Modern Money Theory and Tax Justice

Adapted from a post at magic-money-tree.co.uk

The aim of the tax justice movement is a radical overhaul of the tax system, which it sees as unfair. However, the majority of people have a confused and—more importantly perhaps—an inaccurate idea of how tax works. Clearly, if this is true of the people driving the tax justice agenda, then however laudable their motivations, their proposals may not be entirely coherent. This matters: if you are aiming to bring about radical change you need to be reasonably sure that your premises are sound.

MMT (Modern Money Theory) has a view on tax, but only in relation to its function in a sovereign economy; the question of fairness is a political one, and MMT is not political. Nevertheless an understanding of the way tax works and what it does is bound to have a bearing on the question of its fairness, or lack of fairness.

This note is based on a pamphlet (*Tax for the Common Good**) which is a sort of manifesto for the organisation Church Action For Tax Justice. It is well presented and contains lots of compelling statistics, but its arguments are undermined by misconceptions about tax, how it works and what it does. In this note I have tried to work out what this means for the tax justice agenda. It raises a number of what I believe to be fundamental issues, but the conclusions are tentative.

First some basic facts about tax, drawn from the findings of MMT. (In the UK, the USA, Australia, Japan, and other 'economically sovereign' countries around the world there are actually two significantly different kinds of tax: 'sovereign' and 'non-sovereign'.)

Sovereign Taxes

Sovereign taxes are those that are levied by a (sovereign) government—i.e. a government that creates the money, or 'currency of account', that is used to 'pay' the taxes. The main functions of sovereign taxes are to 'drive the currency' and to regulate

* *Tax for the Common Good*, Church Action for Tax Justice, Evesham, UK, February 2019

domestic spending capacity. But, crucially, they do not actually pay for anything. When sovereign taxes are 'paid' the money simply ceases to exist—it is effectively destroyed. If paid in cash it is *physically* destroyed.

The fact that taxes are destroyed and cannot be used to fund public services does not inhibit government spending, since the government creates its own money (through its proxy, the central bank). The money so created is referred to as 'fiat money', 'fiat' being Latin for 'let it be'. All government spending uses fiat money. It does not use, or in any way depend on, taxation.

Non-sovereign Taxes

Only those sovereign taxes (those that are paid to an economically sovereign government) are destroyed. All other taxes are non-sovereign taxes, and are in effect mandatory fees. When collected they become assets of the collecting authority. Typically they are collected by local government bodies, as Council Tax in the UK and state taxes in the USA and Australia, and they pay for services provided at the local or state level. (Exceptionally, taxes collected by eurozone countries are non-sovereign taxes because those countries are not economically sovereign: they do not create their own currency. Politically they are countries, but fiscally they are more like states.)

Unlike sovereign taxes, non-sovereign or 'local' taxes *do* pay for something: generally for public services.

In this note I'm only concerned with sovereign taxes, since they constitute the majority of the taxes that are levied in economically sovereign countries—the only significant non-sovereign tax in the UK is Council Tax. So from now on, when I refer to 'tax' I will mean sovereign tax, such as income tax and VAT in the UK and federal taxes in the USA.

The Flawed Rationale for Tax Justice

Nearly all discussion about tax justice is predicated on the assumption that tax actually pays for something. It doesn't. This cannot be stressed too strongly, so once again: tax does not pay for anything. In particular government spending is not funded by taxation. When the government needs money it simply creates it.

This has an important bearing on the rationale behind the tax justice agenda. For example, the introduction to the CAT pamphlet states:

> Returning a percentage of our wealth or earnings to the public sphere for the benefit of all is an acknowledgement that we are part of society, and that we all depend on one another.

But taxes do not return anything to the public sphere. They just disappear. If people believe, as most do, that by paying their taxes they are financially supporting public services, they are simply wrong. Taxation is a regulator, not a payment.

So here we encounter that bugbear of practical politics: in Al Gore's memorable phrase, 'an inconvenient truth'. We have to face the fact that if people realised that their taxes do not pay for public services, particularly the NHS, they would be less, not more inclined to pay them. Still, the truth is the truth.

A couple of paragraphs later the document states that:

> it is still too easy for large companies ... to avoid paying their fair share of tax

A simple enough statement on the surface, and indisputable as far as it goes, but let's unpack it a bit. Two questions: what is the tax that large companies pay, actually for; and what would be a fair share?

Companies pay a number of taxes, but the one this probably refers to is corporation tax, which is levied on all companies doing business in the UK. It has become something of a cause célèbre recently, as a consequence of media attention to large America-based international online businesses such as Amazon, Facebook and Google making vast profits but paying (relatively) small amounts of tax.

Why does this matter? The obvious answer is that taxes pay for public services so we would benefit from better public services if these companies paid more tax. But taxes do not pay for anything, so this argument falls.

What else? Well, taxes are important and have to be paid, so presumably we must benefit from them in some way, even if it not clear exactly what that is. This is true in a sense. Taxes regulate spending, which is a benefit because it helps maintain a stable economy, but it's not an *increasing* benefit—the economy doesn't get more stable if more tax is paid!

Nevertheless it is reasonable to argue that if Amazon (say) paid more tax, we, the public, would be able to pay less, but even this is not much of a benefit in reality. For one thing the government is unlikely to reduce tax rates or increase public expenditure just because Amazon pays more, and the net effect of more tax being paid will be a reduction in spending (Amazon will put up its prices) and a slight shrinkage in the economy. And even if our taxes *were* correspondingly reduced, we would end up paying them anyway, via the increased prices of Amazon products.

In short, there is no real benefit, and possibly a slight dis-benefit, in making Amazon, or other major internet corporations pay significantly more tax.* This is not at all what tax justice campaigners, or indeed most of us, would imagine to

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* A caveat is in order here. If our objective is to make a market-dominating company like Amazon less competitive so it becomes harder for it to out-compete smaller businesses, then

be the case, but it needs to be taken on board if their demands are to be properly targeted.

Tax Dodging

I have great respect for Justin Welby, Archbishop of Canterbury, but there's no escaping that his contribution to the pamphlet, under the heading *Tackling Tax Dodging* (page 5), makes exactly the same error. He says:

> ... estimates from a range of organizations suggest that governments around the world lose out on at least $500 billion per year from multinational companies alone. In the UK, several organisations have tried to calculate the annual 'tax gap ... . [E]stimates range from £34 billion to £120 billion per year. If collected and invested in vital public services, these sums could make an enormous difference. (For comparison, the UK schools budget in 2017–18 was £39.4 billion.)

Of course it is true that multinational companies are hiding their wealth and that's a thoroughly bad thing for all sorts of reasons, but it's not true that governments 'lose out on' the money. If it had been collected it would have been destroyed anyway—that's what happens to sovereign taxes. Neither is it true that if collected it could be invested in public services, since once collected it ceases to exist. Further, if the government wanted to it could invest another £39.4 billion in schools anyway—it could just create the money.*

It may seem counter-intuitive, but stashing money away somewhere and effectively taking it out of circulation is functionally equivalent, in the short term, to paying it in tax. Once effectively hidden it could be used in dubious and possibly criminal ways, but that's a transparency issue, not a tax issue.

How progressive is progressive taxation?

If people's incomes were generally stable, then making taxation more progressive would clearly reduce inequality by removing more of the spending power of the richer than of the poorer. But they are not stable. In the days when unions were stronger, wage demands could result in increases mainly at the lower end of the continuum, reducing inequality. But at the higher end, where remuneration is negotiable, increases in pay increase inequality. Suppose that in an attempt to reduce inequality a government decides to increase taxation for high earners. There is a

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making it pay more tax may be effective, and could be part of a tax justice agenda. But this is not, I suspect, quite what people have in mind when they demand that it pays its 'fair share'.

* This is a fanciful example. Such an arbitrary increase in government spending could have unintended consequences—like inflation—but that would also be the case if that extra investment were to come directly from the hidden funds of multinational companies.

strong possibility that the people affected would simply negotiate a higher gross payment to compensate. If the tax were subsequently lowered again for any reason inequality would then have increased overall.

This suggests that however intuitively appealing progressive taxation is, even if it is effective in the short term it is likely to be ineffective in the medium term and quite possibly counter-productive in the long term. This appears to be borne out by the statistics: In OECD countries the highest-paid 10% have an income that is nine times greater than that of the lowest 10%. Twenty-five years ago it was only seven times.

My guess is that progressive taxation probably works—particularly at the lower end of the pay scale, but less than we imagine.

What else is tax for?

We have seen what tax is not for, and found that some key parts of the case being made for tax justice are based on false premises. But we have not considered, except very cursorily, what tax *is* for.

We noted that the primary role of taxation (sovereign taxation, that is) is to regulate the economy. In simple terms, increasing taxation reduces spending capacity and prevents inflation, while reducing taxation increases spending power and stimulates the economy. There is what can be thought of as a kind of 'circuit': the government spends money into the economy, initiating greater (or more specific) economic activity, and subsequently withdraws it in taxation when it has done its work. The amount withdrawn is generally less than the amount injected, the difference being absorbed, generally, by an expanding economy.

Leaving aside for the moment questions of equity and fairness, it doesn't really matter very much how the money is withdrawn. As long as the government spending is allowed to do its work (e.g. we don't immediately take it all out again in tax), and the appropriate amount of tax is withdrawn, the regulatory function of the taxation will be fulfilled.

But taxation also has other, secondary, functions. Some groups (e.g. the rich) can be taxed more heavily than others (e.g. the poor) in an effort to compensate for disparities in income through progressive taxation. Sales tax (VAT in the UK) can be applied differentially to goods and services in order to influence people's spending choices. The balance of assets held by the wealthy can be influenced by means of targeted wealth taxes, and taxes such as land tax and capital gains tax can be used to modify the behaviour of land and property owners.

But none of these taxes *pays* for anything—that is just not what tax is for. So that leaves us with two questions: in what way or ways *is* taxation unfair, and how can it be made fairer?

These are difficult questions, although most people would at least agree that the rich should pay more and the poor should pay less. But how much more, and how much less? And why? Is it just because richer people can afford to pay more than the poorer, or is it also because we can see no good reason for some people to be rich and others poor?

And does changing tax make much difference anyway? We have already noted the ability of high earners to avoid reductions in income caused by increased taxation, by negotiating a higher gross remuneration—thus neutralising and, paradoxically, even reversing any intended redistributive effect. We demand (quite rightly) that people pay their taxes rather than hiding their wealth in tax havens, but once we realise that the tax they owe wouldn't pay for anything anyway, the moral argument against such behaviour can only be that if they paid more tax the rest of us would have to pay less. And as we have seen, even that argument may not be valid.

So it is at least arguable that taxation is really a side issue. Tax dodging is wrong and should be stopped; luxury (and harmful) purchases should be taxed more heavily than basic essentials; and below a certain income people ought not to pay tax at all; but if greater equality is our aim, should we perhaps be looking less at taxation and more at income itself? We could, for example, impose both a floor and a ceiling on incomes and gradually bring them closer together. And wealth is only nominal until it is spent, so very high taxation on high-value non-essential goods and services would go some way toward dealing with wealth disparities.

For the sake of argument, suppose we imposed a 100% level of taxation at, say, £250,000 p.a. (still a phenomenal income by most people's standards) and introduced a universal basic income (UBI) or a job guarantee (JG) scheme to eliminate poverty? We could gradually increase the level of UBI or JG while continuing to use taxation as a regulator, thus progressively reducing inequality. Simple, in principle at least!

Is this entirely fanciful? Lots of things seemed fanciful until they happened—the collapse of the Soviet Union, global warming, mass extinctions, the coronavirus pandemic, the furlough scheme. The movement for fundamental change is growing, MMT is beginning to enter the mainstream (disguised as 'quantitative easing'), and Yanis Varofakis is seriously proposing alternatives to monopoly capitalism. These are encouraging signs in a world overburdened with discouragement.

Perhaps we should be bolder?