The Retreat of High Income Tax Rate Philosophy in the World

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One important indicator of how socialist or (forced) collectivist leaning a country is, is the level of tax rate that citizens are forced to surrender their income to the state. Economies that emphasize forced collectivism and coerced contribution to social welfare have high income tax rates, say more than 40 percent. At this rate, the hard-working, high-earning, and performance-driven citizens are left with less than 60 percent of the fruits of their hard work, unless they learn to cheat their income tax payment and the tax system is easy to be manipulated, or the tax administrators and collectors are corrupt and easy to bribe.

The decades after WW2 saw many countries, especially their politicians, hugging socialist thinking. That is, in order to hasten the development of their societies, a big portion of the income and savings of the rich and high-earning people should be confiscated through high income tax rates, and the money be distributed to the poor and the weak, including the lazy and irresponsible, so that there will be more equality and more social progress. This thinking has pervaded until the early 80s, so that by 1980, the vast majority of countries have top marginal income tax rate of 50 percent or more. Exceptions were HK in Asia, Switzerland in Europe, and Argentina in South America, among others (See table 1 below). A lot of tax cheating also happened in many countries where income tax rates are very high, resulting in lower tax collection by governments.

The wave of globalization in the 80s made many politicians and their respective technocrats realize that they need to relax a bit their level of income confiscation as there was an emerging “income tax competition” among countries. A number of their people and businesses are moving elsewhere where income taxes are lower or easier to comply. So that by 1990, more than half of Asia-Pacific countries have top marginal income tax rate of less than 50 percent. The same pattern was observable in South and North America. Europe remained enamored with social democratic and other variants of “limited socialism” ideology, except Switzerland and the UK. For African countries, there was tax rate reduction but still high, except in Jamaica.

The continued wave of globalization, especially the formation of GATT-WTO in the mid-90s, compelled more governments to further slash their income tax rates. By 2000, until 2005, only Japan and some European countries, have marginal income tax rate of 50 percent or higher. The philosophy and practice of high income tax rates, for both personal and corporate incomes, have retreated.

In addition, the new trend now for some countries in income taxation, is low, flat (or single rate) tax. This is particularly true for many formerly Eastern European countries. Russia is one of those countries that have recently embraced the flat tax philosophy and subsequently implemented it. This is after a realization by many governments that high income taxes not only push many of their productive and entrepreneurial citizens to migrate to other countries, but high and multiple-rate taxes encourage cheating, of lowering the declared income so that the corresponding tax rate will also be lower.

The tax burden for the citizens can be computed as:

Tax burden = tax rate + cost of compliance.

Regulations on tax exemptions for dependents, expenditures that are tax-deductible, plus the multiple tax rates or tax brackets, can be confusing, so that people have to spend extra time studying these things, or have to hire tax consultants to make their compliance easier. Hence, the attractiveness of low, single rate income tax.

Table 1. Top marginal income tax rate, selected countries

Country	1980	1990	2000	2005
1. Hong Kong	15	25	17	20
2. Singapore	55	33	28	21
3. Bangladesh	60	25	25	25
4. Malaysia	60	45	29	28
5. Philippines	70	35	32	32
6. India	60	53	30	34
7. Indonesia	50	35	35	35
8. Pakistan	55	50	35	35
9. Thailand	60	55	37	37
10. New Zealand	62	33	39	39
11. S. Korea	89	64	44	39
12. Taiwan	60	50	40	40
13. China	45 ('85)	45	45	45
14. Australia	62	49	47	47
15. Japan	75	65	50	50
16. Russia	100	80	30	13
17. United Kingdom	83	40	40	40
18. Switzerland	31-44	33-43	31-40	26-42
19. Germany	65	53	56	44
20. Spain	66	56	48	35-45
21. Italy	72	66	51	43-45
22. France	60	53	54	48
23. Sweden	87	61-68	51-58	52-59
24. Brazil	55	25	28	28
25. Mexico	55	40	40	33
26. Argentina	45	35	35	35
27. Chile	58	50	45	40
28. United States	70-75	33-42	40-46	35-42
29. Canada	60-68	44-54	39-49	39-49
30. Ghana	60	55	30	25
31. Nigeria	70	55	25	25
32. Jamaica	80	33	25	25
33. Kenya	65	50	32	30
34. S. Africa	60	45	45	40

Source: Gwartney, James and Robert Lawson, Economic Freedom of the World, 2007 Report. Published by The Fraser Institute (www.freetheworld.com)

But while it is true that many governments were compelled by new circumstances to reduce their income tax rates, this did not mean that they have fully abandoned socialist-leaning philosophy. Almost coinciding with the reduction of income tax rates, they introduced new, or hiked the existing, consumption-based tax rates, like value-added tax (VAT), sales tax, excise tax, vehicle tax, property tax, amusement or entertainment tax, travel tax. In addition, they also introduced new or hiked existing government fees and charges, like passport fee, visa fee, driver's license fee, airport/seaport terminal fee, business permit fee, mining/quarrying fee, and so on.

This is a new ballgame for the citizens aspiring to have bigger leeway and freedom how they should spend their earning and savings given their household-specific needs and priorities. Meanwhile, the fight for even lower income tax rates compared to existing levels, if not the abolition of income tax, is a pressing challenge for the citizens, the free market-oriented NGOs and research institutes in particular. A zero income tax with high consumption-based taxes like those mentioned above, should be a good compromise and advocacy.