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Hypothecation:

Beyond the 'factory model' of taxation (Part One)

Danny Dorling

There is an argument that we should oppose hypothecation on the grounds that it is misleading, reducing the economy to a 'factory model' of inputs and outputs.

The hypothecation of taxation implies that politics works like a~~n~~ factory making many products. This *factory model of taxation* implies that you get out of the economy what you put in. Taking the example of a cereal factory, if you Increase the inputs of oats and wheat and sugar-and ramp up the amount of cardboard you buy, more packages of cereal will come out of the other end of the production line. In essence, you give the public power over the inputs and they will get more of what they want.

The factory model of taxation is misleading in a similar way to how misleading it is to think that the economics of a whole economy is similar to the economics of a household. That household - or 'handbag' - model of economics[1] suggests that if you are frugal, and spend less, you will prosper.

[1] Most closely associated with Mrs Thatcher, the first person to call herself a "handbag economist'. 'James, A. (2015) Orwell's Faded Lion: The Moral Atmosphere of Britain 1945-2015, Exeter: Imprint Academic Press.

There is, of course, some truth in all models. The handbag model of economics is an analogy that will at times appear to be pertinent. For instance, at some point it will not be possible for the United States of America to carry on spending vastly more money than it raises in taxes every year, increasing its national debt to astronomical levels.[2] However, the reason it will not be able to do that is not because the United States economy is like the household budget of a family. For a state, which is made up of many millions of households, money does not play the same role as the money you might have in your handbag. A country's current account does not determine what its people are able to buy at the shops that same day.

The factory model of taxation, like the handbag model of economics, is initially attractive and intuitive because it reduces a process to something you think you understand well, although most people have never been in a factory and most of us run our household economics on debt. For example, I have a mortgage and no one calls me profligate.

Consider health care. The factory model of health care implies that the more you spend on health care the better your health will be. I am not saying that the opposite is the case - just that it is not as direct a process as simply putting more in to get more out.

The USA is, again, a useful example for this. Far more is spent on healthcare in the USA, per head, than in any other country in the world. As much is spent from the country's public purse on schemes like Medicare and Medicaid as is

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[2] $14,344,566,636,826.26 on June 15th 2011. Friedman, T.L. and Mandelbaum, M. (2012) That used to be us: What went wrong with America and how it can come back, London: Little Brown.

spent privately, and yet the results are not good. On closer inspection it turns out not to be health spending that best predicts health outcomes in the separate states of the USA and other affluent countries of the world, but the influence of factors such as historical levels of economic inequality, especially income inequality[3]

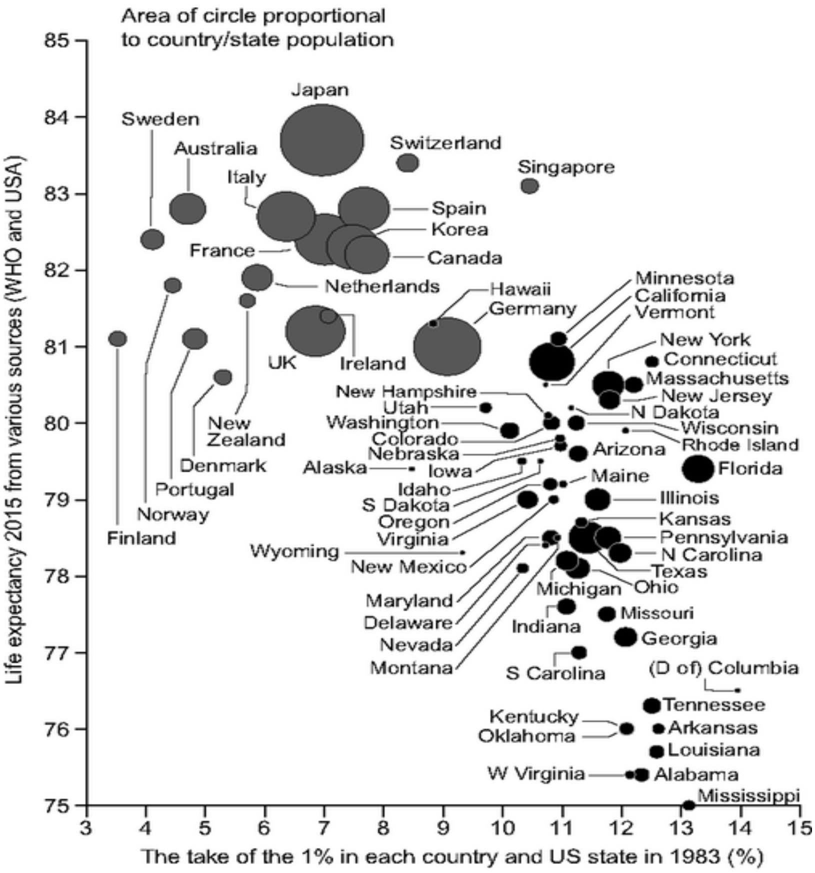

Figure 5.2 Take of the 1% and life expectancy in 19 countries and all US states

Source: World Wealth and Income Database, accessed December 2016. Infant mortality data from the Centers for Disease Control (USA) and Gapminder.

Source: http://www.dannydorling.org/books/economicinequality/figures-and-tables/figure-5-2.html

[3] See the graph here: http://www.dannydorling.org/books/economicinequality/figures-and-tables/figure-5-2.html And an interactive version of it can be found here: http://www.dannydorling.org/books/economicinequality/interactive-charts/figure-5-2.html

Of course, you have to consider multiple issues at once when considering tax. Health spending matters to improve health, but so many other factors also contribute to health outcomes. For example, housing policies to ensure that doctors and nurses can afford to live near their patients. Affordable housing is required so that most of the taxes spent on healthcare do not simply end up being wasted on higher salaries-used to pay the rent to private landlords or financing mortgages so that home can be purchased from an older generation who will be cash-rich but health-poor.

The same applies to education policy. Again, it is not just the amount that is spent on education that contributes to the education levels of the population as a whole. When societies are more mixed, children end up better educated.

Social policy is not like a cereal factory. All the inputs go in and all the outputs come out, but they are mixed up in the middle in ways that we are still learning about. All this lends itself to an argument against hypothecation of taxes, which is too heavily reductive about inputs and outputs. However, there is one case were the argument for hypothecation is stronger, and that is in the introduction of new taxes. This is a concept I explore in part two of this blog.
[The case for hypothecation in the introduction of new taxes (Part Two)]