

Is it time to raise taxes on the rich?

A 2-point tax hike for each of top two income tax brackets can raise S\$1b, which will help build reserves for the next crisis or benefit those badly hit by the pandemic

By Sumit Agarwal

THE Singapore Budget 2021 brought news of increased petrol duty rates and the Goods and Services Tax (GST) on small-ticket items bought online. These measures will go a long way in raising the future revenue of the government. However, there is another way of increasing revenue that also helps narrow the income gap of citizens at the same time – raise taxes on the rich.

It has to be said that income inequality in Singapore is at a historic low since the government started tracking the data in 2000. During CNA's *Ask The Finance Minister* programme, Deputy Prime Minister and Finance Minister Heng Swee Keat said that Singapore's Gini coefficient was 0.375 in 2020 after government transfers, down from 0.398 in 2019.

He also added that the top 20 per cent of households in Singapore pay 56 per cent of the taxes but get back 11 per cent of the benefits. On the other hand, the lowest 20 per cent of households pay 9 per cent of the taxes but get 27 per cent of the benefits.

While I applaud these results, I think that more can be done to reduce the income gap further. Taxing the rich will increase government revenue that can go back into redistributive policies.

Some may argue that this measure will reduce the rich's consumption and hence the reduced spending does not help the economy. However, research has shown that increasing their taxes by just a few percentage

points does not affect their consumption. My co-researchers and I found that the 2017 tax increase of two percentage points on wealthy Singaporeans had minimal impact on their consumption because their sensitivity to an income tax change is close to zero.

The rich did not incur greater debt to fuel their consumption, they tapped into their savings. The tax increase on the rich did redistribute wealth – the lower income groups had more to spend and indeed spent more. This had a positive impact on the Gross Domestic Product (GDP).

While additional tax revenue is always welcome, I do note that such policies on raising taxes on the rich are usually not popular among leaders.

People argue that it hurts innovation and entrepreneurship. This is the classic Reaganomics argument. However, evidence of the downside of such raised taxes is at best, scant.

To be clear, I am not arguing for raising the taxes of the well-off to the degree as is the case in Europe, particularly Scandinavia, and the US, where it can be more than half of their taxable income.

Instead, I am proposing to raise the taxes by about three to four percentage points for those in the top 20 per cent of the income bracket. This can have significant implications for tax revenue, strategic reserves, and redistributive policies that Singapore can pursue.

The 2017 tax hike for the top income tax bracket by two percentage points increased revenue for the Singapore government by an

expected S\$400 million per year.

If we implement a similar two-point increase in tax for each of the top two income tax brackets, the expected S\$1 billion raised can go a long way in building our reserves for the next crisis or for redistribution to benefit those badly hit by the pandemic.

In economic theory, when taxes are raised, people try to avoid paying taxes us-

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ing different means, hence this result may go contrary to the original intention of collecting more tax revenue. But this is true only when rates go up very high, and even then, the evidence thus far has not been clear.

Policymakers may also fear that a high tax rate on the rich will encourage them to move elsewhere. But there are more factors at play

that keep one in the country. The rich still like to live in Scandinavia even though it has one of the highest tax rates in the world.

More than a year has passed since the start of Covid-19, and it has been more painful for some than others. Around the world, when lockdowns and social distancing rules kicked in, the lower- and middle-income groups have been the ones most affected. Many of their jobs require them to show up in person. Think of that shop assistant in the shoe store, or the videographer in large corporate events.

Many lost or saw their incomes dwindle. Meanwhile, the high-income group has jobs that allow it to work from home. They save more as their travel expenses became non-existent. With more disposable income invested in the stock market, they became richer as the bourse ran up the charts.

Benefits have also not been the same for all. Monetary policies around the world have seen interest rates decline to spur spending and boost the economy. Ideally, this allows individuals, rich and poor, to refinance their mortgages at a cheaper rate. But the benefits of such lower rates did not benefit everyone equally.

The rich, who have more time and resources to look at various refinancing schemes, tapped on these policies and increased their savings. What did the poor do? They refinanced as well, but to a much lesser extent.

My colleagues and I studied the distribution of savings from mortgage refinancing across income groups during the pandemic

in the United States. We found that from February to June 2020, the difference in savings from refinancing between the high- and low-income borrowers was 10 times higher than before. The rich were engaged in more refinancing activities than the poor, and so they benefited more from the large decrease in interest rates. We estimated that those in the top 20 per cent income group saved US\$5 billion more compared to what the rest saved from refinancing.

While this study is conducted in the United States, it is likely that across the world, the rich have more time and resources to seek beneficial refinancing schemes than their lower-income peers. This is also relevant for Singapore where the rates have adjusted downwards and some people could not adjust their mortgages rates lower.

I am sure the government has weighed various options that balance the increase in revenue and also people's welfare. For example, road tax rebates will be given out to offset petrol duty hikes.

But increasing taxes on the rich is one redistributive measure that could be given more consideration. It may well be time to bite the bullet and impose a slight increase in taxes on those who can well afford to pay more.

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