Does the international mobility of talent make it impossible to tax the rich?

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Higher taxes on the rich- a winning strike or an own goal?

For the average worker taxation is an inescapable chore that we grudgingly concede makes economic sense. Is this universal... or are the rich different?

Welcome to the world of the wealthy elite! But who exactly are they? Unfortunately, there is no clear-cut definition for ‘rich’- much to the disappointment of many an A-level Economics student writing an essay on this topic. The rich cut-off point is an arbitrary choice; however, we will focus on the top 1% of income earners. In Britain this is anyone earning more than £156,000; together they contribute almost a third of all income tax revenue. However, it is necessary to look at both the ‘rich’ and the ‘super-rich’ who earn millions -if not billions- a year. The ultimate question is not should we impose high taxes on the rich but can we?

With ever increasing austerity to reduce budget deficits along with attempts to reduce income inequality through income redistribution, this ideologically driven debate has never been so prominent, drawing upon principles from politics, economics and sociology. Although taxing the rich at a higher rate may appear to be good politics, it may not necessarily be good economics as it can be subject to the law of unintended consequences. With significant improvements in the mobility of talent over recent decades, it has never been easier for the rich to emigrate in order to reduce their tax liabilities. This connection was noted by Mirrlees (1982): “High tax rates encourage emigration”, implying the affluent are likely to leave if their domestic utility is less than their utility abroad net of migration costs, as a result of high taxation. This is supported by evidence from the 50p top income tax rate that was introduced in the UK: in 2009/10 more than 16,000 people declared annual income over £1 million but this fell to 6,000 after the top rate was raised, costing the government £7 billion in lost tax revenue. It is believed many rich Britons moved abroad or took steps to reduce their taxable incomes. Can governments afford to adopt such risky tactics in this precarious economic climate with one’s private jet so easily available?

When it comes to the rich, the lack of homogeneity of workers means the labour market is not perfectly competitive, resulting in the emergence of economic rent. In the case of some ‘talented’ individuals, the supply of individuals able to do the job is limited in the short run and unresponsive to wage increases, for example, an international footballer may be paid £150,000 a week but might have been initially willing to do their job for much less. This ‘excess’ payment could be said to be unearned income since it is beyond the weekly value the person put on their labour when they decided to do that job so the government could tax away all their economic rent. If they attempt this, leaving a worker with their transfer earnings alone, then talented individuals will move abroad, to where taxes are lower. Tax revenue is lost along with associated skills/ jobs/ investment. As a consequence of the international mobility of talent, combined with barriers to entry in the labour market and the potential for relatively lower tax rates in other countries, it makes it almost impossible for the government to tax the ‘excess’ earnings of the ultra-affluent.

Moreover, low barriers to international mobility of labour have also contributed to increased difficulties when taxing the footloose wealthy. As a result of close economic integration in Europe, the free mobility of labour within the EU removes barriers to labour mobility which helps facilitate the migration of talent within the continent. The threat of migration is strongest within Europe
where wealthy, talented individuals can easily relocate to lower tax economies. The repressive 75% tax rate on the rich in France has cost the country one million jobs with 60,000 of the country’s rich now living abroad to avoid the tax. Concerns have also been raised that the mobility of talent is creating harmful tax competition in some countries leading to a ‘race to the bottom’ and a loss of tax progressivity within Europe. Low barriers to mobility aren’t just an added difficulty in Europe, but also in the US where wealthy Americans are very mobile: if they don’t like the tax system in one state they can easily move to another one.

How do these ideas fair in reality? A study by Kleven, Landais and Saez on taxation and the international mobility of superstars in the European football market revealed that due to relatively low mobility costs, professional European footballers have greater mobility since their talent requires minimal place-specific investment of human capital. The study takes advantage of variations in tax policies and labour regulation across Europe to identify the relationship between tax rates and emigration of the rich. A strong negative correlation between top earnings tax rates in a country and the fraction of players from the country playing at home in the domestic league was found, suggesting significant behavioural responses to tax rates. The elasticity of probability of playing in a given country depending on the net-tax rate on earnings is relatively large; younger players are more sensitive to taxation with a parameter estimate of 0.72 compared to 0.48 for the sample as a whole. When the sample is restricted to just top quality players, the coefficient is 1.15 meaning the most talented players are much more responsive to tax rate differentials making them the most mobile with fewer geographical constraints on earning capacity. As a result, their residential decisions may depend more on the ‘tax price’ of a given jurisdiction.

Preferential tax laws such as the ‘Beckham law’ saw a surge in the share of top international players (figure 1) living in Spain with Cristiano Ronaldo moving to Real Madrid in 2009 to take advantage of the 24% flat tax rate. Belgium and Denmark also adopted similar tax systems and saw the fraction of foreign players rise sharply. However, with the Spanish tax system changing so that high earners such as Ronaldo must now pay 52% on their earnings, is this the real reason he’s considering a return to the Premier League? Large tax differentials across Europe, along with preferential tax systems, encourage the mobility of talent. Some see tax rate harmonisation as the only possible solution in this deeply economically integrated area but at present this seems unlikely.

However, in reality how many rich can follow in Beckham’s recently retired footsteps and simply transfer to the country of their choice? Footballers and talent of this nature are a very select, elite group and so the ability to tax them in relation to the international mobility of talent will differ substantially from, for example, a highly skilled banker who may have higher geographical constraints on earning capacity resulting in them being quite immobile. Positions in the most highly-skilled and highly-remunerated professions are often concentrated in particular places, for example bankers in London’s financial district or Wall Street. In industries such as banking, agglomeration and concentration effects of external economies of scale are important and consequently, this may restrict the international mobility of talented bankers since they must reside in the same country as they work in. However, the US and UK both have fairly high relative top marginal tax rates and so these talented individuals must also face these high taxes. Moreover, talent is attracted by the availability of other talented individuals and this may not be present in relatively lower tax economies. The demand for their ‘talent’ is derived from the demand for workers needed for the
output they are required to produce. As a result, it may not be as easy for rich individuals to simply locate to the country with a lower rate of income tax. If there is not sufficient demand for their skills, there may be large wage differentials which could lead to a net loss of utility rather than a gain from lower income taxes.

We must also consider—something we inadvertently forget—that not all wealthy, talented people are motivated by money. Neoclassical economic theory suggests a simple cost-benefit analysis when deciding whether to emigrate and non-pecuniary factors are just as important. The rich still have strong ties to their country such as: home, family and community and they must also consider linguistic compatibility, networks and socio-cultural affinity. Together with an individual’s ability and willingness to give up their job to migrate, these factors influence an individual’s propensity to migrate which determines how the incentive for tax flight translates into actual behaviour. Economic literature suggests the general propensity to migrate in response to tax changes is fairly low for the majority of rich people. This is corroborated by empirical evidence from the New Jersey millionaire tax, which raised top income tax rates by 2.6 percentage points. The study found little responsiveness to the tax increase with semi-elasticities generally below 0.1. The millionaire tax did not lead to millionaire migration but in fact the overall population of millionaires increased (figure 2). It was a similar case in California in 2005, which raised the tax rate on income by 1 percentage point (figure 3). These findings are suggestive of the socio-economic factors that constrain wealthy individuals’ ability or willingness to migrate in response to higher tax rates. So although there is a potential for the international mobility of talent, it may not always translate into emigration and lost tax revenue.

If the rich still decide to emigrate, can the government ensure that they pay their fair due? Tax flight concerns are lower when a country has worldwide tax jurisdiction meaning assets can be taxed wherever they are located: similar to Mirrlees’ optimal nonlinear tax model in which both residents and emigrants are taxed. Individuals can leave the tax system, if they renounce their citizenship after emigrating. The US is the only advanced economy to enforce income and capital gains tax on expatriates causing some high-profile Americans to take extreme measures to avoid tax, including Eduardo Saverin, co-founder of Facebook, who renounced his US citizenship and took up residency in Singapore to benefit from a top tax rate of only 20%, saving him an estimated $67 million. Evidently there is a trade-off: allowing emigrants to avoid taxes by surrendering their citizenship limits the ability of the home government to tax these individuals. In order to minimise this, governments could tax rich emigrants on the same basis as non-resident citizens, who maintain a tax home in a foreign country and benefit from the same tax laws as domestic citizens within home territory. Although, this is a very stringent policy measure, it makes it almost impossible for the rich not to pay tax despite the international mobility of talent which becomes superfluous.

So if the rich do emigrate, is high taxation to blame? You may be surprised to hear that the top destinations of the footloose wealthy who emigrate from Britain include even higher tax economies. According to research by Lloyds TSB, the top destination is France, followed by Spain, the US, Australia and New Zealand, thus, going against the conventional wisdom. One in five wealthy Britons has threatened to emigrate in the next two years with the biggest two reasons cited as crime and weather and they would prefer infrastructure spending and ‘cutting red tape for business’ rather than lower taxes. So, quality of life factors may be more influential for the rich than tax rates.
Moreover, an increasing number of the mega-rich around the world are surprisingly willing to pay high rates of tax with affluent German and French even signing petitions for higher taxes! In the US there is the “Buffett rule” named after the billionaire Warren Buffett, who strongly disagrees with the US tax system allowing him to benefit from an effective tax rate which is lower than his secretary’s. This suggests that they feel it is their duty to pay their fair share of the tax burden.

Ultimately, the mobility of talent may not be the greatest obstacle to taxing the rich; instead it may be the mobility of taxable incomes. ‘The rich are different’ (Alm and Wallace) and their taxable income elasticity may be more sensitive to marginal changes in the tax rate. Their greater tax responsiveness may be facilitated by access to the best tax advice which finds them legal ways other than emigrating, to readjust their income to avoid top rates, for example, through income splitting, investing in tax shelters like flow-through shares or the use of off-shore accounts in so called ‘tax havens’. The problem isn’t so much individuals moving their incomes somewhere else, instead it is them legally moving their incomes somewhere else through tax avoidance or using illegal strategies to evade tax. Financial liberalisation has generated rapid growth in off-shore banking with the rich around the world holding $18 trillion in off-shore banks according to the IMF, which is greater than the annual GDP of the US. Tax evasion is potentially an even bigger problem and recent cases have highlighted this with Lionel Messi finding dodging taxes easier than dodging defenders and Dolce and Gabbana being sentenced after evading $1.3 billion in taxes. This reinforces that whether talented individuals emigrate or not, they can still reduce tax liabilities, making the international mobility of talent less important.

Ironically, the British tax system is not driving the global elite from our shores. Why do so many wealthy people choose to live in Britain when we have a relatively high rate of income tax? The answer is: tax. In Britain there is a distinction between residence and domicile, with a favourable tax regime for people who reside here. Britons are taxed on worldwide income whereas foreigners are only taxed on the money they bring to Britain and spend here. This influx of talent makes a very useful contribution to the UK economy.

So, does the international mobility of talent make it impossible to tax the rich? It makes it harder but we must remember that not all rich individuals are perfectly mobile especially those who own businesses or are in certain professions. It could be concluded that the mobility of talent to avoid taxes may only be an option for those such as footballers- those who do not face constraints on mobility. Perhaps reforms which close loopholes and broaden the tax base are a more efficient way to generate revenue than high taxes on the rich which create the threat of the mobility of labour to reduce tax liability. International tax cooperation reform is essential to end the abuse of tax havens and off-shore finance and limit the extent to which rich individuals attempt to pursue less socially productive activities to avoid taxes. According to Benjamin Franklin: “In this world nothing can be certain except death and taxes” so it’s not impossible to tax the rich but it probably will be impossible to convince the average tax payer that they’re ever paying enough!

**Word Count: 2,499**
Appendix:

Figure 1:

Impact of the ‘Beckham law’ in Spain


Figures 2&3:

New Jersey Millionaire Tax Filers

Source: Adapted from The Wall Street Journal

California Millionaire Tax Filers

Source: National Tax Journal
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