David Smith

That sound of pips gently squeaking will get a lot louder under Labour

While we await the white smoke from Brussels life goes on, and sometimes in rather interesting ways. The rich, like the poor, are always with us and they are helping to ensure a healthy flow of tax receipts into the Exchequer.

The Office for Budget Responsibility, the fiscal watchdog, observed in its update last month that revenues were up because of “particularly strong earnings growth among the highest earners”. The golden goose, it seems, is laying eggs.

But what is the story here? Does this reflect a widening of inequality and how does that compare with the past? And why are the highest earners, normally good at finding ways to reduce their tax liabilities, proving to be such a rich source of revenue?

As it happens, research provides a source of comparison with today’s distribution of income. A paper presented to last weekend’s Economic History Society annual conference in Belfast, The Comfortable, the Rich and the Super-Rich, by Peter Scott and James T Walker, of the Henley Business School, Reading University, provided some perspective.

At present, the top 1 per cent of earners account for 12.2 per cent of incomes before tax and the top 5 per cent, 24.4 per cent. Both shares for 2018-19, the tax year just ended, are at their highest for three years but are lower than immediately before the financial crisis, when the peak shares were 13.9 per cent and 26.4 per cent, respectively. The Scott-Walker research shows that in 1911, the gilded age immediately before the First World War, the income share of the top 1 per cent was just over 30 per cent and that of the top 5 per cent was 45 per cent. Society was much more unequal then and remained so through the inter-war years, although these top income shares were declining.

By 1949, however, after the Second World War and four years of the Attlee government, the income shares of the highest earners were down to roughly what they are now — 11.4 per cent for the top 1 per cent and 23.4 per cent for the top 5 per cent. These income shares fell further until the 1970s, rose again in the 1980s under Margaret Thatcher and have been roughly stable, within relatively small margins, since.

The first half of the 20th century was, the research shows, particularly tough on the super-rich. The income share of the top 0.01 per cent fell from 1.44 per cent to 0.27 per cent between 1911 and 1949, while that of the top 0.01 per cent went down from 4.6 per cent to 1.06 per cent.

It is often the case, as the authors note, that changes within the top 5 per cent matter most: “Income redistribution in western countries is typically dominated by changes in the shares of the top 5 per cent and especially within the top percentile.”

The tax system, of course, has got a lot better at redistributing income. In 2018-19, according to official estimates, the top 1 per cent of earners accounted for 27.9 per cent of all income tax revenues and the top 5 per cent nearly half, or 48.4 per cent. This reduced the post-tax shares of income of the two groups to 19.6 per cent and 9 per cent, respectively.

There is another reason why the Exchequer is doing well out of high earners, highlighted by the Institute for Fiscal Studies. In the 1970s Denis Healey was said to have boasted of squeezing the rich until the “pips squeak” with his high tax rates, including an 83 per cent top rate of income tax and even higher rates adding in unearned income. The late Labour chancellor denied saying it and in truth even a moderately skilled accountant could drive a coach and horses through the many allowances and reliefs that could be offset against tax in that era.

Today inertia, perhaps deliberate, is creating a modern version of making the pips squeak. It is now more than a decade since the additional rate of income tax, originally 45 per cent, then 50 per cent, then reduced back to 45 per cent by George Osborne, was introduced at an income threshold of £150,000. In that time, the threshold has not budged. Had it been raised in line with inflation, it would now be £180,000, the IFS notes. The fact that it has not is the main reason why the number of people hit by this higher rate of tax has gone from 319,000 to 428,000.

There is an even more insidious feature of the tax system a little further down the income scale. At present, the top 1 per cent would now be £180,000, the IFS notes. The fact that it has not is the main reason why the number of people hit by this higher rate of tax has gone from 319,000 to 428,000.
£100,000, taxpayers experience a withdrawal of the income tax personal allowance, so that the better off did not benefit from the government’s policy of raising the allowance. Above £100,000, taxpayers suffer a marginal tax rate of 60 per cent until the point is reached — at double the personal allowance — when the effect stops. The threshold has stayed at £100,000, while the personal allowance has increased regularly, meaning that this high-tax anomaly now stretches from £100,000 to £125,000 and affects nearly a million people (988,000), up from 647,000 a decade ago. Indexed, that threshold would now be £120,000.

Or, if you can shed few tears for six-figure earners, what about families who see their child benefit withdrawn when their income reaches £50,000? This now pulls in an extra 300,000 people compared with when it was introduced in 2013. Indexed, that limit would now be £54,000.

There are too many examples of such inertia in the tax system. They include the annual allowance and lifetime allowance for pensions. In some cases they cost money, like the apparent inability of any chancellor to raise fuel duty. As with that, it is hard to imagine a future chancellor announcing increases in the £100,000 and £150,000 income tax thresholds. A Labour chancellor would be more likely to pile on higher tax rates. In which case, that sound of the pips gently squeaking will get a lot louder.

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