The 50p tax rate is a small price to pay for the privilege of being able to live and work in our society

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***Alan Manning** looks at arguments against restoring the 50p tax rate for those earning more than £150,000 a year and finds them lacking. One of the biggest real problems is that the tendency of the 1% to resent the government taking what is seen as 'their' money also leads them to take steps to minimise their tax liability, threatening to make the revenue raised trivial and risking their reputation as 'wealth creators'.*

The shadow chancellor, Ed Balls, announced last week the intention of the Labour Party to restore the top rate of income tax to 50% for those earning more than £150,000 a year if it wins the next election. The proposal has attracted criticism across the spectrum. David Cameron said it would be "very bad" for the economy and that it would "cost jobs and investment". 24 business leaders wrote, in a letter to the Daily Telegraph, that the policy "would very quickly lead to the loss of jobs in Britain". Lord Digby Jones, a former Labour minister (though not Labour party member) pronounced it "lousy economics".

One should neither ignore completely nor trust completely pronouncements by business leaders about economic policy. In the past they have opposed – on strikingly similar grounds to their opposition to the 50p tax rate – the Equal Pay Act and the National Minimum Wage, both policies now seen almost universally as very successful. Rather one should conduct a careful analysis of the claims, something that is noticeably absent from most of the debate. Writing in the Financial Times, a normally very sensible paper expressing a variety of views, Janan Ganesh suggests that the policy should be "laughed out of the room" though his article contains little more than rhetoric.

Ed Balls promised to restore the 50p tax rate

First, the economics. The central claim is that a higher rate of tax discourages work effort and the work effort of the highest earners is of particular value in providing jobs for us all (though the work of us is also important in providing the income for the highest earners so it's really a case of symbiosis). But there is no economic model in which it is the tax rate per se that determines the incentives to work – it is much more plausible that it is the amount one can earn after tax that is important. As the work of my colleague Tony Atkinson has shown, the share of the UK's top 1% in total income has risen hugely over the past 25 years though may have fallen back slightly in the most recent years. What this means is that even a rise in the marginal tax rate to 50p in the pound simply takes the 1% back to a level of after-tax earnings they had a few short years ago. They were not writing letters to the newspapers then about how their earnings were so low that jobs were being lost because it was not worth their while to get out of bed in the morning.

But this, I think, perhaps misses the point. The highest earners are no different from the rest of us and are vulnerable to the endowment effect – they think the money they earn is theirs and resent the government taking half of every extra pound for itself. In the Financial Times Janan Ganesh expressed the view that a 50p tax rates was “morally troubling”. The 1% might point out that they already pay between one-quarter and one-third of all income tax in the UK (though income tax, while very visible, is only about 25% of total government revenues). But whether the original income is entirely theirs depends on one’s perspective. As Warren Buffett has pointed out, the business leaders writing to the Telegraph are fortunate enough to have been born or able to move to a part of the world where their undoubted talents can be used to earn a very high standard of living. The economic and political system that has made it ever easier to earn large incomes is not the product of their efforts – they are the beneficiaries of it and should see themselves as fortunate to live and work within it. It is not unreasonable or unfair to levy a charge for access to this system that is highest for those who have done best out of it.

I think the tendency of the 1% to resent the government taking what is seen as ‘their’ money also leads them to take steps to minimise their tax liability that risk their reputation as ‘wealth creators’ that is often so precious to them. One of the biggest real problems with the 50p tax rate is that such tax avoidance threatens to make the revenue raised trivial. In the year before the 50p tax rate came into force, the HMRC has documented clear evidence that billions of income was brought forward into a tax year with a lower tax rate, a luxury not open to most of us. Perhaps some wealthy individuals will move to Switzerland. The extent of these activities make it clear that not all the activities of the top 1% are generating wealth for the 99% as well as themselves. Some of what they do is redistributing from the 99% to the 1% and, to the extent that this process consumes resources, they are actually destroying wealth at the same time as they are benefiting themselves.

Virtually all of this is perfectly legal but it is following the letter and not the spirit of the law and there is an old saying (nowadays normally applied to some entries to the Eurovision Song Contest) that just because you can doesn’t mean you should. I am sure that all of those business leaders opposing the 50p tax rate think of themselves as among the UK’s strivers but in this regard there is a danger that they find themselves among those who are shirking their responsibilities.

None of this tells us exactly what the impact of a restored 50p tax rate will be. The IFS has expressed doubts about how much will be raised but has called for more research to be done. It may be that it raises little revenue but is important in the average voter’s eyes as a symbol of fairness. If that is the case I think it is a small price to pay for the privilege of being able to live and work in our society.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. (Image of Ed Balls credit: http://underclassrising.net/ CC BY-SA 2.0). Please read our comments policy before posting.

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