

23 May 2017

“A Compelling Reason for Increasing the Top Income Tax Rates for the High-Earners”

Sir,

In the Labour Party’s recent election manifesto, there is a fair and modest, in our opinion, pledge that 45p income tax rate would apply above £80,000 and a 50p rate would apply above £123,000. Following its release, the Institute of Fiscal Studies (IFS), a think-tank, reported last week that the highest income tax rate under Labour plans would be 67.5p, up from 60p, and would apply to those earning between £100,000 and £123,000; this mainly results from the withdrawal of the personal allowance at £100,00.

Given the well established long-run challenges on the UK’s public finances for adequately funding the NHS, social care, education and a plethora of vital benefits for the worse-off and people in need, Labour made a convincing case to remould the debate for means-tested direct tax hikes in the near future.

Besides configuring the fiscal revenue space (together with other direct/indirect taxes, insurance contributions and government borrowing), we would like to point to another, much neglected, redistributive function that progressive income tax serves in a rich, albeit highly polarised and divided advanced economy such as the UK.

The standard economic paradigm focuses in the “holy trinity” of GDP growth, inflation and unemployment management. Still on the fringes of main macroeconomic theorizing and policy making, but receiving recently a great deal of attention, is the heavily skewed income/wealth distribution and the concentration of total personal wealth (wages/salaries, income from real estate and other forms of capital, rents from financial assets, and inherited wealth) by the top 1 per cent, or the top 0.1 per cent, what we call the missing vital fourth statistic(s) of economic well functioning.

In April 2016, the IFS reported that the amount of income tax paid by the richest 1% stands at 27.5% of the total revenue. On this evidence alone, the highest earners are shouldering the biggest income tax burden. True may be, but only in an absolute, dry, sense.

In recent academic work, still in progress, (“Do the Rich Fill the Fiscal Coffers? Myths and Reality”), we have proposed a novel measure,

which can act as a supplementary inequality index (to the Gini coefficient which is the recognised benchmark).

Instead on focusing on merely the absolute income tax contribution, we rather concentrate on the Ratio of the Effective Income Tax Rate per income group divided by the percentage of Total Personal Wealth owned by the same income group.

Our measure is very flexible since in the denominator one can use the percentage of National Income appropriated by a reference income group. We acknowledge that the top x per cent of wealth-holders are not necessarily the same people as the top x per cent of income recipients. We are further aware and we are confronting in our research work the various challenges in obtaining accurate data to make robust calculations.

For the shake of simplicity, let us accept that the top 1% of wealth holders pays an effective income tax rate of 65%, and that the bottom 99% pays an effective tax rate of just 20%.

The 2016 wealth report by the Credit Suisse Research Institute shows that the richest 1% of people in the UK approximately own 24% of the country's wealth.

To make our point clear, consider a stylised setting in which only 100 people live in the UK and the Top 1 earner appropriates 24% of wealth. It follows that, under an ideal uniform distribution of the remaining wealth, the representative agent of the Bottom 99 group appropriates 0.77% of wealth (76%/99).

Under the caveat that the top income tax payer is indeed the same person as the top wealth holder, our ratio for the Relative Tax Burden (Contribution) becomes:

Top 1 person: $65\%/24\% = 2.71$ (pure number);

Representative Agent of the Bottom 99 group: $20\%/0.77\%=25.97$ (pure number).

In other words, the representative agent of the bottom 99 citizen cohort pays the HM Revenue&Customs approximately 9.5 times more than the top 1 person, a staggering 950% more in **relative** income tax contributions.

In this light, party leaders and policy makers alike with a strong social conscience should holistically re-evaluate the progressivity of the income tax system (as indeed of other direct taxes such as wealth, inheritance, real estate, etc.) and make the electorate aware of the rightfulness of imminent direct tax hikes for the top income earners/wealth holders.

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