

Why soaking the rich won't work

People who support higher taxes on high-income earners usually justify such progressive taxation for a reason. Apart from saying that it is fair, they argue that taxes on high-income individuals usually have little impact on their incentive to work hard. This view comes from the belief that high-income individuals already earn enough income after tax to keep them working hard to help the economy. The game, however, changes when high-income individuals can escape from high-tax regions.

“The effect of state taxes on the geographical location of top earners: Evidence from star scientists”, a 2017 paper by Enrico Moretti and Daniel J. Wilson, published in the American Economic Review, finds that high-income earners don't stay too long in states that tax them too much. In other words, high-income earners may not be too different from the rest of us when it comes to the way they respond to an increase in the tax rate.

The researchers study the inter-state migration patterns of 'star scientists' in the United States to gauge the effect of state taxes on the behavior of scientists. By star scientists, the authors mean scientists who are highly productive with multiple patents to their credit and earn enough to put them in the top 1% of American wage earners.

They find that these scientists tend to move out of states with higher tax rates into states with lower taxes. In terms of numbers, the researchers find that when a state lowers its tax rate to increase a scientist's after-tax income by 1%, it leads to a 0.4% increase in the number of star scientists residing in the state. Also, when the after-tax income in a state in comparison to another increases by 1%, the authors find that in the long run, this leads to an increase of 1.8% in the inflow of star scientists.

The paper challenges the belief that countries or states that soak the rich can escape from the negative consequences of this in a globalised world. In addition, the fact that high-income individuals take the effort to migrate to low-tax regions probably also supports the observation that everyone, even the rich, like to keep the fruits of their labour. The paper leads us to conclude that the disincentive effect of high marginal taxes on the rich is unlikely to be negligible as the supporters of progressive taxes usually believe.

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