

# Is Now the Time for a Wealth Tax?

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*In the face of ever-worsening wealth inequality, one solution for Malta (or elsewhere) could be a tax on wealth. **Jonathan Firbank** speaks to **Dr Charmaine Portelli** about why this idea is flawed, and yet, why this flawed idea might still be necessary for today's world.*

Anywhere you look, wealth is concentrated into fewer and fewer hands. Those outside the shrinking category of 'wealthy' are struggling more and more to meet their expenses. Wealth concentration, where a smaller group of individuals amass a significant share of resources, puts immense financial pressure on the majority. To many, the obvious solution is a wealth tax.

One way of observing the success of wealth taxes is through data from The Organisation for Economic Co-operation and Development (OECD). This global initiative, in part, facilitates ethical and collaborative taxation. Of its 38 nations, four have some form of wealth tax, with notable caveats. But despite the OECD growing by almost a third since the early 90s, the number of members with a wealth tax has shrunk by two thirds. Each implementation of a wealth tax is different and faces unique challenges. Generally, however, this decline is attributed to the wealthy's political influence and their exodus when faced

with robust national taxation. But in a critically strained global economy, it may be time to re-evaluate this idea.

Dr Charmaine Portelli is an economist and resident academic at UM with specialisations in public finance, taxation, monetary economics, and central banking: 'The world is facing serious fiscal challenges. About one hundred million people were pushed into poverty by COVID-19 during 2020 alone,' and that number continues to rise. In response, governments 'dipped deep' into spending and debt. 'In these circumstances, it seems logical to ask the wealthiest to pay more,' as their resources are far in excess of their cost of living.

## INEQUALITY AND MALTA

Global 'studies identified similar trends,' explains Portelli. 'The very wealthy are getting far wealthier while the poor keep losing out. There is wide consensus that inequality is out of hand.' Malta is no exception. 'There are clear direct consequences of this growing inequality



for Malta', with significant, negative 'implications for growth and macroeconomic stability,' as supported by the International Monetary Fund's data.

One example of this is lower growth by depriving lower-income households of 'the ability to accumulate physical and human capital.' An increasing concentration of wealth also undermines growth, because the wealthy spend a lower fraction of their income than other groups. Another example is inequality concentrating 'political and decision-making power in the hands of a few.' This leads to 'suboptimal use of human resources', 'investment-reducing instability', and raises the risk of crisis. Beyond direct economic consequences, Portelli explains, 'unequal wealth may also undermine democracy, as wealth confers political power. The wealthy want (and tend to get) self-serving policies opposed by most citizens.' This is a well-evidenced phenomenon, on the basis of which one may argue that 'a wealth tax may potentially curb the political power of the wealthy.'

### **LOCAL LEGISLATION IN A GLOBAL ECONOMY**

However, a wealth tax is no silver bullet. As hard as it would be to legislate, it may prove harder to enforce. Malta has a painful recent history with tax evasion. It was deeply embroiled in the Panama Papers scandal, in which the extent of global tax evasion was exposed. It is also where a leading journalist of the story, Daphne Caruana

Galizia, was assassinated, likely in retaliation. But her work, alongside other journalistic efforts, incentivised change. As Dr Portelli explains, due to 'high profile cases outing grand corruption and extreme tax minimisation', tax evasion has become harder. She attributes this to the OECD's Base Erosion and Profit Shifting initiative. 'Over 135 countries and jurisdictions are collaborating on measures to tackle tax avoidance, improve coherence of international tax rules, and ensure a more transparent tax environment.'

But no matter how effective these measures prove to be, wealthy individuals and institutions have both the means and incentive to legally move their wealth elsewhere. This, along with them being 'difficult to administer', is why previous wealth taxes failed. 'Most European nations that implemented a wealth tax have abolished it,' reveals Portelli. For instance, Sweden's wealth tax pushed many of its businessmen abroad. Similarly, so many millionaires left France 'that the net revenue generated by the tax may be negative.'

Malta's economy is far smaller than either, and the consequences from an improperly implemented wealth tax may be worse. 'The central rule of taxation is that we should tax actions we want less of, and tax things that are more difficult to move elsewhere.' Broadly speaking, wealth is not something nations want less of, and in a globalised, digitised economy, wealth can be moved elsewhere with relative ease. Dr Portelli sees two core issues with a Maltese wealth tax: ▶



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‘the negative impact it has on foreign direct investment and that it discourages people from working and saving.’ This policy might boost the government’s cash flow, but taxing the wealthier ‘implies taxing wealth which ultimately gets invested in our economy, that drives economic growth.’

### **A CHALLENGING PROPOSAL**

‘Now is the time to consider a wealth tax. It can support fairness and deliver serious recurring revenue,’ argues Dr Portelli. ‘This can help close the inequality gap, address – at least partially – the current fiscal challenges and win back trust.’ However, Dr Portelli considers economists’ hostility to the idea ‘unsurprising’. A wealth tax increases government revenue, but in isolation, it doesn’t ‘help low-income earners, while hurting the broader economy, invariably reducing savings, investment, productivity, and growth.’ Unless there is robust legislation that ensures the taxed wealth benefits lower earners, a wealth tax ‘short-circuits the route to improved equality by merely reducing income at the top of the distribution. It does nothing to improve living standards of people at the bottom of the distribution or make it easier for people to climb up the income ladder. It’s akin to losing weight by lopping off body parts: it achieves a numeric goal but is ultimately counterproductive.’ The solution would seem to be a wealth tax being the smaller part of a broad range of measures to tackle wealth disparity, adding more challenges to an already daunting prospect.

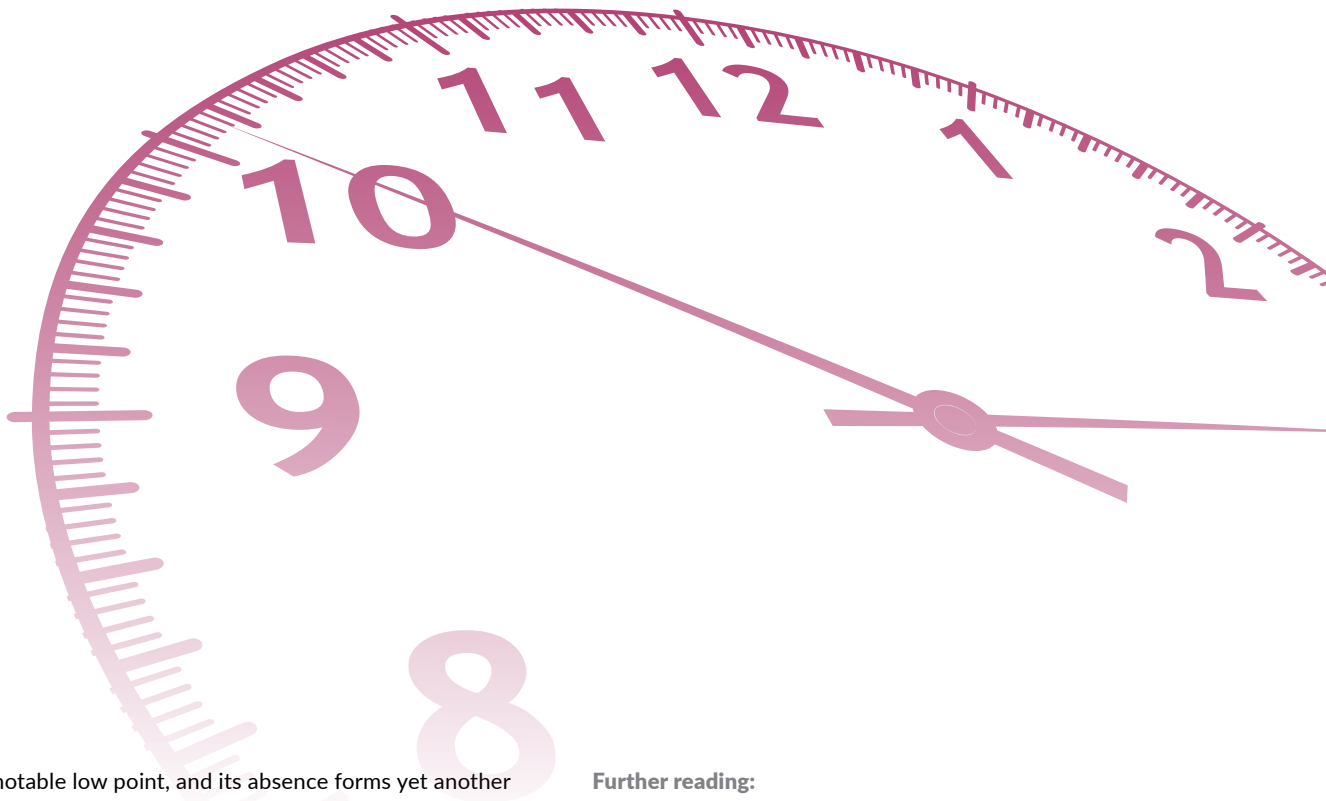
‘The economy needs the wealthy community and a wealth tax may push them away’, as evidenced in France. As the Panama Papers proved, ‘those paying wealth taxes have a substantial incentive to relocate themselves or their assets overseas, legally or otherwise.’ A wealth tax would also impact

the economic choices of those just below its threshold, incentivising them to spend savings on temporary luxuries ‘rather than invest in ways that meaningfully contribute to long-term economic growth.’ Dr Portelli is reminded of the philosopher Jean Baptist Colbert, ‘who said “The art of taxation is to pluck the feathers from the goose with the least amount of hissing.” I believe it is fitting to add – a wealth tax produces a lot of hissing and no feathers.’

### **THE ALTERNATIVES TO A WEALTH TAX**

‘The most obvious alternative to taxing wealth is taxing income’, whether from wages, business earnings, or returns on investments. Just like a wealth tax, ‘this is also a double-edged sword. People with higher incomes may not feel all that wealthy, particularly people early in their careers confronted with substantial housing costs. Taxing higher top rates of income will dissuade the most economically productive members of society from working, harming both economic growth and the government’s tax receipts.’


Locally, there has already been a gradual shift from direct to indirect taxes (such as VAT). Dr Portelli explains that, ‘while indirect taxes are less distortionary, they are not redistributive in nature; the poorer members of society have high marginal propensities to consume, so indirect taxation accounts for a higher percentage of their income.’ Further alternatives include better enforcement of existing laws, more progressive tax rates, and the taxation of high-end goods. ‘These proposals should be viewed in the context of their ability to raise revenue, their efficiency, how difficult it is to avoid them, and above all, their fairness.’ It’s vital ‘that a tax is fair. The sense that taxes are fair rebuilds trust, encouraging compliance.’ Trust is another resource



at a notable low point, and its absence forms yet another crack in the foundations of modern democracy. When present, it also makes people more likely to obey tax law.

## CONCLUSION

While Dr Portelli understands the issues wealth taxes present, she believes they need to be reconsidered in the face of today's challenges. When choosing between different types of taxation, governments must 'compare the negative consequences with the beneficial outcomes of each tax, ensuring that the chosen type of taxes are compatible with governments' priorities, goals, and objectives.' Each method has its flaws, each method may incentivise evasion, and each method might leave drivers of the economy feeling disenfranchised or even drive them away. These negative consequences have not disappeared since the 20th century. But the benefits may have improved.

Wealth disparity is reaching critical levels, and once-unpalatable sacrifices might prove necessary. Global, co-operative efforts such as the OECD are stymying illegal exodus of wealth. Similar efforts may yet mitigate what is currently legal. The world is changing radically, and while this closes many doors, there are a few it reopens. Wealth taxation could be one of them. 'Although experience of other countries' wealth taxes resulted in them being deeply flawed, that doesn't mean policymakers need to abandon taxing wealth altogether. Undoubtedly, taxation of wealth in some form remains fiscally and economically imperative. If revealed preference is anything to go by, most countries are extremely hesitant to introduce wealth taxes. But if ever there were a time that wealth taxes could help, it may be now.' 

## Further reading:

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