that this will appear on the right, although part of its language today involves support for spreading wealth more equally. However, more activity is needed if the opportunities offered by recent events are not to be lost.

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Tax Burden. All governments impose fiscal burdens on economic activity through taxation and borrowing. Governments that permit individuals and businesses to keep and manage a larger share of their income and wealth for their own benefit and use, however, maximize economic freedom.Â A free and open investment environment provides maximum entrepreneurial opportunities and incentives for expanded economic activity, greater productivity, and job creation. The benefits of such an environment flow not only to the individual companies that take the entrepreneurial risk in expectation of greater return, but also to society as a whole. 6 ways to build your wealth even in an economic downturn. There is opportunity in adversity so you can grow financially regardless of circumstances.Â Successful wealth builders take the road-less-traveled by seeking to find the best in a difficult situation. Rather than use the recession as an excuse for poor performance, the wiser choice is to realize that dramatic change has occurred â€“ and change brings opportunity â€“ even when it includes difficulty. Get This Article Sent to Your Inbox as a PDFâ€¦ Send Me This Article! Even in a recession, you can find clever ways to extract economic advantage and position yourself for the next economic recovery. Not all times are good, but if you want to lead a wealthy life, then you would be wise to learn COPYRIGHT: Recovering better: economic and social challenges and opportunities A compilation of the High-level Advisory Board on Economic and Social Affairs Published by the United Nations, Department of Economic and Social Affairs New York, New York 10017, United States of America. Copyright Â© 2020 United Nations All rights reserved. Falling house prices create a negative wealth effect, reducing confidence and causing further falls in spending. We are likely to see a drop in house prices in 2020. Bond Yields.Â A recession leads to lower investment and therefore can damage the long-term productive capacity of the economy. outside of the banking sector and creating opportunities for emerging nonbank financial firms to address unmet market demands. At the same time, and as part of a longer-term trend, the rapid development of financial technolo-gies has enabled financial services firms to improve operational efficiencies and lower regulatory compliance costs that increased as a result of the expansion of regulations following the financial crisis.Â Executive Summary â€¢ Emerging Trends in Financial Intermediation. Expanded access to credit and financial services. Digital advice platforms are making financial plan-ning tools and wealth management capabilities previously limited to higher net worth households available to a much broader segment of households.