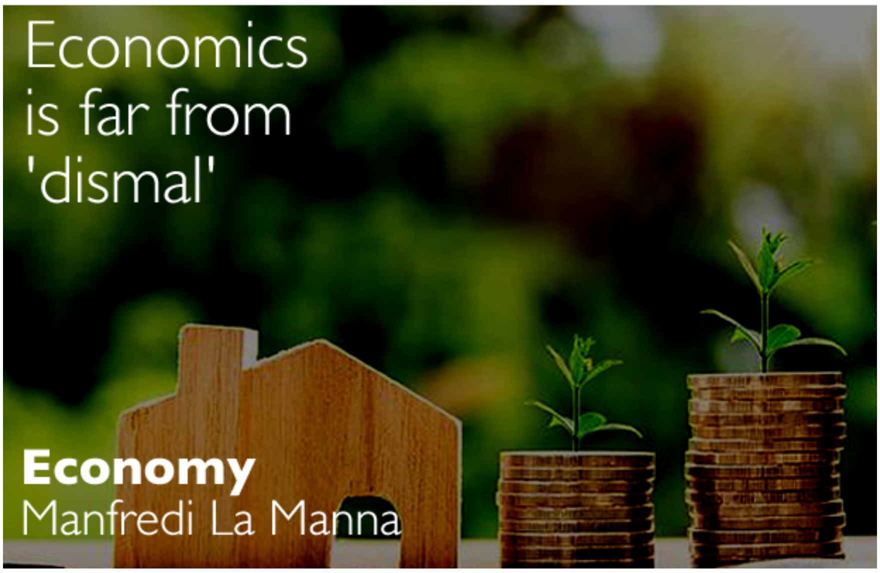
ScottishReview

5 October 2022



Thomas Carlyle's view of economics as the 'dismal science' that aims to 'find the secret of this Universe in *supply and demand*', seems to have a wide currency completely unrelated to its (zero) truth-value. For a recent reformulation of the same sentiment, one can refer to Professor Downie's assertion in **Scottish Review (https://www.scottishreview.net/RobinDownie617a.html)**:

Economists love [mathematical modelling] *because using maths makes them feel really scientific. But alas, mathematical modelling in economics depends on assumptions, such as that we always act rationally and in terms of individual self-interest. But these assumptions do not seem plausible, and indeed mathematical models in economics have frequently been wildly inaccurate.*

Virtually every statement in the above paragraph is either incorrect or inaccurate, but it does reinforce the perception of economics as the futile attempt to 'find the secrets of this Universe' by appealing to simplistic and implausible theoretical contraptions.

The events of the last couple of weeks, when an ignoramus Prime Minister and an incompetent Chancellor bravely decided to ditch 'mainstream economics' in favour of model-free fantasy Trussonomics with catastrophic results, should provide a cautionary tale about dismissing economics as useless.

Instead of supplying a defence of economics as a model-based science (which far more qualified economists than myself have done very successfully – see the works of economics Nobel prize-winner Amartya Sen, for example), I will make three practical suggestions of how the application of simple

SOCIETY (AnthonySeaton631a.htm
Anthony Seaton
The time for a revolution?

COMMENTARY (GerryHassan631a.ht
Gerry Hassan
Deception at the heart of the UK

PHILOSOPHY (RobinDownie631a.ht
Robin Downie
Can pride be deadly?

ECONOMY (ManfredilaManna631a.ht
Manfredi La Manna
Economics is far from 'dismal'

CARTOONS (BobSmith631a.html)
Bob Smith
A Joint Redirection Attempt...

NOTEBOOK (MaryBrown631a.html
Dr Mary Brown
The (Roman) Empire strikes back?

MEDIA (HamishMackay631a.html)
Hamish Mackay
Rallying cry from Ellis Watson, NUJ journ
accept Reach plc's pay offer, and mor

CULTURE (CharlieEllis631a.html)
(Cafe597A.html)Charlie Ellis
Heaven sent from Coventry

CAFE 1 (Cafe631A.html)
(Cafe597A.html)SR Forum
The advantages of studying geometr

CAFE 2 (Cafe631B.html)
(Cafe597A.html)SR Forum
A gloomy walk in Edinburgh

economic principles can solve some apparently intractable problems. These are: (1.) excessive top executive pay and corporate tax avoidance; (2.) high energy prices; (3.) funding affordable housing.

1.
Nothing could be easier than providing glaring examples of extravagantly large top executive pay and bonuses and of corporations paying miniscule (if any) amounts of tax. But devising plans to correct this dual asymmetry seems to be well beyond the combined wisdom of the shadow Chancellor and the TUC, not to mention the current incumbent at 11 Downing Street.

For example, TUC General Secretary Frances O'Grady's main suggestion for curbing CEO soaring pay is to appoint 'worker representatives on the committees that set top pay, and elected seats for workers on company boards'. Would these worker representatives inevitably not be a small minority on the board? Rachel Reeves' speech to *The Times* CEO Summit in June 2022 (the right venue for spelling out Labour's plans on CEO pay, one would have thought) contained precisely zero suggestions (let alone plans) for dealing with what the chair of the Business, Energy and Industrial Strategy Committee (one Rachel Reeves MP) regarded as appropriate 'measures… to tackle excessive boardroom pay awards'.

Labour and TUC plans for increasing the tax revenues from large corporations are similarly as precise on objectives as they are vague on means.

One cynical interpretation of this phenomenon would be to point out Keir Starmer's resolute policy of not scaring the horses (also known as 'moderate voters') with policies that sound 'anti-business'.

And yet there exists a simple solution that, far from smacking of Corbynite extremism, is well within the ambit of mainstream, indeed, neoclassical economics.

Let us take for granted that a CEO's main objective is (or should be) to maximise his/her company's profits thereby creating 'shareholders' value'. Simplifying somewhat, there are two main ways to increase profits: (a) to reduce tax outlays (ie, to increase net profits); and/or (b) to increase gross profits, by product innovation, reducing costs, expanding market coverage, etc.

Under the current incentive mechanism, it is hardly surprising that CEOs concentrate their time and efforts on the low-hanging fruit of minimising their company's tax burden, which – PM Truss please note – does nothing to stimulate growth. Inevitably, the more long-term and growth-promoting aim of increasing organic profits takes second place.

But what if CEO pay and bonuses were constrained to be a given percentage of the total amount of tax paid? The effect is clear: top executives would have a much stronger incentive to increase gross-of-tax profits as a low amount of tax paid would result in correspondingly low rewards. This basic policy could be refined by varying the percentage of tax paid that can be used for executive remuneration by firm/profit size, type of industry, R&D expenditures, etc.

Perhaps Rachel Reeves and Frances O'Grady can explain to voters/ members why they are not even considering a tax and pay policy that curbs

To access previous editions of SR, click on the links below

28 SEPTEMBER 2022 (index280922.h

21 SEPTEMBER 2022 (index210922.h

13 SEPTEMBER 2022 (index130922.h

7 SEPTEMBER 2022 (index070922.ht

excessive executive pay and increases corporation tax revenues.

2.
Keir Starmer's recent plan to establish a state-owned Great British energy company ignores a much simpler and far more cost effective solution to high energy prices and transition to renewables.

Instead of setting up a new company (funded how?) the new Labour Chancellor announces that the Treasury will purchase 51% of one (unspecified) of the five largest electricity suppliers and will commit the acquired company to selling electricity at cost for the next two years. The stockmarket reacts to the news: the share price of electricity companies plummets. Treasury picks the cheapest for acquisition. Customers flock to the state-controlled company that sells the cheapest energy. The share price of the remaining four large suppliers falls further and the Treasury buys a minority stake in them.

After two years, the Treasury either sells back its energy suppliers' shareholding at a substantial premium or, alternatively, commits to a price structure that allows for 'reasonable' profits and a switch to renewable sources and sells (again at a premium) some of its energy shareholding, thereby making the whole plan self-financing.

3.
Although firm figures are not available, a conservative estimate of the number of properties in London that have been unoccupied for more than one year is around 25,000. In view of the dearth of affordable housing in London, this scandal could be turned into an opportunity by resorting to the useful economic concept of 'imputed income'. Take as an example a property valued at £1m: its annual rental income could be estimated conservatively at £50,000 p.a. (ie, 5% of the property value). This is the 'imputed' income that the property owner has voluntarily decided not to earn but this should be no bar to collecting the appropriate income tax.

Depending on the total value of the stock of 25,000 unoccupied properties (which are more than likely to be at the top end of the property scale), the tax revenue from 'imputed rental income' would be in the range between £400m and £800m per annum – not an insignificant amount that could be used to fund an affordable-housing programme.

Far from being 'dismal', economics furnishes concepts, techniques, and a methodology that can be used for the common good, assuming that the pursuit of the common good is the policy-makers' main objective. Perhaps Professor Downie and I may agree that that is indeed an implausible assumption.

Dr Manfredi La Manna is a Reader in Economics at the University of St Andrews

Return to homepage (index.html)