Taxing the rich

By Buttonwood
October 12, 2017 – *The Economist*

For once, the *Daily Mail* and the *Guardian*, British newspapers of the right and left, agree. In the former, Alex Brummer says "IMF's new line of thinking of tax should please Corbyn & co" while the latter says that the IMF "analysis supports tax strategy of Labour in UK". Both are responding to the IMF's fiscal monitor which does indeed say that

> there would appear to be scope for increasing the progressivity of income taxation without significantly hurting growth for countries wishing to enhance income redistribution.

The report details how income tax progressivity in advanced economies declined in the 1980s and 1990s and that the tax system has done little to reduce inequality in recent years

> Between 1985 and 1995, rising fiscal redistribution was able to offset about 60 percent of the increase in market income inequality. In contrast, average fiscal redistribution hardly changed between 1995 and 2010, while market income inequality continued to increase. As a result, average disposable income inequality increased broadly in line with market income inequality.

But the report is about the west as a whole, rather than Britain in particular. When it comes to a specific tax rate, it says that

> Assuming a welfare weight of zero for the very rich, the optimal marginal income tax rate can be calculated as 44 percent

and compares this with the average top tax income tax band in the OECD of 35%. So there is scope for many countries to raise income taxes rather than attempt (as is suggested in America) to cut them.

In Britain, however, the top tax rate is already 45%, almost exactly at the optimal level. Mr Corbyn and the Labour party want to increase this to 50% which the IMF report implies is sub-optimal. So not really support for Mr Corbyn at all. The recommendations are really aimed at other countries.

When it comes to corporate tax, the IMF points out that tax levels can affect the return from income taxes. Richer people can decide to incorporate to avoid paying high marginal rates of tax. That might seem to support higher corporate tax rates. But the problem is that corporations are rather more mobile than people.

Taxation influences the location of firms. Savings can be invested in foreign locations with lower tax rates, making it harder for home countries to enforce taxes.

Labour plans to push up the rate of corporate tax to 26% when it takes office. But this is going against the trend.

In recent decades, international tax competition—resulting from capital mobility—has led to a steady downward trend in corporate income tax rates. This trend reduces overall tax progressivity and may also put downward pressure on PIT (personal income tax) rates. International tax coordination could potentially address this problem but has proved very difficult to implement.

Without this international co-operation, the risk is that Labour drives some businesses away at a time when, thanks to Brexit, the country will want to keep itself as attractive to international companies as possible. So the IMF doesn't really back Corbyn in this area either.