Flat tax promotes growth and enterprise – and with it equality

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Most readers who wrote in last week to slam my advocacy of flat tax missed my main point. Of course – and I in no way sought to deny it – in the first instance flat tax widens the gap between the actual sum that a higher earner keeps back from the state and the actual sum that a middling earner keeps back (low earners are exempt from the tax anyway). On the face of it, then, social equality suffers. But it can be restored in a different way, as I want to show this week.

My true starting point in that first column was the failure of progressive taxation to bring about social equality, even though in the UK it has had every chance to do so over a long time. This country was actually its pioneer, introducing it during the Napoleonic Wars and afterwards abolishing it, before reintroducing it in 1842 (all this, incidentally, done by Tory governments). We have had it ever since, and you would think by now it might have exerted some noticeable effect on the distribution of income.

More recently, we have seen determined efforts to reinforce that effect, for example, the 98 per cent marginal income tax rate imposed by Labour in 1974-79. It was the start of a long process of constructing the more comprehensive and complex tax code we have today, in the hope of closing loopholes. But, if anything, the process seems to have made tax-dodging easier rather than harder. At any rate, the distribution of income remains stubbornly unequal, and in the 21st century has been getting more unequal rather than less. Progressive taxation is never going to hack it.

Actual aspirations

All this has become a particular concern in Scotland now that we have a government dedicated to equality. I'm not suggesting Alex Salmond was, as First Minister, uninterested in equality but, being a man of practical economic experience, he always knew how the capitalist system works.

Today, we have a government which appears to me – with one exception, safely shunted off into education – to be totally ignorant of economics, and not caring much. It thinks the country should grow richer in some ethereal rather than material sense, with a lot of touchy-feely sustainability and inclusiveness. Well, we will see how far that corresponds to the actual aspirations of typical Scots, those perversely obese people who drive in gas-guzzling cars to superstores for shopping sprees, when we get to indyref2.

Meanwhile, the present Scottish Government wants to tax us more, as set out by Nicola Sturgeon in a speech a couple of weeks ago. However, the shape of the devolution settlement means it can't tax us all that much more. In its initial flexing of new fiscal muscles under the Scotland Act 2016, it has so far confined itself to refusing to pass on a little relief the UK Government has given in England, though stronger action is promised in the future.

Prime targets

What a shame that for the time being the prime targets of Scottish tax policy should be those with incomes of something over £40,000 a year, such as junior managers, train drivers, opticians and TV journalists. With their mortgages, holidays, commuting and kids to pay for, I would have thought this was what Ed Miliband used to call the "squeezed middle", with little or no surplus income to save up.

By contrast, younger professionals in their 20s, unburdened by the same commitments, as well as pensioners who have paid everything off, are in actuality richer.

Still, in terms of nominal income, the squeezed middle is already doing better than the average punter in Scotland, and sooner or later such people might expect to move further up the scale, to the point where flat tax would more clearly benefit them.

Voluntary taxation

Why do I see this as a good thing? I'll start my answer by quoting one of my critics from last week, Brian Stobie of Penicuik, who wrote in to say: "If you let rich people and organisations keep more of the money they get, they just shove it into rent-seeking activities and dodgy financial assets that make a heck of a lot more money than merely making stuff. They don't invest in the real economy where you might get a job working for them."

I'm not quite sure of some of the distinctions being made here, because a lot of rich people will already be providing jobs as employers in a factory or store. Once they benefit from flat tax, they would be unwise to squander their extra spending power on wine, women and song, at least if they want to remain as rich as they are. Happily, there is nowadays no dearth of investment advice. Two of the most common ways in which surplus cash can be deployed are in gilt-edged securities or in the stock exchange. Gilts help the British state to finance the deficits it has been running for the last three centuries. They pay interest and their face value cannot be lost (though their price on the market may vary). They are as rock-solid an investment as you can get.

That is why there are more than £1500 billion of gilts outstanding on the UK's capital account, compared to a current government deficit of £58bn. They are the very opposite of "dodgy financial assets". They are, if you like, a sort of voluntary taxation, except you get your money back at the end. The holder, meanwhile, accepts a suitable incentive to lend to the government such cash as he or she has no immediate use for.

Surplus money

The Scottish Government already possesses the power to issue gilts, for which the nickname kilts has been invented. Unfortunately none has so far appeared: I wonder why. But the independent nation would certainly need them.

As for the stock exchange, "rent-seeking activities" is too paltry a description of what goes on there. Its function is in one respect similar to that of the gilts market, except that here the holders of surplus money transfer it to the private sector rather than to the government. They do so by buying shares in public companies.

In other words, available resources go from where they are not needed to where they are needed for investment or expansion. Since the UK is a global leader in the services sector, a large proportion of these resources is not used for "making stuff", in Brian Stobie's sense. But an even larger proportion does go towards "making stuff". Of the companies in the FTSE 100, which account in value for 81 per cent of the entire stock market, 40 are manufacturers.

Profitable opportunities

Now we approach an answer to the question of why flat tax may be better than progressive taxation for a nation which values equality. The essence of the answer is that whereas progressive taxation stunts enterprise and growth, flat tax stimulates both.

It leaves money in the hands of those likely to invest it. They can then devote their energies to the discovery of profitable opportunities rather than to the avoidance of tax. When they do invest, they help to create more jobs for all the workers, and the income of the whole of society rises.

With higher revenue comes higher public spending on hospitals and schools. This has been the actual effect in countries such as Estonia and Slovakia, which have adopted flat tax, just at the point where they were escaping somebody else's clapped-out empire. It can be the same successful pattern for Scotland too.

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