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Hike Taxes on the Wealthy, Not on Workers

Amid the cost of living crisis, April's National Insurance hike will squeeze workers while the wealth of the rich continues to accumulate – it's time to demand tax justice.

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In April 2013, then Chancellor George Osborne announced a cut in the top marginal rate of income tax from 50% to 45%. The following tax year saw reported earnings by higher earners soar. In his weekly Daily Telegraph column, Boris Johnson proclaimed this proof of the 'Laffer Curve' effect—the idea that lower tax rates for the wealthy leads to higher net tax receipts.

At the time, it was thought that this lower rate of income tax on high earners had led to income tax receipts increasing by 6%. But a retrospective analysis by Tom Bergin in his book *Free Lunch Thinking* has shown that receipts actually fell by 4% after the rate was reduced. Furthermore, this new analysis has shown that the 50% rate on top earners introduced by Gordon Brown in the aftermath of the 2008 financial crisis brought in an additional £4.7 billion per year between 2010 and 2013.

Despite empirical evidence disproving the Laffer Curve myth, it continues to influence policy. The pandemic has forced the government to abandon austerity and increase spending, but its approach towards taxation in order to fund this expenditure still puts a disproportionate burden on workers.

The lower rate of National Insurance Contributions is going to increase by 1.25% from April this year, costing most households an additional £240 per year. This comes in the midst of a cost of living crisis with the energy price cap set to increase by between £693 and £708. Meanwhile, the government continues to give corporations, landlords, and the wealthy substantial tax advantages despite surging profits and asset prices.

Voodoo Economics and the Myth of the Laffer Curve

The Laffer Curve is named after American Economist Arthur Laffer who came to prominence in the late 1970s as economic advisor to Ronald Regan and more recently as economic advisor to Donald Trump's 2016 presidential campaign. Laffer's theory is simple: past a certain point, higher taxes lead to falling revenue rather than an increases in revenue. This is because, according to Laffer, lower taxes for the rich will incentivise them to work harder and earn more, whereas higher taxes discourage them from working. In theory, this means they will pay more in income tax overall if the top marginal income tax is at a lower rate. During Reagan's presidential campaign George Bush Sr. deridingly referred to this theory as 'voodoo economics'.

As for businesses, lower corporate taxes supposedly mean they have more money to invest increasing the supply of goods and services, making them cheaper. In the long run, this makes everyone better off and creates more jobs. While the 'optimal' tax rate for wealthy people or corporations is never specified, it's always implied that the current rate is too high and that if governments keep lowering taxes for the wealthy and businesses, they'll reap the benefits with higher net receipts longer term. Evidence to support this theory is weak.

Gordon Brown first opened the flood gates after 2008 to what would become a tsunami of tax cuts for corporations. He reduced the rate of corporation tax from 30%, in line with countries like Germany and Japan, to 28%. After Labour lost the election in 2010, successive Conservative governments have overseen a series of corporation tax cuts reducing it to below 20%—nearly the lowest rate in the G20.

According to HM Treasury, business investment during this time did increase, as did corporation tax revenues. As a result, Osborne was lauded for his 'smart moves' by conservative think tanks like the Cato Institute. In 2017, Osborne's successor, Phillip Hammond, announced that the tax cuts for corporations since 2010 had increased revenues by £20 billion—but this figure omitted some important caveats.

First, inflation hadn't been taken into consideration, which when accounted for erases more than half the purported revenue increase. Second, Hammond failed to mention that the lower rate of corporation tax had made it more tax efficient for sole traders to operate as limited companies. One OBR report estimated that while lower corporation tax had led to a £3 billion increase in

corporation tax receipts it had simultaneously caused a loss in income tax receipts and national insurance contributions of over £6 billion, meaning a net loss to total tax receipts of more than £3 billion. To add to this, a report produced by the 100 Group, an organisation that represents the 100 largest companies in the UK, showed that its members' corporation tax receipts in 2017 were just £6.4 billion—half of what they were in 2005.

Where's the Investment?

With all this extra cash sloshing around from lower tax rates we should expect, according to Laffer, to see a wave of investment in productive assets by businesses—but the opposite is true. Investment in the UK has increased, but this has predominantly been in financial markets, while growth in investment for productive assets remains significantly below 2008 levels.

Data from the CBI indicates that business investment intentions have very little to do with the rate of corporation tax but are closely correlated with uncertainty about demand. In other words, if demand is low as a result of stagnant wages, businesses will be apprehensive about investing in productive capital because fewer consumers will have the income needed to buy what businesses are selling. Instead, businesses will divert the extra profits from tax breaks towards things like share buybacks, which are further encouraged by the fact that director and CEO pay is linked to increases in their companies' share prices. There are even employee share option schemes that are deductible from corporation tax liabilities, further reducing government income from corporate profits and incentivising adverse investment behaviour.

Since the beginning of the twenty-first century, CEO pay has been increasing exponentially. In 2019, the median pay of a FTSE100 CEO peaked at £3.61 million, 119 times greater than the median earnings of a full-time UK worker. This fell to £2.7 million in 2020 due to a temporary suspension in bonuses during the Covid-19 lockdowns, but with corporate profits now above pre-pandemic levels, CEO bonuses are coming back bigger than ever.

According to Laffer, this disparity between CEO and worker pay must be because the average CEO is 119 times more productive than the average worker, given that remuneration is supposedly related to 'hard work'. But the pandemic has highlighted that those who work the hardest, under the most strenuous conditions, and who are most vital to the functioning of society are often the worst paid.

Nurses have lost thousands in real pay over the past decade and, despite current levels of rampant inflation caused by supply chain bottlenecks, have been stiffed with a public sector pay freeze. In the private sector, labour shortages have recently seen unions win a number of inflation-busting pay rises, but the Bank of England is now trying to counteract this by raising interest rates. By introducing a series of rate hikes the BoE is making a concerted effort, alongside the government, to protect returns on the investments of the wealthy at the expense of wages and the standard of living for ordinary people.

Wages vs. Wealth

Contrary to the doctrine of Laffer, the wealthy receive a large portion of their income passively through investment portfolios and property ownership—not through their own work. Analysis from the *Guardian* found that the top 1% of individuals received over 13% of their income from capital gains or 'unearned income' in 2017, with the figure reaching nearly 20% income for the top 0.1% of individuals.

Typically, those on higher incomes have more money to save and so are better able to channel those savings into investments that give them capital gains. These gains can be re-invested again to accumulate yet more passive gains, making the recipients richer and richer with less and less work required. It is this mechanism, combined with a lower tax rate on capital gains than for earned income, which is attributable to the growing levels of wealth inequality over the past decade.

After the financial crisis capital gains continued rising, aided by quantitative easing from the BoE, while real wages fell. By 2013, the rate of wage growth began to converge with the growth rate for capital gains, but capital gains had a considerable head start. Between 2008 and 2018 capital gains rose from around £15 billion to £60 billion; during the same period, real wages fell short of recovering to pre-2008 levels.

Creating a More Just Tax System

The failures of the Laffer Curve are now so stark that even Conservative think tanks like Bright Blue are calling for higher rates of capital gains tax. An equalisation of the capital gains tax rate

with income tax rate would raise £16 billion a year, far exceeding the proposed £12 billion from a higher rate of NIC.

On top of the cost of living crisis, we are also in the midst of a housing affordability crisis. The average house price has increased from around £50,000 in 1990 to over £260,000 in 2021; the average annual salary, during the same period, has risen only from around £10,000 to £30,000. Simultaneously, the stock of social housing has been steadily declining while the cost of private rental accommodation has been increasing, with rents in 2021 rising at their fastest pace in 13 years.

£23.4 billion per year is spent on benefits to enable tenants, most of whom are in work, to pay rents to unscrupulous landlords. The value of houses owned by landlords during this period has risen by 124% to £1.62 trillion. Despite this worrying trend landlords continue to receive preferential tax treatment by the government, such as being able to claim tax credits for the deduction of interest on their buy-to-let mortgage repayments. Scrapping credits for expenses like landlord mortgage interest could save the government millions. Equally, taxes on land value would raise revenues while making housing a less attractive investment vehicle for speculators. Houses should be homes, not retirement assets.

The UK still has one of the lowest rates of corporation tax in the G20, even with Sunak's increase in the rate to 25% that will take effect from 2023. And even as the Chancellor raises corporation taxes, he provides other relief for industries like banking. Already, he has cut the surcharge tax for banks by over 60%, claiming that the taxation of banks would make them 'uncompetitive' as one of the UK's key exports.

Similar exceptions are made for energy firms. BP and Shell have made combined profits of over £40 billion this year and over the past decade the oil giants have paid £147 billion to shareholders via dividends and share buybacks. Not only has BP paid no tax but it has actually received subsidies from the government.

This had led to a call from the TUC and others for a windfall tax on energy companies to prevent the growth of food banks and counteract rising fuel poverty. A serious effort at making the tax system fairer long term requires more than just a surcharge and modest corporation tax increases.

Restoring the rate or corporation tax back in line with countries like Germany and Japan at around 30% should be a minimum.

Plugging the holes in the UK's leaky tax system also requires a well-funded tax collection authority. Since 2003 staff numbers in HMRC have been cut by nearly 40%, reducing its capacity for compliance work. Tory minister for counter-fraud Lord Agnew quit last week over the government's decision to write off the £4.3 billion lost in fraudulent Covid loans, accusing the government of 'arrogance, indolence and ignorance' in its approach to the issue.

Multinational corporations are able to employ small armies of lawyers and accountants to engage in tax-avoidance schemes by using techniques such as transfer pricing, research and development credit claims, and the use of intellectual property rights. Proper investigation of these schemes could yield the government billions in tax revenues annually. Instead, the government is setting up a series of onshore tax havens in the form of 'Free Ports', which will make it easier for multinational companies to obfuscate their tax obligations.

Over a decade of tax cuts for the rich and corporations has led to falling tax revenues, has failed to produce productive investment, and has resulted in record levels of wealth inequality. The wealthy aren't productive and lowering their taxes won't make them 'work harder': it just gives them more money to inflate financial markets and property prices, diverting resources away from investment in things like infrastructure and the public sector. This ultimately means fewer good jobs created, worse services and lower wages for workers—who are the real wealth creators.