Likely response to Covid-19 if Asset Based Taxation proposals were adopted

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I have been arguing that the correct response to a pandemic is to invoke a hibernate-and-circulate strategy. "Hibernation" requires the closure of nonessential business and services where there is a risk of spreading the infection. "Circulation" entails replacing the resultant missing revenue by taxing those from whom this revenue used to emanate when paying for goods and services no longer available. Hibernation must last as long as is medically necessary and the circulation element must be sustainable through this period.

This strategy should be adopted irrespective of the taxation system in operation and should be moulded to the latter's form. Hence, although the Asset Based Taxation proposals have no place for taxes on income and profit, these are precisely the taxes I would use to raise circulation taxes: not because they are right but because they are there.

This paper explores how a hibernate-and-circulate strategy might work with the Asset Based Taxation proposals in operation ("under ABT", from now on). Increasing taxes on spending does not make a great deal of sense in a hibernation scenario. Transactional economic activity is reduced, for one, so funding handouts from this spending is made more difficult. Also, increasing prices is liable to push down spending, meaning that the tax take may not necessarily increase in line with the rate, and may even fall. Finally, with much nonessential produce being unavailable, the burden of taxation starts to fall on essential goods, which is not what we want.

Under ABT there would be neither income tax nor corporation tax, so the burden would fall mostly on the asset base. I will look to explore how this might work and compare the likely outcomes when compared to hiking up the rates of income and corporation taxes.

Personal Provident Funds and Business Provident Funds

A key part of the ABT proposals was the introduction of Personal Provident Funds (PPF) and Business Provident Funds (BPF). Inspired by the Central Provident Fund Scheme in Singapore (CPF), these funds are a form of monetary asset belonging to an individual (PPF) or business (BPF) which can be drawn on for limited purposes, one of which being the payment of tax, another for the provision of income in times of need.

The Seven Roads document http://abtax.org/wp-content/uploads/2015/06/Asset-Based-Taxation-20150629.pdf does not elaborate much on the way the fund would be structured, so it's worth getting some ideas together here for how these might work.

PPF and BPF sections

In Singapore, residents' CPF balances are split into different sections, some set aside for pension, some for medical costs and some for a broader range of purposes such as housing and education.

There is considerable merit in this structuring, and something of the same approach could be used in respect of what I would call the ordinary balance in a PPF fund. However, the PPF fund is designed to allow for balances to be overdrawn and I would propose that the overdraft facility is also sectioned into two categories: misfortune and misadventure.

A "misfortune" overdraft ("O1") could be set up to pay benefits in cases of sickness, injury or unemployment or to cover unexpected care costs. It might also be incurred to cover costs of a failed legal action which it was agreed in advance was reasonably contested. The expectation is that the "loan" is never repaid, but the precise detail of the policy will be set by the government in power. In this way, O1 overdrafts would effectively replace grants and benefits. Nevertheless, the government would be empowered to recover some of the loan upon death, if it so chose, perhaps where the value of the person's estate or that of the beneficiary was particularly large[1].

A "misadventure" overdraft ("O2") is run up whenever an individual is responsible for damage, has otherwise unpayable liabilities or has pursued and lost legal action deemed inadvisable. It could be used to pay the medical costs of injuries incurred in dangerous sports or from poor lifestyle choices. It could even be used to pay the costs of an individual to the criminal justice system, including prison costs. Where there has been a failure to insure or to set aside adequately, this overdraft facility acts as a safety net for the individual but it is not, in principle, a handout.

The expectation is that an attempt is made to repay an O2 loan over time, maybe taken from the person's estate at death and, in certain circumstances, the debt may be passed on to relatives. Again, the precise details of the policy would be determined by the government in power.

Each overdraft request will initially be given a default grading of O1 or O2, but these would be regularly reviewed. It is not necessary that a person lack funds in their ordinary balances to be granted either type of overdraft. Indeed, there would be an expectation that every citizen made and maintained appropriate contributions to their PPFs to cover their tax bills and to make provision for retirements and some set-aside for misfortune.

BPF sections would operate along similar lines, with O1 and O2 overdraft sections.

Circulation strategy and the use of PPF and BPF funds

The first thing to note is that the funds are designed as instruments to be drawn on in times of need, so it is entirely reasonable that the set-aside for misfortune is used to maintain regular incomes at time of lockdown. The call on these funds would also be subject to limits, otherwise there is a danger of penalising the prudence of those who had set aside ample provisions. Beyond that, the government is able to fund shortfalls through the award of PPF and/or BPF overdrafts.

A government is likely to provide support through O1 overdrafts under ABT in the event of a pandemic. It could conceivably take the view that the burden should be largely met through pandemic insurance, in which case individuals or businesses would be expected to have covered

[1] Note that there is no inheritance tax under ABT, so they may be some support across the political spectrum for it being refashioned as a loan repayment borne by the broadest shoulders

themselves accordingly and a failure to do so may result in any subsequent overdraft request being categorised as O2. Nevertheless, for the insurance industry to support the whole world in the time of a Covid-like pandemic insurance companies will probably require some government support if they are to survive and this is likely to take the form of an O1 overdraft.

The question is then whether the aid is provided through PPFs or BPFs. Either could be used, but I would argue that a hibernate-and-circulate strategy is about changing the environment for business primarily and therefore the main instruments used should be BPFs. A company should meet its all its obligations through its BPF (including maintaining full salary commitments) and where that proves insufficient then it should be able to draw a BPF overdraft to do this. This way no business should need to close or make redundancies as a result of the pandemic.

Those self-employed or without work would have access to PPF overdrafts, however, thus ensuring that nobody fell through the cracks.

Paying for the funding of a pandemic response

The provident funds are essentially a set of contracts between the government on the one hand and its citizens and resident businesses on the other wherein the government borrows money and pays interest on that borrowing. If the government provides overdrafts, then essentially the arrangement is reversed.

Governments can decide the extent to which they choose to ring-fence money placed in funds, but I am assuming that they will operate a policy whereby a reserve is maintained sufficient to meet expected drawdowns and the rest is either invested or used to fund infrastructure projects.

A government responding to a pandemic by providing overdrafts is thus lending back money it has already borrowed. Nevertheless, it will be understood that the government's liabilities in respect of the aggregate funds will not be significantly reduced by the amount it lends back. This is because any credit it could take for its loan book to the fund would be extremely limited: "O1" loans will mostly be written off, as will a large percentage of O2 loans.

The pressure on aggregate fund reserves will be increased during a pandemic as there will be a marked increase in the amounts drawn down. It is likely, therefore, that an injection will be required to top up the reserves.

This top-up could be met through bond issue, but I have argued that if a circulation strategy is adopted the aim would be to finance the bulk of this requirement from taxation.

Of the four "CHAD" levers (see the Seven Roads document), the first two are taxes on spending (Consumption and Health Risks) and thus not such a suitable source for funds at this time. Whilst the Degradation lever can be varied as a matter of policy, its purpose is to preserve assets and varying rates to raise revenue is likely to deflect from that aim. That leaves us, then, with Asset taxation.

Since Asset taxes are drawn from the funds, the net effect is one of peer-to-peer financing of the injection principally between those holding assets outside the funds to those who are not able to work.

Looked at this way, it is clear that this is effectively a circulation strategy. Money is raised from wealth that has not been set aside for future subsistence. It will be recycled to fund the current subsistence of those no longer able to fund themselves and towards the maintenance of the state's activities. Still, much of it will return from whence it came simply because many assets directly or indirectly generate income[2].

Tax-payer impact

The raising of tax on assets might potentially lead to the following:

1. A sell-off of assets to fund increased tax demands and/or reduce liabilities. This might cause asset values to fall.
2. Inability of some to pay tax liabilities on subsistence assets such as one's own home

Asset value reduction will also reduce tax-take, so there is a potentially dangerous spiral if this in turn necessitates the further raising of asset tax rates. However, because the circulation strategy rate-hike is conceived of as temporary, the likelihood is that asset prices will move in the opposite direction when the policy ends. This should ensure that demand for assets is maintained and thus mitigate against any potential free-fall.

The government can limit the personal impact of its tax measures through the granting of O2 overdrafts to pay the additional tax liabilities. This effectively defers the payment of the tax until a family is in a better position to schedule the repayment of the resulting overdraft[3].

Of course, the granting of O2 overdrafts to meet tax demands is, in effect, the same as a deferral of that tax demand (plus interest). This should not, however, create any additional pressure for a further injection per se which will be largely dictated by short-term draw-down demands. Over time, these particular O2 loans are likely to be repaid, thus ensuring that overall the tax take is not diminished.

Comparison

The circulation strategy I promoted in today's tax system looks principally to use income and corporation tax to raise the revenue to fund hibernation costs. Whilst it is true that in aggregate the

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[2] A simple example would be rental income. The tenant paying the landlord is a subsistence payment, but the measures have protected the landlord's rental income at the same time. As an asset-owner, the landlord will be paying extra tax, but this is not dissimilar from paying additional insurance premium to cover an increased risk of default.

[3] The intention here is to avoid having to throw people out of their homes as they near the end of their lives. If they live alone, the debt can be paid upon death; if they live with family then the government is better positioned to arrange a longer-term repayment plan.

revenue streams of hibernated businesses largely came from disposable income of UK residents and businesses, it does not follow that all residents and businesses can afford to pay them without experiencing hardship (because some have more disposable income than others). The strategy would certainly help the burden falling disproportionately on the unfortunate (i.e as prevails in countries providing inadequate or no government support), but the tax rates would most likely have to be set conservatively to make them manageable by a sufficient number.

This means that the rest would have to be funded from borrowing, and whilst the levels of borrowing would be much lower than are currently being taken on, the solution falls short of being self-financing. It would most likely see us through the current pandemic, however, without having a major impact on the levels of government debt.

Under ABT there are, however, a number of advantages:

- The solution utilises existing provisions that have been set aside for funding misfortune, albeit these provisions were not expected to shoulder burdens of this scale.
- The burden of taxation is spread in proportion to wealth rather than falling on just those who are the principal income-earners at the time.
- Mechanisms exist (the Funds) to ensure that any tax-hike can be afforded, thus enabling higher temporary asset tax rates to be applied.

Overdraft write-offs

The writing off of overdrafts becomes a regulation activity under ABT. Ordinarily, as an expense, a write-off needs to be matched with additional revenue in order to balance the books. Options for doing this include:

- Raising more tax
- Traditional borrowing
- Selling parts of the fund capital that has been set aside (convert it into borrowing)

Another more interesting option is to use the write-off as an alternative form of quantitative easing (QE). To do this, the debt would not be written off but sold to the central bank in exchange for new money. Instead of owning an IOU from the government in the form of a bond, the central bank would own IOUs from the public and resident businesses. These could then be bought back by the government at a later date if it needed to reduce the stock of money (most likely by socialising the debts using taxation, though it could theoretically still call on the debt from the people/businesses - or beneficiaries of the same - who owed it).

Aggregate fund size

At the end of March 2020, Singapore's Central Provident Fund pot stood at SGD 435.4bn [approximately GBP 241.6bn] (Singapore Government, 2020). Based on comparative population size, if the UK operated a similar scheme the pot would be nearer GBP 2,900bn. It is difficult to accurately project from this to anticipate the size of the aggregate funds under ABT, but there are few reasons for thinking it would be any smaller.

The anticipated costs of UK Government Coronavirus support for this year is likely to exceed GBP 300bn according to the Office of Budget Responsibility (King, 2020), so less than 12% of this projected aggregate fund figure. For reasons discussed earlier, this does not mean that the government could use funds of this nature to entirely finance a pandemic response, but it does give some indication of the size of the necessary economic adjustments and offers a bit more perspective on the relative scale of the problem.

Conclusion

The operating premiss behind the hibernate-and-circulate strategy is that if an economy is correctly structured then the outcome of forcing businesses to close is the temporary loss of the goods and services these businesses provide. It is simply not sensible to allow the business-as-usual penalties of insolvency and financial hardship - ordinarily there to ensure businesses and individuals operate within acceptable parameters - to apply the same way when the rules have changed. The virus has caused none of these things; the paucity in imagination of the policy response has.

Current UK policy is to pursue a return to normality as soon as it is safe, though the concept of “safe” has been pressured in the direction of “less-safe” the longer the lockdown has been in force. What’s missing is any capacity to pursue a support strategy over a longer term. The government may well get away with this because opposition politicians have no programme that’s significantly different and the public at large have bought the narrative of their being a lack of alternatives.

Recognition of the credibility of a hibernate-and-circulate strategy would be a game-changer. Not only would it give us an alternative strategy today, but it could become the model for dealing with pandemics in the future. More importantly, it would show us how we could survive in a world of reduced economic activity, essential if we are to have any chance of ordered management of the climate crisis.

A circulation strategy based around the existing taxation system would get us through this pandemic with fewer casualties both physically and economically. This strategy would, however, work better under ABT with the benefits that the provident funds bring.

In the medium term, the global workforce needs redeploying and we need a framework to enable that transition that is not so centred on consumption and market forces.

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