

Institute for
Fiscal Studies

Tax By Design: The Mirrlees Review

Paul Johnson, IFS

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The review

- Built on a large body of economic theory and evidence
- Inspired by the Meade Review
- Aimed to:
 - Identify features of good tax system for open developed economies
 - Assess the extent to which the UK system conforms
 - Propose reforms
- Two volumes
 - *Dimensions of tax design*
 - *Tax by design*
- A distinguished set of authors:
 - Sir James Mirrlees, Stuart Adam (IFS), Tim Besley (LSE), Steve Bond (Oxford), Richard Blundell (IFS and UCL), Robert Chote (IFS), Malcolm Gammie QC, Gareth Myles (IFS and Exeter), Jim Poterba (MIT and NBER)

Assessing tax policy

- Baseline is a progressive neutral system which:
- Works as a system
- Doesn't discriminate between similar activities
 - Except under very limited conditions
 - Balances economic and practical considerations
- Achieves progressivity as efficiently as possible

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 - A mass of different tax rates on carbon
 - Failure to price congestion properly
- Does not achieve progressivity efficiently
 - VAT zero rating a poor way to redistribute
 - Taxes and benefits damage work incentives more than necessary

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- Whilst proposing sensible deviations from neutrality
 - Imposing a consistent tax on GHG emissions and on congestion
 - Imposing zero rate of VAT on childcare

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- Achieve progressivity through the direct tax and benefit system
 - Recognising constraints imposed by responses to incentives
 - Taking account of lifetime welfare

Today

- Richard will run through our analysis and proposals on earnings taxation
- Jim will look at capital and corporate taxes
- I'll pick up some other bits and pieces, specifically
 - Indirect taxes and assessments of equity
 - Environmental taxes
 - Property taxation

We arrive at two guidelines for indirect taxation

1. Tax final consumption only

- VAT generally achieves this
- Transaction taxes, business property taxes and VAT exemptions do not

2. Tax goods at the same rate

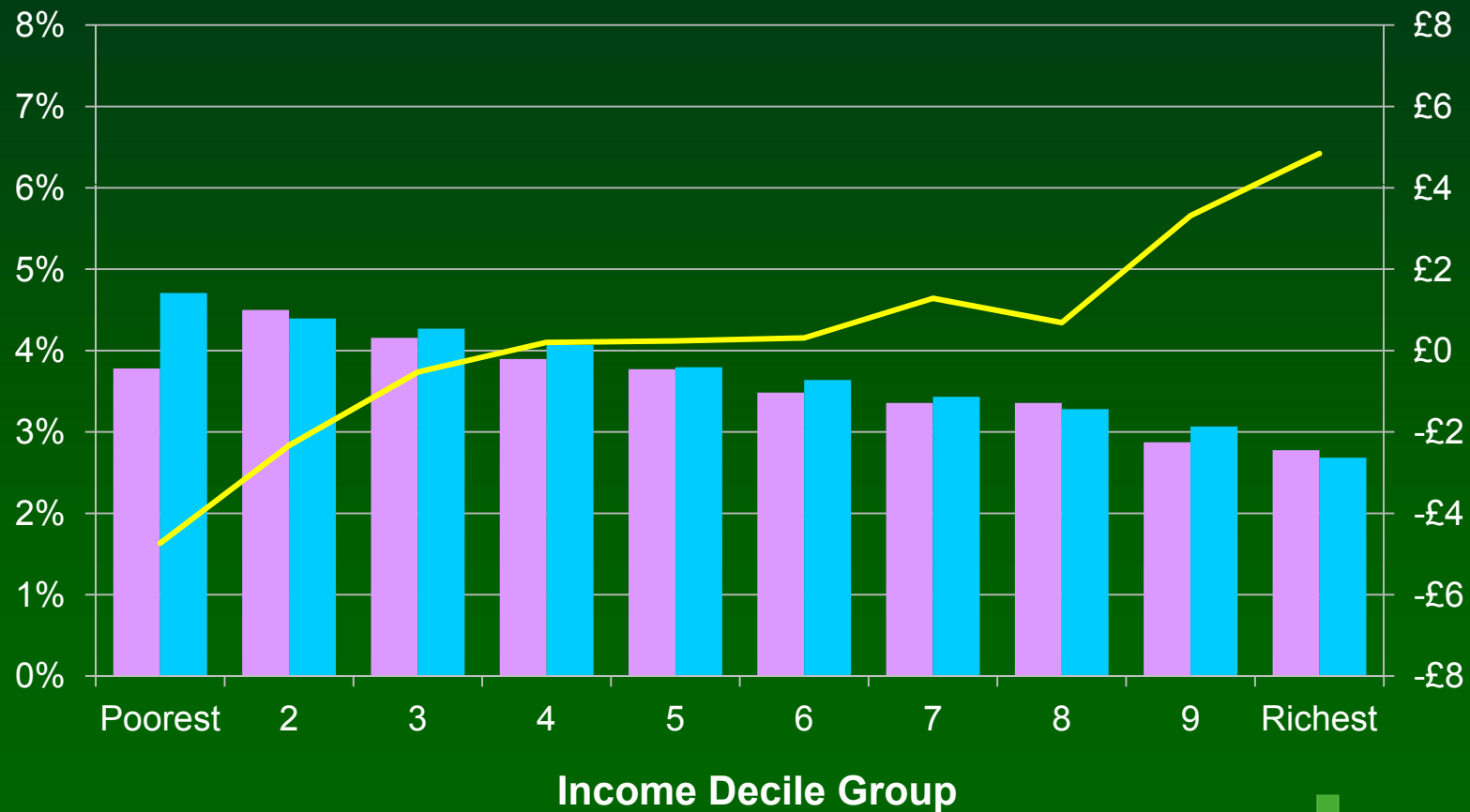
- Complexity creates strong presumption against differentiation
- There are sound economic efficiency arguments for differentiation
- But case sufficiently strong in only a few cases
 - Alcohol, tobacco, environmentally damaging products
 - Childcare
- Distributional arguments for differentiation are weaker

Evaluating VAT in the UK

- UK zero-rates most food, water, books, children's clothes, ...
 - Clearly for distributional, not efficiency, reasons → should be ended
 - Other countries show that it is not inevitable
- Reduced rate on domestic fuel looks particularly bad given environmental concerns
- Exemptions violate *both* of our principles
- We look at imposing a single rate on almost all consumption
 - Most work suggests this can be done with compensation on average for poorer groups
 - *But taking account of work incentive effects is important.*
- And equity is not a straightforward concept

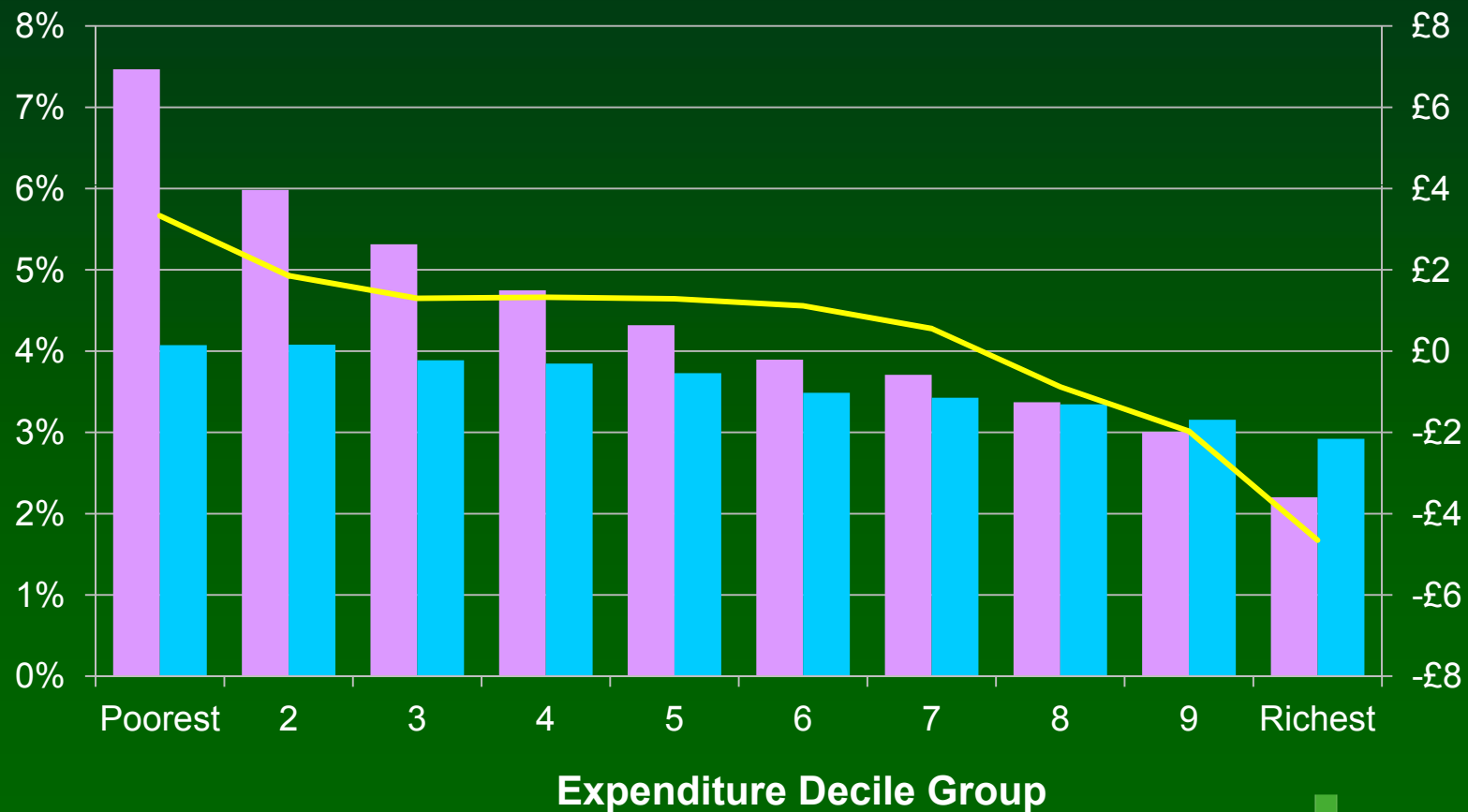
VAT reform: effects by income

■ % rise in non-housing expenditure ■ % rise in income
— cash gain/loss (£/week, RH axis)



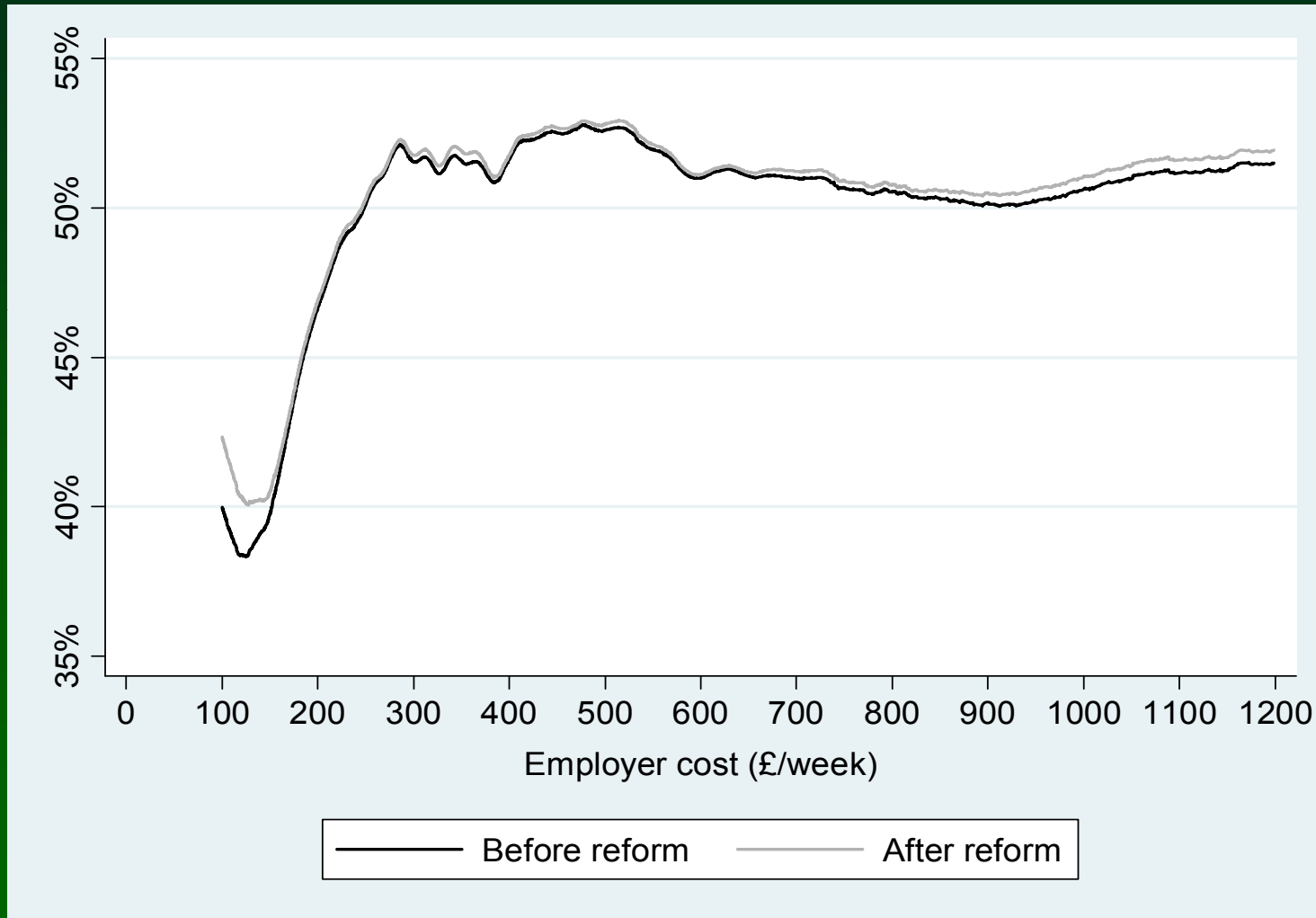
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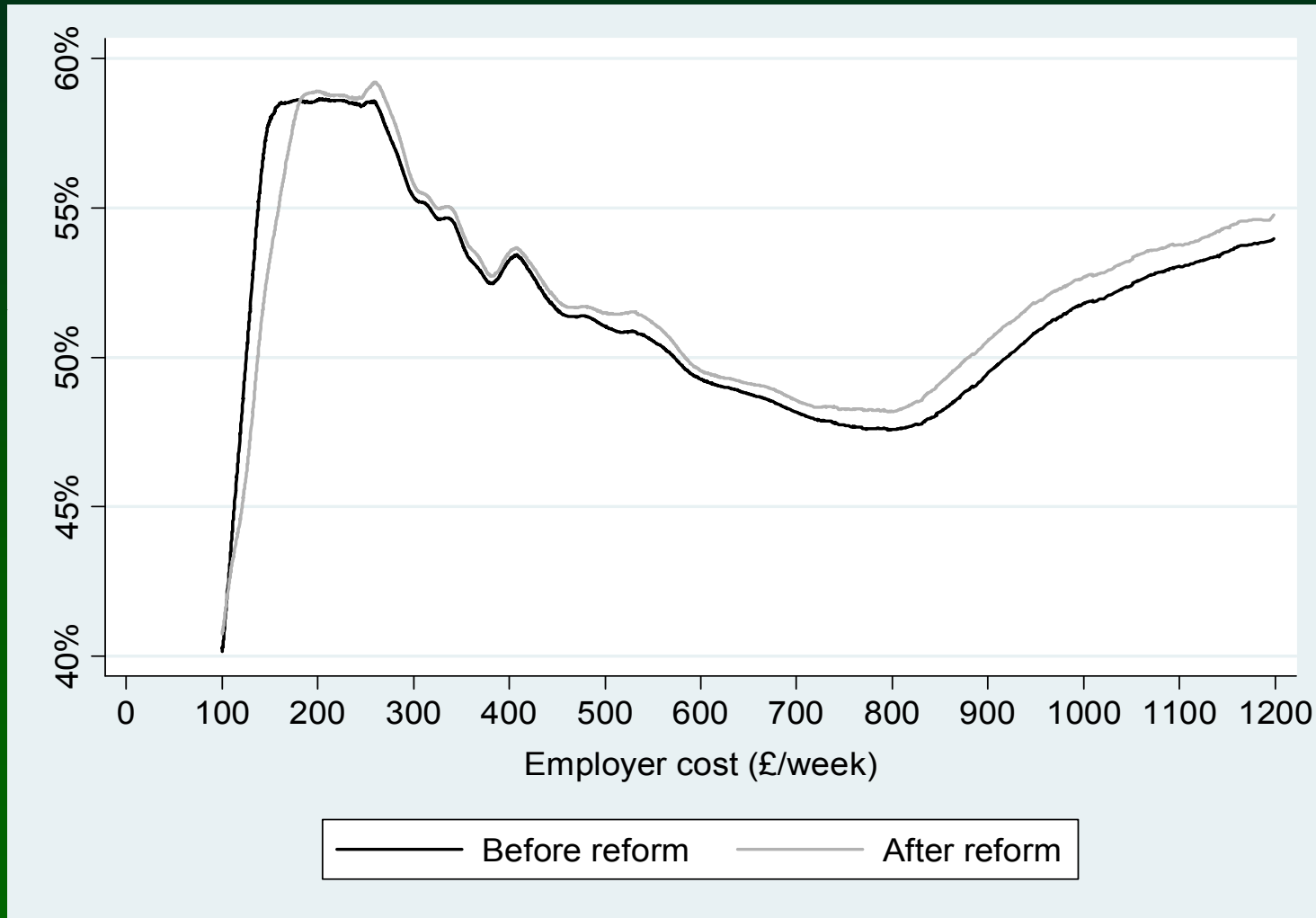
VAT reform: incentive to work at all

Participation tax rates



VAT reform: incentive to increase earnings

Effective marginal tax rates



Taxation of land and property

- Conceptually, must distinguish:
 - Business land
 - Business property
 - Domestic land
 - Domestic property
- And the fact that housing represents both an asset and a consumption good

William Vickrey:

The property tax is, economically speaking, a combination of one of the worst taxes – the part that is assessed on real estate improvements...and one of the best taxes – the tax on land or site value

Land and property taxation: a summary

Current, ideal and proposed treatments

	Business	
Buildings	Business rates Don't tax No tax	
Land	Business rates Tax arbitrarily high Land value tax	

Land and property taxation: a summary

Current, ideal and proposed treatments

	Business	Domestic
Buildings	Business rates Don't tax No tax	Council tax Tax like other consumption Housing services tax
Land	Business rates Tax arbitrarily high Land value tax	Council tax Tax arbitrarily high Housing services tax

Greenhouse gases and road transport

- For GHG emissions a consistent price is the key – from taxes or trading
 - EU ETS is context for UK policy
- We are a long, long way from this ideal

Implicit carbon taxes in the UK, 2009-10

Excluding VAT subsidy of domestic energy



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 - EU ETS is context for UK policy
- We are a long, long way from this ideal
- High taxes on driving in the UK are probably close on average to the externalities created
 - But very poorly targeted on much the biggest externality: congestion
- Road fuel taxes are important to the exchequer and to taxing the externality
 - Also unpopular, declining, and disappear if GHG targets are to be met
- Big benefits to national road pricing