Some commentators call for the introduction of a wealth tax in the UK. Proposals range from a regular wealth tax to a more specific and time limited one to help finance the fiscal burden of the COVID-19 pandemic. Discuss the economic rationale for and against such wealth taxes.

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Introduction

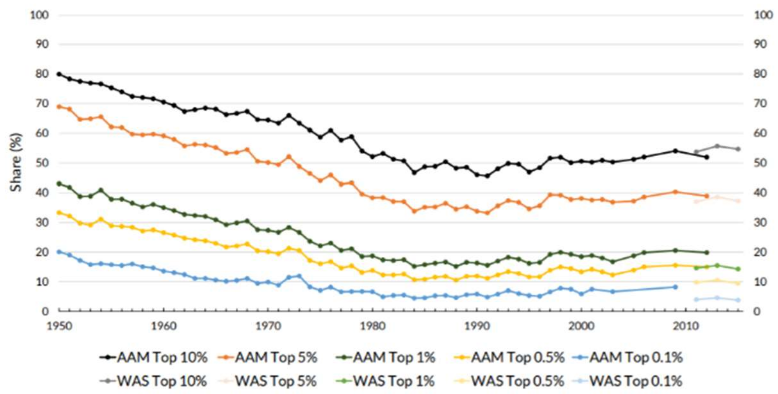
On the 11th of January 2020 state media in China reported the death of a 61-year-old man due to an outbreak of pneumonia, caused by a newly identified virus[1]. Fast forward 18 months and COVID-19 has drastically changed the world. For the past year and a half the UK has undergone months-long lockdowns, social distancing, the closure of non-essential businesses and schools; along with a Coronavirus Job Retention Scheme that, as of March 15th 2021, has cost the government 57.7 billion British pounds[2]. The scheme has recently been extended until September 30th. As a result of strict lockdowns causing an idle nation, the year 2020 saw Gross Domestic Product (GDP) decline 9.1%, following 1.4% growth the previous year, which is more double the decline seen during the 2009 financial crisis[3]. Furthermore, the *Institute for Government's* report "The costs of Covid-19" estimates the total cost from March 2020 to September 2020 in terms of public borrowing at £317.4 billion, with an updated forecast of £1,108 billion for the financial year 20/21[4]. The impacts of COVID-19 however, stem much further throughout the economy: relatively large unemployment, socio-economic damage to young generations (Major and Machin 2020) and straining public services to name a few.

The ensuing debate revolves around the way in which public spending both during and after the pandemic is going to be financed. The prime minster himself has indicated that a return to the austerity measures implemented before the COVID-19 pandemic will "certainly not be apart of our approach"[5]. Moreover, that explanatory fiscal policy will be utilised to revive the economy. This expenditure, in accumulation with current and previous spending on the furlough scheme and other emergency necessities, is likely to be financed through increased tax revenue. For the rest of this paper, I will evaluate the economic rationale behind a wealth tax's use in the UK to offset the fiscal burden of the COVID-19 pandemic.

Wealth in the UK

Wealth in the UK has been growing over time, in fact over the last 25 years total net household wealth has increased to 700% of GDP (Perrett 2020). Figure 1 below illustrates that the distribution of wealth is more concentrated to the wealthiest 1%, with Alvarado et al (2018) finding that between 1995 and 2005 this segment of society had seen their net wealth double. Furthermore, data taken from the ONS site reveals that in 2016 the wealthiest 10% in the UK owned 44% of all wealth[6]. In the context of this paper, it is crucial to understand what the key drivers of wealth are and to what extent wealth is concentrated at the top. This gives guidance to the analysis of a wealth tax in terms of who the tax should apply to, on what it should apply, and at which rate it should be set.

Figure 1: Share of wealth going to people at the top



Notes: 'AAM' series taken from Alvaredo, Atkinson and Morelli (2018), based on HMRC 'identified and excluded wealth'. WAS series constructed from the Wealth and Assets Survey waves 3-5. Population control totals taken from WID (World Inequality Database), based on the ONS mid-year population estimates.
Source: Alvaredo, Atkinson and Morelli (2018) for 1950-2012; authors' calculations based on Wealth and Assets Survey 2011-2015.

Source for "authors calculations"- Advani et al (2020)

As the evidence suggests a great accumulation of wealth, especially for the top 1% and a recent fall in wealth taxes relative to total wealth (Advani et al 2020), it is logical to suggest that in a time of crisis greater redistribution is necessary.

A wealth tax

In the UK, there is no direct tax on "wealth". This has not been considered in the UK since Harold Wilson's government in the mid-1970s and has received little academic attention since the work of Sandhurst et la (1975). The age of this report now makes it outdated and inapplicable. Currently the UK utilises other methods to provide some form of taxation on wealth. Summers (2020) defines these current measures as inheritance tax; which provides taxation on the transfer of wealth, VAT; which provides taxation on the spending of wealth, income and capital gains tax; which provides taxation on the returns of wealth. This shows it is clear policymakers understand and agree with the economic rationale to tax wealth in some way.

A wealth tax in principle would be designed as a broad tax on an individual's/household's ownership of wealth, defining wealth as all tangible assets such as property, cars and jewellery as well as intangible ones namely investment portfolios, minus one's debt. In the application of a wealth tax difficulties arise regarding honest asset valuations, full disclosure of assets, residency and citizenship, administrative and collection costs. Despite this, the estimated tax gap of 10% (Troup et al 2020, in the case of an *annual* wealth tax) falls in line with magnitudes observed in other taxes on capital.

Drawbacks of a wealth tax

The argument against introducing a wealth tax in its simplest form focuses on the unintended negative consequences on innovation and investment in the private sector. The wealthy segment subjected to the tax largely consists of business owners and CEOs who often have worked harder and longer hours to earn their wealth[7]. Their innovation and output also provide jobs and economic prosperity in the UK, a key part of the recovery from the pandemic. In the face of high unemployment and low spending in the economy since the beginning of the pandemic, this policy appears counterintuitive to recovery.

Currently only three OECD countries operate a wealth tax; Switzerland, Norway and Spain. Figure 2 illustrates the decline in applications of a wealth tax in OECD countries, with 6 countries abandoning their policy in the last decade[8]. An analysis of countries currently enforcing a wealth tax as well as why countries have been abandoning their wealth taxes, would help us better understand its benefits and drawbacks in application.

Figure 2: Evolution of the number of OECD countries levying net wealth taxes between 1970 and

2017

Source: OECD Net Wealth Tax questionnaire.

(4th country in 2017 was France, the country has since abolished its wealth tax.)

The decline in international use of a wealth tax suggests its difficulties. Research carried out by Brülhart et al (2016) found that in Switzerland, which operates an annual wealth tax, wealth appeared to cluster just under the tax's threshold and that a 1% wealth tax lowers reported wealth by 34%. Or a 0.1% increase in the rate leads to 3.4% less reported wealth. The findings in this paper illustrates the difficulty in hampering the mobility of wealth in the face of taxation and how if a method to hide wealth can be identified, individuals would be incentivised to transfer wealth to the untaxed asset.

Authors Mirrlees et al (2011) find in their *Mirrlees Review* that taxing should exempt "normal" returns to savings but instead tax "excess" returns, but that a wealth tax does the opposite. For example, a 1% annual tax on £100 is equal to a 40% tax on 2.5% interest on £100 (Mulheirn). This illustrates how a wealth tax discourages individuals to save, while taxing excess returns on savings at the same rate.

Adam and Miller (2020) writing for the *Institute for Fiscal* propose that a wealth tax does not tax those who are better-off but instead those we wish to “spend their money today rather than tomorrow”. They emphasise how this reduces incentives for those trying to save for the future and warps the decision-making process when choosing assets. Another point is the possibility of taxing wealth multiple times. The example provided states a person saving in order to spend in 40 years’ time, with an annual rate of return of 5%, along with a uniform 1% annual wealth tax would see their savings reduced by about a third. This violates the tax neutrality principle with the disincentives to hold wealth evident, this distortion to behaviour is a cause for concern. In our case however, the fiscal burden of the pandemic could be dealt with relatively early (not over 40 years) and perhaps this demonstrates the benefits of a one-off time specific wealth tax as agents will not have to deal with the prospect of a lifetime general wealth tax. Furthermore, the risks of capital flight from the economy would be substantially less as wealth individuals would have to weigh up the benefits of avoiding the taxation for a short period of time, rather than indefinitely, with the costs of a long-term relocation. But as later mentioned, the wealthy can be mobile. No previous mention of the tax before its application would ensure wealth cannot be hidden or relocated before collection.

Benefits of a wealth tax

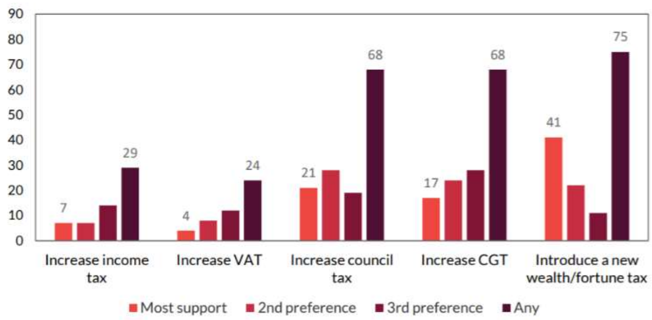
A case in which a one-off time specific wealth tax was implemented with success was the capital gains levy applied in Japan between 1946–7. This taxation was motivated by sociopolitical dissatisfaction at a collective making up the top 2-3 per cent of society, dubbed *Zaibatsu* (Shavell, 1948). Through a group of interlinked holding companies and other investment vehicles, this class of elite had near dominion over Japanese commerce and industry. Within this year the capital gains levy revenue was equal to 120% of general tax revenues, raising over 9% of national income. This application is an important illustration of how a wealth tax can be effective at raising capital in a time of national urgency. Other success stories include the Irish pension levy, which raised over 2.4 billion, and the French *Impôt de Solidarité Nationale* which generated revenue equal to around 5% of national income (Robson, 1959).

Furthermore, much more recent and contextually relevant evidence in favour of a one-off time specific wealth tax in the UK was recently published in the *Wealth Tax Commission's* final report (Landais et al 2020). Their analysis demonstrates that a tax of 1% on wealth after mortgages and other debt above £500,000 per person for five years would yield an astonishing £260 billion (Advani et al 2020) net of administrative costs to HMRC. Or, as a more targeted approach to the wealthiest 1% of society, the threshold could be set at £2 million; still yielding £80 billion in tax revenues. This report was published almost in response to the pandemic and gives evidence to the argument that a prudent one-off time specific wealth tax is the most economically efficient form of taxation possible.

A wealth tax provides an insight into the current wealth of individuals, rather than their flow of wealth (like income tax or VAT). It is fair to say individuals with the most wealth based on their current/past situations have the best ability to additional contribution in a time of crisis as raising other taxes such as income tax or VAT would have proportionally a greater effect on lower income households- perhaps the ones already most impeded by the crisis. In addition, individuals with a high net wealth have, in most cases, a better ability to avoid tax. Whether that be through residency complications, shell companies in tax havens or asset management; the wealthiest 1% are much more equipped. Famous examples include Richard Branson and Donald Trump, with the former not paying any UK income tax in the 14 years he has been a resident at the British Virgin Islands[9]. A wealth tax, ensuring its soundness, would aim to recuperate the losses incurred within other forms of taxation by these individuals.

In our democratic society it is imperative to understand public opinion. Rowlingson et al (2020) research surveyed the public on the topic of a wealth tax. Figure 3 shows the answers to a question asking if the government decided to raise taxes to fund public services, which measure would they most strongly support.

Figure 3: Preferences for particular taxes if an increase were to take place.



Source: Rowlingson et al (2020)

Should policy-makers chose to introduce a wealth tax findings in this paper indicate the public's approval, with nearly double choosing this as their most supported answer (41%) over the next most popular answer (council tax- 21%). This paper discusses some limitations with the public's understanding of how this tax may work, but in general their support and dismay at wealth inequality is clear.

Further interpretations of what public reactions would be are insightful when choosing between a general wealth tax and a time limited wealth tax. In my opinion, individuals subject to this tax may feel a sense of companionship in helping fund the nation's recovery in the terms of a one-off time limited tax, whereas a general wealth tax may be perceived as a general penalty for wealth, leading to less chance of capital flight or tax avoidance.

Which tax is best?

In conclusion, the decision surrounding the introduction of a general or one-off time specific wealth tax will account for many factors. Firstly, whether the cost-benefit analysis in terms of administrative, enforcement and non-compliance costs relevant to revenue generated, is satisfactory for both options. This analysis would typically need more care but the pandemic's strain on the economy and the need for funding make it simpler. Given we have established the need for this tax, next to consider is whether the negatives of enforcing a general wealth tax outweigh the benefits in raising public funds long term. Moreover, whether a one-off wealth tax is a better compromise. Much of the discussion on the drawbacks of a wealth tax are not in the context of COVID-19 and do not address the severity of the current fiscal burden; but should still be considered.

Advani et al (2020) workings show a 1% uniform tax over a 5-year period generates enough to cover 23% of the total estimated £1,108 billion cost to public finances. Though their report praises this an efficient way to raise capital, the COVID-19 pandemic is predicted to cause the worse financial burden in history, and it could be argued this extension will not be suffice, but that wealth tax with a large/extended time limit may be adequate.

Therefore, I conclude a wealth tax should be implemented and that the benefits of a time specific wealth tax outweigh the risks of introducing a general wealth tax, but that it's time limit be wholly longer than the 5 years illustrated in the *Wealth Tax Commission Report*. This is a sufficient compromise between reducing incentives for capital flight and avoidance while providing funds to public borrowing.

Conclusion

When considering the rationale for a wealth tax as a means of financing the long-lasting shocks of the COVID-19 pandemic throughout the economy, it is imperative to notice how large corporations, especially in the technology sector, have benefitted supernaturally in terms of profit. Even before the pandemic global companies such as Facebook and Amazon have been ousted and shamed for their use of legal loopholes to avoid tax contribution. With Facebook reporting a gross profit of 1.04bn in 2019 its tax bill at the rate of 19% should have numbered £196 million, instead the company paid only £28.5 million[10]. Despite this topic being beyond the aspects of this paper and a suggestion to reform corporation tax laws being a bold one, the need for big corporations to step up and contribute at least the amount our policymakers intended is clear.

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