



ICAEW DEBATE - FULL TRANSCRIPT

Bronwen Maddox, Director of the Institute for Government, in conversation with Vince Cable, former leader of the Liberal Democrat party

TAX TODAY AND THE POTENTIAL FOR CHANGE

BRONWEN MADDOX: It's really interesting to be talking about tax at this point. It's one of the things we look at here at the Institute, and that I write about quite a bit. You've got various trends that have made it hard for governments to collect tax: things like more people becoming self-employed, and the digital giants being mobile between countries and very hard to tax. On the other hand, you've got a lot of pressures that make it desirable for countries to raise more tax. You've got an ageing population, certainly in Britain and many other democracies. There are lots of things that people want their governments to spend tax on.

And the coronavirus, it seems to me, has brought this home. Whether it's people wanting their governments to have money for furlough, for healthcare itself, even things like local parks, people have really been reminded of the importance of what the government pays for. Against all that, though, there's a lot of mistrust of government, and I date some of that back to the financial crisis, and people feeling nervous about what governments do on their behalf. And that's not something that makes them more willing to pay tax. You've got things pulling in different directions.

VINCE CABLE: I think you're absolutely right to start by stretching the argument around these structural problems - digital business and lack of taxation, international mobility - but there are fundamental political problems too. The mood has changed cyclically. I think around 1993 there was a flip in the surveys where people had got a bit fed up with low taxes and poor services, and they wanted more tax and more services. That lasted about 10 years in the Blair/Brown period. And then they switched again - less public spending, less tax - that sustained us through the coalition, and there was a period when austerity was quite popular. But it's gone the other way now, and the mood has changed.

But the difficulty, and I speak as a former practical politician, in trying to translate this into policy is that there's a perfectly normal human instinct whereby you want to pay less tax and have more spending, and trying to sell a balanced approach to the public is quite difficult. I tried in three successive general elections with so-called tax-neutral ideas and what happened was that people ignored the spending pledge because

they assumed that politicians were going to spend money anyway. But they deeply scrutinised the tax policies and found all the nasties that were going to affect them. So, against a sceptical public opinion, trying to change tax in a sensible way and getting spending priorities right is extremely difficult, and I think is collectively making politicians very conservative, with a small C, in their approach.

BM: I think that's right. In the broadest terms, if you don't have an ability to raise tax as a government, you don't really have a functioning government. It's a discussion I've had in Pakistan and Afghanistan and other places, but when you get down to it, for the reasons you've said, changing it can be incredibly hard because any change creates losers who are really aware of that loss. And the winners from any change may be much more widely dispersed and less conscious or grateful or appreciative of that particular change. So any change can be really politically difficult and what you end up with is what we have now, which is a very complicated tax system where even bits that were created for good reason might have atrophied, but are really hard to get rid of.

VC: I think you've put your finger on the key issue, which is that it's not symmetrical between winners and losers. But as a politician you've got to try and balance them, and trying to get the tax and the spending proposals that are palatable involves quite often a lot of dishonesty. I think a very good example is the recent change for trying to finance social care with national insurance charges. The social care had very little to do with social care, it's really an inheritance subsidy to help people cope with means testing in middle-income property owners. And the tax measure is probably the worst you could possibly have chosen from the point of view of fairness and age and so on. But it actually proved quite popular because the public were persuaded that some form of social insurance was involved and we all pay in through our income tax, so actually a very bad tax and a very dishonest message on public spending was wrapped together to perform actually quite a popular package, which will probably survive the test of time.

BM: I think that's a brilliant example because it captures how the badging of this matters so much. National

insurance, as you said, sounds like an insurance scheme, whereas it is in fact a tax, and in this particular case, a tax on working people used to benefit, largely, people who are much older. And as they said, much of the storm of criticism, I think rightly, was that this was a badly designed tax, but it did get through in that way. It's still fairly recent. We have to see what the response is. But it's very hard, it seems to me, for politicians to begin what they always say that they want of an honest conversation with the public about all kinds of difficult things, because there are so many taboos and totems around that they just don't want to or don't feel that they can dare raise.

VC: Yes, and I think the problems we're describing make it incredibly difficult to have radical reform and deal with the kind of anomalies you're describing, the vast complexity and irrational behaviour. If we take the national insurance case, there are lots of worthy economic tomes. There was the classic piece of work by Sir James Mirrlees, one of Britain's Nobel Prize winners in economics, describing an ideal tax system for Britain that involved combining national insurance with income tax. Well, no real-world politician would ever dare to go anywhere near that because, of course, you create a lot of losers among the higher- and middle-income people in the top rate of tax and change the thresholds for paying national insurance. So, in the real world, radical change is very difficult to achieve in this political context.

BM: Yes, the unfortunate thing that pollsters find quite regularly is that people see the need for more tax to be raised. And the spending tends to be quite popular, but they want other people to pay the tax. And then you get into these complicated dances about allocating the pain, if you like, into politically convenient, or least painful ways.

VC: I think there's an interesting question, where your work on looking at the structure of government is terribly relevant, which is that Britain is in a rather anomalous position in that there is clearly a yearning for American levels of tax and European levels of spending. We'd love to have Danish/Swedish services, but we don't want to pay for it. So we have this slightly unstable equilibrium somewhere in the middle that fluctuates backwards and forwards. How do you see the Americans on one hand and the Europeans on the other creating a consensus behind a significantly higher or lower level of tax that is stable, whereas the British are somehow stuck in the middle?

BM: I think tax is really a national bargain. That's almost

what makes sense of the nation state as a unit, it is that bargain between people and their government, what they're willing to pay for and what they expect. It's interesting to me that in the US taxes are not all low and local taxes are really quite considerable. And if you add in property taxes levied locally, you've really got something quite steep. But there is broad acceptance of these, or people move state or they vote the people out, and you get quite a sharp demarcation between the states in terms of their willingness to pay taxes.

So, I see it as a bargain. And it's one that the Scandinavian countries have found to be quite stable. They've persuaded their populations, "Look, you will get this." And you can rely on getting this very high level of social services, whether it's childcare or parental leave or whatever. And in return, you will pay quite a lot. I remember one *Financial Times* reporter going to Denmark and writing about the pleasure of moving to Denmark, apart from learning the language, and then found a very high proportion of his pay disappearing in tax and was shocked at that. It's a different system.

It falls apart when people become mistrustful. And I think it's really striking how immigration and other factors in some of these countries are making people more mistrustful of what their governments are doing generally on their behalf. And I think that has quite a quick impact on their willingness to pay tax. So, coming back to the UK, I think it really does come back to the question of, do people believe in what the government says it's going to give them? And, therefore, are they willing to pay for it?

VC: I see two points coming out of that. We're still a long way from European levels of state intervention. People were shocked recently to discover that the British state is taking something like 38% of national product in tax. In France, in Denmark it's more than 50% - there's an enormous gap. And I think the other thing that comes out quite strongly, and this is very important from your comment, is the local/national. Britain is a highly centralised country. We have relatively little devolution, little discretion at a local level. And that may have contributed to the feeling of 'if you don't trust the national government why would you support more revenue raising?'

BM: Hearing my own words played back to me by you, I am now thinking that framing it as just about public trust is perhaps wrong. As it is to imply that if people trusted the government more they'd be prepared for a higher tax rate. I think Britain has had a culture of comparatively low tax rates because that is the culture that people have found healthy. And it is one that businesses have argued, many governments have done

persuasively, as the one that encourages investment and encourages people to work and start businesses and do all kinds of things and that something would be lost from British life and economic life if tax rates were to rise sharply. And I think it is hard to get a step change in a country when you have that kind of tradition and expectation in business life as well as in people's individual lives.

VC: That step change issue, it isn't just about the aggregate level, it's also about the nature of tax. I think most economists and analysts would agree that there are some really awful problems in the British tax system, for example, the property council tax system is a complete mess and we're still operating on prices from 30 years ago, but no politician would dare to go anywhere near it.

BM: You're talking about the valuations of people's houses?

VC: Yes, the valuation system or, indeed, the structure of slabs and so on. It's terribly dated, but nobody wants to reform it. We've got the same problem with business rates, where there's big national debate. Can we get rid of business rates and replace them with something else based on land or something else, sales taxation? Nobody wants to go near radical reform - the income tax/national insurance issue, the VAT exemptions, which all analysts agree are distorting and unhelpful. Even post-Brexit when we have freedom, no government wants to do more radical things than exempting sanitary towels, which I think is a top priority. But the basic structure is unchanged and unlikely to ever be tackled. Is there any way past this?

BM: I think pressures are going to force it. I think pressures of health cost for a start are going to force a conversation about how to pay for it. And some of these taboos, as they have been, about whether people who can afford it should pay for some healthcare may be raised. They're being raised in social care after all, and that's not so very different.

VC: But we pay for prescriptions, don't we?

BM: We pay for prescriptions. We pay for eyecare.

VC: What's the next step? A visit to a doctor or something? What do you think?

BM: I think there needs to be a question about this. The joke is that Britain is becoming a health service with a country attached. But there is a real sense in which

healthcare is squeezing out other public services, even education, which is very much about the next generation, because of these costs going on primarily for the benefit of older people.

You raised a really interesting point about local government and local taxes. And I guess one question is whether a way to change this would be to give more power to local governments to raise taxes. The argument might be that people would be happier to pay taxes to a government they know is really looking after them. We could see in the coronavirus lockdown responses that the Welsh government, for example, got quite a high degree of trust from Welsh people saying we're going to do things slightly differently.

On the other hand, I find myself a bit worried by that because it does deprive central government of the ability to say, "Look, we're really going to go out and help this part of the country." And this is what the government's strategy of levelling up is about, or should be about - to say, "Look, we are using the power and the money of central government, and the money drawn from the richer parts of the country, we're going to go out and try and help the places that have got stuck for one reason or the other." And you can't do that as much if you have devolved the power to raise tax enormously to local regions.

And the consequence of devolving more of that power would also be that poorer regions would raise comparatively less money. And you see that very strikingly in the US where you get this doughnut-ing of cities, as they're called - the flight of more affluent people to the suburbs meaning that the inner city can find it very hard to raise the money it needs to regenerate or whatever. So, I find myself pausing when people talk about more power and more tax-raising power to local government as a way of changing all this because I think it would deprive central government of some of the real ability to change things.

VC: Isn't there an important distinction here between decentralisation and devolution? I mean devolution involving local revenue raising for exactly the reasons you've given, that poorer areas can raise less revenues so you're perpetuating disadvantage. But decentralisation of, say, public spending, just handing over slabs of central government tax to local authorities presents problems of its own. You have the Scotland issue and the London Mayor.

BM: Which Scotland issue? There are many.

VC: Well, in Scotland and in decentralised areas like London you have the Mayor or the First Minister being Father Christmas. They don't have to take responsibility

for raising the revenue. They just hand it out and everybody applauds because they seem so generous, and the revenue is actually hidden. So, we've got a real dilemma. How do we get local empowerment without impoverishing the poorer areas?

BM: Where are you on this, given my scepticism about giving over a lot of local tax-raising powers?

VC: Well, I would actually accept more devolution and accept that in the shorter run it puts poorer areas to disadvantage. But you'd also give them borrowing powers. And you'd hope that, over time, if they use things like business rates intelligently, they begin to help themselves. But you also need a topping up system, you need some redistributive system - 40% of Americans' tax revenue is equalised, for example, you need something like that. But it's a messy problem and there's no easy solution.

INTERGENERATIONAL UNFAIRNESS AND PAYING FOR THE PANDEMIC

BM: It's an interesting question about whether coronavirus has made people more willing to pay tax. My sense is that people are conscious of what the government has done and how expensive that is. But I wonder if that's going to strain a kind of generational bargain. Younger people have been badly hit in terms of jobs and education by the pandemic and in some ways are going to bear the cost of this and I wonder whether that generosity, if you like, might be strained if taxes fall particularly on them?

VC: Yes, coronavirus has had one enormous effect, which is it's made us all very conscious of being part of the same society. But I'm not sure that it's changed very much. It's intensified the national love affair with the Health Service. And any problems with the Health Service will now automatically be filled with enough money to keep people happy, but it's at the expense of other things. We know schools have suffered terribly in the coronavirus, but they haven't got the back-up they need. We've become very dependent on Amazon and Zoom, but we still resent the fact that they're not paying any tax. So, I'm not sure how deep all this goes.

And I think the public, although they don't necessarily express it in formal language, are conscious of the fact that there is a big economic debate, which is whether the debt from the pandemic needs to be paid for at all. There is this strong view among some economists, and I'm one, that you just let it roll over and eventually growth and inflation will deal with it. But then there are

the purists who say, you know, we've now got to pay for it, we've got to raise some taxes to pay for it.

BM: It is really striking how much that debate has changed. Even as you said, the middle ground of economists since the days of austerity following the financial crisis, because what you've just described is now quite a popular view among economists and would have been thought of as quite reckless even just a decade ago, which may not increase people's trust in economics.

But I wonder how high people's tolerance will go. I think there's absolutely a passion for putting more money into the Health Service now and, indeed, for education, and probably for the less loved and less public bits of public services, such as prisons and courts that people perhaps don't think about so often unless they've got contact with them, but which they really want to work. But it's a question of how high that goes. And the fact is that the money going into the Health Service now, the extra money will do something to clear the backlog. But it's not really enough to cope with an ageing population and the consequences of that and more and more money is going to be needed.

VC: But nonetheless, we've all collectively agreed that the priority is to keep people like me alive a bit longer at the expense of, as you put it, a generational issue and the young people that did all the hard work have missed school, missed college, and are now being asked to pay more tax. This generational problem was already serious, and it's now become much more so. And I don't see any change in mood among my generation that we've all got to pay more inheritance tax or tax on property, which are the obvious things that an older generation should be doing. The resistance to that is as hard as ever among the older people who, of course, are the voters. And the generational divide has become wider, but it's not clear how this is all going to come to a head.

BM: So, what you're describing is precisely the kind of thing that can make a bargain on tax really unravel and unravel very fast in a way that is very hard for governments then to address. At the moment there's this mood of national solidarity, sort of, though people have taken different views through the pandemic about just what they owe to each other. Some very much saying I owe mask wearing and vaccination as my contribution to society, others taking a much more individualistic approach. But what you've described is a real difference in how it hits the generations and a willingness to pay tax and how taxes fall on the generations. What I worry about is that that sense of

unfairness, of intergenerational unfairness, actually begins to collectively break down people's willingness to pay tax because people will pay tax when they have a basic sense that it is fair and that they trust what it's being used for. And if that sense of fairness breaks down, I think any government has a problem.

VC: But then how does this breakdown in trust manifest itself? Do we see growing numbers of people resorting to clever forms of avoidance because the tax has got nothing to do with them anymore? Or is it just anger? How does this happen?

BM: It can be just anger. It can be disenchantment with the whole business of politics. And we see quite a lot of that in the questions we get towards public events that we're running at the Institute, of scepticism about the value of government. Can it really do anything for me? What's the point of voting and all this kind of thing. We get lots of other questions as well. But I think that's the danger, more than people deciding, "Oh, I'm going to set up some clever scheme not to pay tax" - more expressed towards politics and government as a whole. And that becomes very difficult to overturn.

WEALTH TAXES AND PROPERTY TAXES

VC: Yes, but the logic of that is that we really do need to overhaul the system so that we restore a sense of fairness. And although it's politically challenging, and it's easy for people like me to describe our problems and explain how difficult it is, what would we do if we were setting about the task within a politically realistic framework of trying to make a fairer system? I would be very tempted to go for some form of wealth taxation, but I know how onerously difficult it is because half of personal wealth is property. And we know that there is real unhappiness about the payment of property taxation, particularly if it was actually fairer, rather more proportional or progressive. And inheritance tax is probably the least popular tax of all, strangely, given it affects so few people. So, if you and I were launching a political party tomorrow with a realistic programme to address this sense of intergenerational unfairness, what do you think we would be concentrating on?

BM: I would start with property taxes. I wouldn't call it wealth taxes because when you're talking about wealth you have to discuss people's pensions. And even more than property I think people's pensions are politically very difficult to deal with. And yet, pension wealth represents a great deal of the wealth, however you calculate it in this country.

VC: Even though £20bn a year goes into pension tax relief, some of which is of questionable merit?

BM: I wouldn't go for a wealth tax in itself because it bundles so many things together in people's lives, not just what people think of as wealth, like money in the bank, but principally property and pensions. I'd deal with them both separately. And I'd begin with property because it is a real choke, I think, on British life, the way that property is taxed in such a lumpy and peculiar way. You've got Stamp Duty, which discourages people from moving, and there's much debate at the moment that discourages older people from downsizing and freeing up badly needed property. You've got taxes across the board that really don't represent the current value of that property. And we see that most acutely in council tax based on values from 30 years ago, which has not recognised in any way the huge inflation in property values that there has been in the UK.

I would start with trying to simplify these things and saying to people, look, there has been this enormous inflation in the value of property, and this is something that we need to address in a much, much cleaner and more straightforward way. We want people to buy and sell properties, but if they've benefited from this enormous increase in value, then part of that, arguably, should be subject to tax. I wouldn't exempt inheritance tax from that. I think people have got very stuck on these questions of what is owed, that somehow this idea that the British middle classes, if you like, should have a right to pass on their house to their children seems to me a peculiar one. I am aware that challenging that gave Theresa May an enormous amount of trouble in her election manifesto and it was immensely unpopular, but it is, I think, one of the anomalies in the British taxation system. I would start with property.

VC: I agree with you, but as a practical politician I've experienced how awfully difficult this is. I feel a little like a summer hiker faced with the north face of the Eiger. If one was going about it in a rational way, you'd start presumably with the structure of council tax, where the slabs are not even proportional and try to make them proportional.

BM: You're referring to the banding valuations, and if you're in this band you pay this much and so on?

VC: So, that would be the first step, and to make it less painful for a large number of people you could probably even just start by adding some new bands at the top, which I used to call a mansion tax, and which had some negative repercussions and lost a lot of

voters. I had this extraordinary experience of going around houses that can't have been worth much more than half a million, but they believed that their houses were actually worth millions and millions and that they lived in mansions and I was going to penalise them in a terribly unfair way.

BM: You've tucked all that into a parenthesis. The word mansion tax did sound threatening to a lot of people. It sounded divisive. It sounded like British class politics of the past: "Look, we're just going after the mansions and the wealthy" and lots of people saying, "No, no, that means me."

VC: I realised in retrospect this is bad psychology.

BM: Ah, I'm glad to hear it. So you think the label was bad psychology?

VC: I think the label was bad, but the basic approach was reasonable. But having done those things, and having done the revaluation, which you rightly mention, it would be horrendously difficult politically. But I think if one is really tackling property tax properly, one would have to go for a national system that is based on the value of property, which wouldn't be fair within communities. But it would mean that if you live in Burnley in a £150,000 house you pay a tiny fraction of what people would pay in London who have a similar style of housing but have much more valuable property. So, it would be regionally redistributive as well as redistributive between social groups, and then that would be a really radical step and it would be fair. I can see the political horror story but isn't that ultimately what we should be aiming for?

BM: It would give a sense of fairness, which I think is very important if people are going to accept any kind of tax change. Obviously, you get all kinds of objections to that and one would be why should London and the south-east be penalised, so to speak, for being, some people say, the wealth generators of the whole country? And, yes, it's where people want to live and the property has become expensive, but people would be suddenly taxed for being there. What do you think the result would be? Do you think people would move outside the south-east? Or do you think property prices would fall?

VC: Well, there would be an enormous amount of grumbling. I doubt it would result in mobility. It's very difficult to see people heading up to Pennine towns. Where are the jobs? So it would just hit massive political resistance, but I can see that there is a fair

programme where we start by reforming council tax, we have revaluation and then we move over to a nationally equitable system. I think if we were in a fair and rational world that's how we would be approaching the problem. But I bow to people with superior political skills to actually do it.

BM: I wonder what the effects would be. I find it fascinating. I'm not sure. I'm not rushing to endorse it all, a completely equal one across the country, but I really would be fascinated to know what the effects would be because you say you don't think there would be more mobility. But what we've seen because of coronavirus is a sudden increase in mobility, people's ability to go and live and work in other places. All right, that's being reversed at the moment as offices encourage people to come back with greater or less success, but you might well get people deciding, "OK, we're going to go and live somewhere completely different."

VC: Yes, some shorter-range mobility, sort of moving from posh London to Reading or something, but not going all the way to Lancashire and Yorkshire.

SELF-EMPLOYMENT AND CORPORATION TAX

BM: But why not? And we have seen a bit of that in coronavirus. And one of the things that I think is always interesting about tax changes, particularly when governments try and be quite radical about it and say, "Look, we're going to do what everyone's been talking about for 10 or 20 years and make a big change," is that there can be quite unexpected effects on that. I'm thinking in part of self-employment, the tax advantages of being self-employed. Some of that has encouraged people to do what, I think, the spirit of it was, which is to start up businesses and so on, but also led to the generation of lots of almost individual sole trader companies or people forming themselves that way. You can get all kinds of unexpected effects because people do notice tax and they do adjust their lives.

VC: Now, you mention the self-employed, and you've obviously thought about this in detail, what about the effect of the attempt to shift more taxes onto the self-employed with IR35? Certainly when I was in Parliament, that was a massive issue with these entrepreneurial young people wanting to work on their own rather than within a big corporation, and then being stung with an extra bit of national insurance, with many of them facing enormous retrospective penalties. Where has the pendulum got to on that? Do you think

we're at a reasonably fair point in balancing self-employment against organised employment?

BM: I think we're still seeing a desire to try and do something a bit more about the self-employment tax. It does seem to have settled down compared to some years ago.

There is an interesting question about where corporation tax is heading. Companies have been unhappy at the recent rise in the UK in corporation tax and saying this is going to have a huge discouraging effect. Critics of that position say, "Well, it all gets passed on to consumers in the end, it just washes through." But I think there is a rethinking of corporation tax going on, of trying to get the right companies, if you like, to pay. There's obviously still enormous public and governmental anger at digital companies not paying very much. And again, I wonder whether one of these old bargains between companies and the state, that they pay tax in return for some privileges like limited liability, whether that is really being reinvestigated now.

VC: The conservative side of governments on the coalition have been through a kind of epiphany. When I was in government with George Osborne, taking corporation tax down 1% a year was a heroic achievement and considered to be extremely popular with business. And then all of a sudden government decide this doesn't really matter and we'll push it right back up to where it started. Who's right, who's wrong?

I think in a sense populism in politics consists of recognising that most people see corporations as some kind of a bad thing, that they are real things that you're taxing and that somehow or other they've been dodging the column. The idea that tax is shifted, whether it's back to workers or onto shareholders, or onto consumers, is completely missing. And you get this sense of moral indignation. Why are corporations/companies not paying tax? And I think that the popular image is of fat cats sitting in their office not being taxed and shareholders sitting in the Cayman Islands and not being taxed. But, of course, corporation tax has got nothing to do with that. It is a tax on the legal entity and it's then passed somewhere else. So, there's an awful lot of mischief being made here. I'm still not sure myself.

BM: Mischief being made, but I'm not sure who by. I think it's absolutely right that that is a big part of the public image of business in Britain, but much less so in the US, for example, where there's more of a culture of starting your own business and becoming big and successful and so on.

VC: But US corporation tax until recently was much higher than here.

BM: Absolutely. But there is a suspicion of it. And the business community is feeling very aggrieved by the rises in corporation tax, by the things that Brexit has made more awkward for them and so on, feeling that they're not understood by government. And even if government doesn't feel that it has to woo them as much as it does other constituencies at the moment there is a real sense of strain in that relationship.

VC: But I do sense the government has been, in a way, quite smart. OK, they've got the public mood, we need to tax these awful people more, but at the same time they've eased the actual impact on companies through these big enhanced investment allowances, which actually are a big incentive for companies to move forward their investment plans and offset them against tax. So the actual impact on companies has been considerably modified, and in a more general sense, but also in a more economically helpful way.

LEVELLING UP

BM: But government will need to give business some real incentives if it's going to achieve the things it wants to do. I'm thinking of the UK government's levelling up agenda, where it wants to regenerate parts of the country. It's phrased it very much as parts of the country as opposed to education. It wants that kind of regeneration. It wants a lot of investment in coronavirus and treatments and vaccines and all kinds of other things. Again, thinking of the climate change transition - the painful, expensive transition it wants the country to make - and government on its own cannot do all this stuff. It needs the private sector to *think* of a lot of the ways, not just do it and pay for it. And I said the words 'private sector' pausing a bit because actually, I've never heard the words 'private sector' in the private sector - people say, "Oh, I'm in business." You only hear it in government - "them over there in that sector." And yet government's plans, the very core of its plans on these huge changes in national life that it wants to bring about, are going to depend on commercial life.

VC: Yes, but how do you have a tax system to promote the levelling up agenda? And how do you get business to do what we want business to do? Set up factories in Hull and the poorer bits of Tyneside where otherwise they wouldn't have done it. The approach they've adopted, I think, is on one hand quite helpful. I think giving big investment allowances is a good and

constructive way of doing it. But these freeports, which are simply switching the tax burden from one side of the road to the other, I don't think the record of that is terribly good. And my big beef about it is that if you're really levelling up the country, it starts with people and skills. And we've got this ridiculous apprenticeship levy, which, instead of doing what a good apprenticeship levy does, that is to tax the non-training companies and subsidise the ones that do train through the tax system, effectively taxes everybody just to pay for training whether they train or not. It's a terribly inefficient way of encouraging skills development and levelling up. So, I think the starting point of the discussion is that we do want to support private enterprise in the depressed parts of the country, but we haven't yet got a package of skill and investment incentives that actually makes a great deal of sense.

BM: You've worked on this for a great deal of your career. What do you say to the argument that not every part of the country can be levelled up, and some places are just not going to find that the jobs come back? Or maybe they never had the jobs and perhaps you can make them nicer places in which to live and from which to commute to places that do have the jobs, but you just can't do it for the whole, you can't get jobs in every part of the country.

VC: Yes, I think there's a lot of sense in that. I lived in Scotland for some years and was active in Scottish politics and this idea that we've got to set up a car plant here because it's a depressed bit of the west of Scotland and because of subsidies didn't make any kind of sense. And I think at the moment we're getting very excited about the unfairness of the fact that Manchester is succeeding and Oldham isn't, and how do we level that out? Well, no, you can't. The fact that Manchester's flourishing and generating all kinds of new activities and digital companies and so on is great. And the objective, as you imply, is getting Oldham to be a more pleasant place for people to live in. And that may be environmental rather than economic incentives. But, no, I think if we're getting good growth centres in Leeds, in Manchester, in Newcastle, that surely is the bedrock of regional rebalancing.

BM: What would you say, as a politician, to Oldham? For example, "Look, we're not aiming for you to be as shiny and buzzy as Manchester, we're just aiming to make the quality of life a bit better and here's your train to somewhere else?"

VC: Well, the one thing we should be giving them is good communications so that they can get a bus into

the centre of the big metropolitan area, so that they've got a train link and a pleasant place to live. If companies also choose to settle there and create more employment, that's great. But I think one of the things we've learnt over the whole post-war period is that pushing businesses into areas that they don't particularly want to go is just an absolute non-starter.

BM: It's very hard to do that. Northern Ireland has shown that. And I'm thinking as well of East Germany, perhaps the world's biggest experiment in levelling up if you like, where there has been some success, particularly around certain cities, but very hard, even with the money and commitment that the German government has put into it, to do a lot about the rural hinterland of the former East Germany,

VC: Where we have had levelling up in very depressed areas it's come through unpredictable channels. We've discovered that Dundee, which was a depressed city in Scotland, re-emerged through games. Nobody could have predicted that this was going to be the centre of the games industry, that Hull, with prompting from government, has got into renewable manufacturing.

BM: There are successes there and Belfast in Northern Ireland with television production and all kind of things, but it can be hard.

NUDGE BEHAVIOUR AND CLIMATE CHANGE

VC: There is an interesting debate around this theme about whether government can fundamentally change the way we behave and stop us doing bad things and encourage us to do good things. Of course, there's this traditional view that governments shouldn't be paternalistic and nanny state. But we've got one or two very good examples. I think probably the best is leaded petrol, where the small tweak in the petrol duty system helped to produce a big switch to unleaded petrol. Another one could be the small tax on plastic bags. But I worry that we're probably leaning too heavily on this because really big changes, introducing the Fuel Tax Escalator to try and get people off the roads didn't. It wasn't just that it didn't work, it actually produced a major backlash against the whole idea and we've gone backwards in trying to get a better balance between road and rail through the tax system. So I just wonder what you think are the limits to behavioural taxation, which have become very fashionable.

BM: I think you put it very well. I wish the plastic bag tax weren't the great shining example. It's a very successful

one but then there are remarkably few examples of behavioural nudges like that after that. Not none. And government, I think, has got much better at working out how to do this without people rising up. But the trouble is if you do something, say if you raise the price of fuel a bit, quite frequently, people's first response tends to be to use that thing a bit less. You really have to do quite a lot to get them to change completely, not just drive a bit less this month and hope the petrol price comes down, but actually choose a different kind of car or go for a heat pump instead of a gas boiler, or solar panels or whatever. You've really got to put together quite a hefty package of incentives and obligations or directions to get that kind of shift and you can get the kind of backlash that you've just described on fuel duty.

So, I think it's difficult. People don't like being told to make big changes and they're afraid of them. And they're afraid of the cost of them, which is completely rational. I guess the words 'nanny state', though, are more about the ones that have a hefty moral component, whether it is smoking or some of the health ones, but I think public opinion has changed on a lot of these. It really has changed on smoking. It's changed on drink driving. It's changed on all kinds of things. And a tax on its own doesn't seem to me to bring about that change. But if you had a tax that coincides with a shift in public opinion, as there has been on a lot of these behavioural things, then suddenly you've got something very powerful. But I guess the point is to pick your moment, as someone devising taxes, to make sure that you're going with the grain of what people actually want, and think is good.

And we may be at that kind of moment on environmental things. I think one of the big questions that came out of the climate change summit is whether there is now such a deep acceptance of the problems of climate change caused by human actions and the problems that are going to flow from this? And that people are willing in a way that they weren't to make these changes, in which case environmental taxes even on things like fuel, which affect loads of people and pretty well every business, those things may come into their own, whereas in the past they were just intolerable. So I think that's one real thing to watch for.

VC: The example you used that was, I thought, telling was cigarette taxation, which I think we would regard as probably the most regressive of all taxes, but enjoys widespread support because of the link with lung cancer. And it's been persistent over a long period of time, and nobody goes around campaigning for lower cigarette taxation. So, I guess the question is whether carbon has got to the stage of public dissatisfaction that governments can do brave things. I think we're

currently operating on the assumption that carbon tax is just too difficult, precisely because it affects the motorist and the domestic use of fuel and hits older people in winter and this kind of thing.

BM: And it affects fuel and loads of our energy generation and all kinds of things. My sense is we're not there for a carbon tax on any level big enough to change behaviour. The kind of very low carbon taxes that you've seen countries try have generally been too low to be really significant in that. But, 10 years from now, when some of those changes have been made in the economy so that it doesn't hit everyone at once, it might be easier to get there. And in the meantime, individual, more targeted environmental taxes may themselves get more support

VC: In the coalition years, we did have something called the Carbon Price Floor, which was a kind of hidden carbon tax. And then we had its incidence on energy intensive industries, which then produced a backlash, another example of which we've seen recently. So even something quite subtle and indirect ran into difficulty, which has left us with a view that economists would find very unsatisfactory, which is that actually regulation probably works better than the price mechanism and carbon taxation, which is why the government's talking about actually banning the sale of future petrol engines and diesel engines and gas boilers. There will be a terminal date at which these things will no longer be sold. And I think that we've got to a kind of consensus, regrettably, for economic logic that the price mechanism just doesn't work in these areas and you need tougher enforcement action.

BM: I think that's right, regulation has a huge part. But I was thinking as you were talking about the Ultra Low Emission Zone in London, really quite a hefty tax, a daily tax on having a car of a certain polluting standard, if I can put it that way, within now quite a large block of central London, and that it seems to me has produced quite a lot of effect. We're going to see over the coming year how much effect it's had at getting to people to change their vehicles, so maybe I'm adding to my list of examples that have worked.

VC: Well, I think the ultra-low emission vehicle point is a good one because it's about ownership, isn't it? It's not about use. I'm going back to the Mirrlees reports, the sort of bible for tax reformers, that the ultimate objective of a rational transport tax system is that you don't tax the vehicles, you tax road use through road user pricing. But experiments in road user pricing have been, apart from rather crude things like the London

Congestion Charge have actually been desperately unpopular. The M6 alternative motorway was not considered a great success and there is no appetite to do road user pricing. It just isn't going to happen. So, it's these indirect incentives through the tax system and the regulatory system that seem to work best.

TAXING BIG TECH GLOBALLY

VC: While we're discussing carbon tax, there is this wider question about how far taxation should be thought of in an international sense rather than in narrow national terms, given that we have a high level of globalisation anyway and it's continuing despite a few protectionist restrictions. So how far is tax a global issue? And we've had this big advance recently over the acceptance, through the OECD countries at least and some others, of minimum levels of tax, 15% corporation tax, the idea of digital services taxation so that we can tax digital companies where the sales take place rather than necessarily where the company is headquartered. And these are, in principle, quite big advances. Do you see this as a big breakthrough in terms of international co-operation on tax? And would we take it further in other areas?

BM: I think it's a big breakthrough on the taxing of tech companies. And I think that's really what's driven a lot of anger and a lot of governmental frustration at trying to get these companies to pay tax. And this has been building up for, I can't say a long time because these companies haven't all been in existence for a long time, but it's been building up for more than a decade. They operate so internationally it's been very easy for them to sidestep individual countries' attempts to get them to pay tax and say, "No, no, we're not based there or our profits aren't there or whatever." And public and governmental anger at this, I think, has driven this move to try and do something in a co-ordinated way. David Cameron made a lot of attempts through the G20 and I think got the ball rolling on this. But I think it is the digital companies' behaviour that has really given some heft to it, as opposed to just your more traditional, big international company.

I don't know how much further it will go, though. I think we have to see whether countries really manage to extract these taxes and the next few years will show how that's playing out. I'm not sure how much of a drive there is to raise that floor. Either you've got countries - Ireland was one very loud in there - saying, "Look, one of our points of competitive advantage and one of our ways of getting companies to come and locate here is that we favour and can work our country very well, work

our finances well, with a very low corporation tax rate," and that's the way we think it should be. So, I don't think it's going to rise and rise and rise. It is, I think, primarily a device for trying to get the tech companies to pay more tax. And if that succeeds it may stop there. And if it fails in that respect, I think there may be more things targeted at that sector, which is a sector of gigantic companies. But maybe you think I'm just too focused on tech...

VC: No, I think you're right. And so it's, a) important and b) it's positive, but I think we probably shouldn't be raising expectations too far. George Osborne introduced a Google tax and we discovered it didn't raise any revenue. And I suspect that these smart companies with very large teams of accountants will find ways of mitigating the effects. And the minimum corporation tax ratio, of course, is a separate issue, it's only 15%. We're now up to almost 25%. So, we don't gain any benefit from it in the UK. The tax havens will continue to exist. And since corporation tax, as we discussed earlier, is ultimately passed on to somebody else and the shareholders will still be able to take advantage of all kinds of loopholes in income tax and capital gains tax - it's not at all clear to me, however welcome this change, if it is going to radically improve our sense of fairness.

BM: Then I think something else might be devised. Companies with good accountants will always find the way of paying, I won't say always, but often find a way of paying the minimum tax. And many would argue they owe it to their shareholders to do that, to follow the rules but then to make the best of those rules. I think the test of this is going to be whether it produces a step change in what the tech companies are paying. And to me what may drive this and give more success than you're sketching out is that I think public opinion is really turning against the tech companies in some important ways.

People, yes, would absolutely acknowledge that the tech companies owned the lockdown if you like. People couldn't have had the kind of contact with their families or with the health services or with their companies, their employers, if they hadn't been able to use Zoom, and and didn't watch Netflix, and so on. And phones with all these apps have changed people's lives profoundly in many, many good ways. But people are very aware of their dependency on them, they're getting more and more aware of how their data is used on them, they're getting more aware of the harm done to them and, indeed, done to democratic systems. Facebook is coming under immense pressure, political and popular pressure, because of that. And when you've got that

kind of wind behind a change of direction, then you've got much more chance for it to succeed, I think.

So a simple change, an agreement by governments at a high level that they're going to have a new tax, I agree with you, has not an awful lot of chance of success. But backed up in many, many countries with people saying, "I'm coming off Facebook," you've suddenly got a change in mood that is very hard for those companies to control and it gives a lot of heft, I think, to what governments are trying to do. So, we'll see. But I think something is changing.

VC: I'd like to think that's true. A lot of the things have been done in other areas, like the European Commission cracking down hard on competition abuses and the Biden administration doing the same with competition policy in America, that's part of that public mood. But I'm not sure that the very modest levels of taxation – was it 2%? – on digital transactions really deals with some of the underlying problems that if you're a bricks-and-mortar store in a high street you're paying quite high levels of commercial rates, unless you're exempted for some reason, whereas these guys are paying a relatively small levy on their digital transactions. And actually, we probably need something else like taxation on sales to level the playing field in a really meaningful way.

GLOBAL CARBON TAX

VC: Well, I think we both agree that in an ideal world trying to tackle global warming does require action and the use of carbon taxation along with regulation is clearly important. Then the question is, how do we do this in a consistent way across borders so that businesses are taxed in one country and not in another and that sense of unfairness? I would love to believe we could get a global carbon tax, and there are some fine people out there arguing in very idealistic terms, but I don't see it somehow.

But the concept I think is right. The problem we're going to have in practical terms is that if the European Union, for example, were to introduce a carbon tax, as it's planning to do, what does it then do about products coming in from countries that don't apply one? China is talking about a cap on trade, a kind of carbon tax system. They'd probably be exempted. But the Americans don't have such a system. So, would their goods then be taxed at the border? Or India, which doesn't have a system? So, we're potentially getting into an absolute minefield of cross-border tax adjustments, which will easily be portrayed as tariffs and protectionism. So, there's a grand ideal and a lot of very

murky, messy problems that would have to be dealt with in the wake of it.

BM: I agree with you. I think a global carbon tax is an economist's dream. But the practical obstacles to it are so enormous. I'd be astonished if we look back in even 20 years and say that that has been a big part of the world's attempts to deal with climate change.

CHANCELLOR FOR THE DAY AND IS THE CONVERSATION ON TAX CHANGING?

BM: If I were Chancellor for one day, sitting in Number 11, I'd start with changing property taxes. I'd start with the revaluing of local council tax bands. And I would change Stamp Duty to make it easier for people to move around. These would be unpopular, so I might only be Chancellor for one day, but it'd be good day.

VC: Well, I would want some assurance that the changes I brought in today are not going to be reversed tomorrow or next week or next year – you'd have to be giving me the power to make permanent changes. And if I had that power, I would actually go down exactly the same road that you're going anyway, which I think is absolutely right. I think this is the biggest anomaly in our tax system, it's desperately unfair between generations, between parts of the country. So, a system of council tax banding reform, revaluation, maybe a national form of property taxation that is consistent from one part of the country to another. That would be my ideal if you gave me the time and the power to do that.

BM: I don't think the conversation on tax and spend has fundamentally changed in recent years. I think you got a lot of resistance after the 2008 financial crisis with people wondering why should they have to pay for these mistakes by their governments, though there was some support for austerity feeling, "OK, we've got to do something about the public finances." Coronavirus has brought more willingness to pay tax, I think, a little bit to pay for public services, but I don't think we've got fundamentally a different conversation about tax and spending. People want considerable public spending and up to a point are prepared to pay tax for it. But I'm not sure that that has radically changed in the last decade and a half.

VC: I agree with that with some qualification. The conversation on tax is always the same. In a sense, we all want to pay less tax and have more spending on things that benefit us. So, we're all a bit selfish about tax

and the conversation is a bit selfish, but the economic context has certainly changed. I was in government in the aftermath of the financial crisis and the basic problem was we couldn't use fiscal policy in the way that it's often used to steer the economy. Banks were not lending to business, so you didn't have the kind of multiplication of income that you get through fiscal policy, and so we were concentrating on getting down this extraordinarily high deficit. So the macroeconomic framework was rather different. But now that at least that aspect of behaviour has returned to some sort of normality, we are back to this question about - how do we get a tax system that is fair. And of course different people have different concepts of fairness. How do we raise more revenue, particularly when there are inexorable demands to spend more money on health in particular and public services in general?