



Briefing - The Myths About Tax Cuts

November 2019





The National Union of Public and General Employees (NUPGE) is a family of 13 Component unions. Taken together, we are one of the largest unions in Canada. Most of our 425,000 members work to deliver public services of every kind to the citizens of their home provinces. We also have a large and growing number of members who work for private businesses.

The office of the National Union of Public and General Employees is on the traditional and unceded territory of the Algonquin peoples and is now home to many diverse First Nations, Inuit, and Métis peoples.

We recognize the crimes that have been committed and the harm that has been done and dedicate ourselves as a union to moving forward in partnership with Indigenous communities in a spirit of reconciliation and striving for justice.

Bert Blundon, President

Jason MacLean, Secretary-Treasurer



Executive Summary

Income and wealth inequality are rampant in Canada and worldwide. The extremely-wealthy continue to get richer, while working people face stagnating wages, increasing precarity, and the rising cost of living, with billions of people around the world still living in poverty. All of this occurs while corporations and wealthy individuals are paying lower tax rates and public services are under threat.

Despite the mounting evidence of these trends (and the connections among them), neoliberal governments and theorists continue to argue that low taxation, austerity, and privatization agendas are the way to foster prosperity for all.

Most recently, we have seen Jason Kenney's government in Alberta touting the alleged benefits of tax cuts (as well as spending cuts). In its 2019/20 budget, the Kenney government has committed to cut the corporate income tax rate by one-third, from 12% to 8% by 2022, arguing this will grow businesses and create jobs.¹ The Kenney government has cited a study by University of Calgary economists, which projects the proposed corporate tax cut will lead to increases in GDP and employment.²

Conservative governments in other provinces, such as the Brian Pallister government in Manitoba and the Doug Ford government in Ontario, have also brought in tax cuts. They cite "fiscal responsibility" as the reason for these cuts.

However, numerous studies and experts around the world have long debunked the myth that lowering taxes will spur growth, create jobs, and raise wages. The briefing that follows provides an overview of some of this evidence and analysis.

Tax cuts have not led to increased prosperity for all. Rather, a tax system characterized by low income tax, low corporate tax, tax credits as substitutes for public spending, and tax loopholes has fueled income and wealth inequality and starved the public sector.

Indeed, research and case studies have shown that it is fair and progressive taxation, along with investment in public and social services, that leads to more widespread benefit and equitable outcomes.

The Promise of Low Taxation

The failures of tax cuts and other neoliberal policies have become widespread and increasingly apparent around the world.³ In spite of this trend, proponents continue to cite low taxation as a primary driver of economic growth, job creation, and prosperity for all people. We see this position from governments across Canada, and most recently from Jason Kenney's Alberta government, which justifies a corporate tax cut on the supposed basis it will create GDP growth and new jobs.⁴

This briefing provides an overview of some of the literature that debunks this myth. Critics have long demonstrated that low taxation does not contribute to widespread prosperity. In

fact, it has fueled income inequality and starved the public sector. Indeed, evidence shows that progressive taxation, and investment public services, social programs, and infrastructure, lead to more benefit.

Low taxation is often sold as a necessary tool for economic growth. Known as supply-side economics, the rationale behind it is that by keeping taxes on businesses and wealthy individuals low, the money will instead be invested, spurring economic activity. In turn, it will contribute to new jobs, rising incomes, economic growth, and prosperity for all.⁵ Proponents argue, therefore, that low taxes should be governments' main tool for stimulating growth.⁶

This theory, also known as trickle-down economics, is often associated with the Reagan administration in the US, Thatcher's in the UK, and Mulroney's government in Canada, though it has roots further back in history, and it maintains a strong presence today.⁷ The support for tax cuts grew in a context wherein taxes had become highly politicized, contributing to a strong anti-tax sentiment in Canada and the US.⁸ It lingers today.

The logic is that tax cuts at the top—for the wealthy and for large corporations—will enable investment and job creation, causing benefits to “trickle down” to the rest of society.⁹ At the root is an assumption that the private sector plays a larger role than the public sector in generating economic activity and prosperity. Proponents argue that low taxation will, through private and business investment, lead to greater tax revenues in the end than if governments were to tax directly.¹⁰

However, extensive research shows that there is little empirical evidence that tax cuts do, in fact, lead to economic growth, investment, and job creation.

In Canada, we have seen numerous tax cuts to both income tax and corporate tax rates in recent decades. The corporate tax rate has fallen from 50% in the early 1980s to 29% in 2010 to the current 15%, one of the lowest rates in the OECD, costing billions in government revenue and failing to deliver benefits to all Canadians.¹¹ Between 1998 and 2011, federal and provincial taxes as a share of GDP dropped from 45% to 33%.

Economist Jim Stanford analyzed Canadian business investment and cash flow data from 1961 to 2010. His analysis finds no evidence that lower tax rates directly stimulated investment, but rather business investment decreased as a share of GDP and as a share of corporate cash flow.¹² Furthermore, his calculations show that government investment in public infrastructure would contribute to 10 times more investment than the amount resulting from tax cuts.

Similarly, economist Jordan Brennan's historical analysis of Canada's corporate income tax regime finds no empirical or statistically significant relationship between the tax regime and economic growth. He looks at 5 dimensions of growth: business investment, private sector employment, GDP per capita, labour compensation, and productivity.¹³ Corporate income tax cuts have failed to spur economic growth and may have actually contributed to

slower growth. As the cuts allow the corporate sector to accumulate more money, and as large firms tend to hoard cash rather than invest it productively, corporate income tax cuts have enabled this “dead money,” leading to slower growth. Given these findings, “corporate income tax cuts will go down as one of the great Canadian public policy blunders of recent times.”¹⁴

Despite the promise that low corporate taxes would stimulate investment and higher wages—trickle down to the rest of Canadians—corporate tax cuts have failed to stimulate business investment spending. Instead, we have seen rising corporate profits and executive compensation, while investment has decreased as a share of the economy and wages have stagnated.¹⁵ Economist Armine Yalnizyan has argued that corporate tax cuts are the least effective way to create job growth.¹⁶

In his academic literature review exploring the link between tax cuts and economic growth in the US, researcher Mazerov found that “there is simply no consensus whatsoever that cutting taxes is a good strategy to boost state economic growth and create jobs.”¹⁷ While proponents of low taxation have very few studies that support their claim, there are many more studies that find little to no link between low tax levels and measures of economic performance (e.g., job creation, and income growth), or find that the link is inconsistent depending on the context, including factors such as time or other measures.¹⁸

Analyzing US economic performance over time, another study shows that the supply-side eras did not outperform the non-supply-side eras. Several factors, including growth in investment, productivity, the economy, jobs, middle-class income, and wages, were weaker under the low-tax policies.¹⁹ Notably, this was the case under Reagan’s 1981 Economic Recovery Tax Act. According to the U.S. Treasury Department, the tax cut, the largest between the 1968–2006 period surveyed, did not yield tax revenue increases as promised.²⁰

More recently, the failed promise is evident in the wake of the Trump administration’s corporate tax cut in 2017, which has had little impact on boosting economic growth. Despite the administration’s claim that tax cuts would lead to higher wages and a rise in business investment—a promise of “trickle down”—analysts have observed that there is little evidence to support that the tax cut is contributing to either.²¹ Instead, it has further enriched corporations, allowing them to amass increasing levels of profits while reducing government revenues, and has done little to stimulate the U.S. economy.²²

Another outcome was a spike in share buybacks. Mainstream sources such as *The Economist*, the *Financial Times*, and *Harvard Business Review* have critiqued this practice, which has been considered “stock price manipulation.”²³ Allowed by regulators in the 1980s, it has eroded employment opportunities for the middle class.²⁴ The Trump tax cut encouraged the practice, leading to a record-setting \$1 trillion in share buybacks in 2018,²⁵ thereby enriching shareholders while wages stagnate.²⁶

Cuts to income tax have not delivered as promised either. Like corporate taxes, income tax rates in Canada have dropped in recent decades, meaning that the wealthiest are paying less in taxes than in previous generations. During Canada's high-growth years from 1940 to 1980, the top marginal income tax rate was over 70%, while in recent years it has been 29%. According to the CCPA, accounting for tax cuts and loopholes in recent decades, "the top 1% now pay a lower overall effective rate of tax than all other income groups, including the poorest 10%."²⁷

Research shows that tax cuts for the top 10% of income earners lead to little employment growth.²⁸ When there is a positive relationship between low taxes and employment growth, it is lower taxes on low-income groups that are responsible.

Proponents of low taxation often argue that high taxation will cause economic activity to relocate. In his literature review, Dalhousie University economist Lars Osberg finds little evidence that an increase in top tax rates causes "job creators" or "the best and the brightest" to flee.²⁹ Other scholars have observed that tax increases are not shown to have a significant influence on where people live.³⁰ More progressive income tax systems have not proven to cause tax flight amongst the wealthy,³¹ nor do they slow income growth.³² One study found that, in the 1990s, lower taxes in the U.S. did not cause a "brain drain" from Canada to the U.S., despite fears that this would occur.³³ Notably, it is actually public services and amenities that play a role in determining where people want to live.³⁴

As tax rates have fallen in recent decades, inequality has risen. Since the mid-1980s, the top income share has surged, with the exception of 2008–09. Although this period has also been marked by globalization, skill-based technical change, and rising CEO compensation, Canadian economist Michael Veall underlines changes in taxation as a key factor.³⁵

It is worth acknowledging that the pro-low taxation approach is focused on economic growth, a preoccupation of mainstream economics broadly. Evidently, though, low taxation is failing to foster such growth.

The International Monetary Fund (IMF) and the World Bank, not known for their progressive stances, have begun to acknowledge widening income inequality within and between economies,³⁶ and the role of taxation.³⁷ A 2015 report from IMF staff found that the gap between rich and poor is costly for economic growth. For each 1% the rich get richer, a country's GDP growth decreases by 0.08% over the next 5 years (whereas a 1% increase for the poor and the middle class contributes to a 0.38% increase in GDP growth).³⁸ This is likely because the super-rich continue to accumulate more wealth than they can use, while the poor and middle class use a larger portion of their income.³⁹

The IMF analysis is evidently paying attention to rising inequality as it affects economic growth. It is worth noting that numerous scholars and advocates have challenged the more fundamental issue of growth, with studies and movements under the banners of degrowth,⁴⁰ planetary boundaries,⁴¹ ecological rift,⁴² and the contradictions of capitalism (or capital accumulation) more broadly.⁴³ These critiques call for a more systemic shift.

As economist Dan Lieberman summarizes, the claim that lowering income taxes will automatically stimulate the economy is a fallacy:

Individual workers and taxpayers benefit from tax cuts; however, stimulating the entire economy by income tax breaks is a psychological phenomenon. The exaggerations, promises, and optimism generated by tax breaks fashion a more optimistic public that incorrectly assumes they stimulate additional spending to already combined consumer and government spending. Creeping into the debate are other false assumptions—those who have excess funds will purchase domestic goods, invest, and stimulate growth. Not considered is that individuals might purchase imports, invest in speculative ventures that only churn money, and decrease available purchasing power in the domestic economy.⁴⁴

Rather than contributing to widespread economic gains, low-taxation policies disproportionately benefit wealthy individuals and corporations.

The Actual Outcome: Rising Inequality

According to Jim Stanford, “as a means of stimulating growth, employment, and even private business spending, the historical evidence suggests that business tax cuts are both economically ineffective and distributionally regressive.”⁴⁵ Not only has low taxation failed to deliver what its proponents promised, but it has had negative effects on working people, particularly on those who are marginalized or most vulnerable.

It is true that recent decades of low taxation have contributed to massive wealth for very few individuals and corporations, but this has not translated to widespread or public benefits. In other words, it has fueled income inequality.

There is growing recognition—in the public discourse, across the political spectrum, and around the globe—of rampant income inequality. One of the more popular accounts, *Capital in the Twenty-First Century*, by Thomas Piketty, the French economist, charts the rise of income inequality and wealth inequality, pointing to taxation rates as part of the puzzle.⁴⁶ Wealth inequality is even more pronounced than income inequality, and the gap between the rich and the rest of us continues to grow.

According to Oxfam’s 2019 report, *Public Good or Private Wealth*, the collective wealth of the world’s billionaires increased by \$2.5 billion per day over the last year.⁴⁷ The Canadian Centre for Policy Alternatives (CCPA) produces an annual report comparing the pay of the top CEOs to the average salary in Canada. The 2019 report found that Canada’s 100 highest-paid CEOs netted 197 times more than the average worker’s salary in all of 2017.⁴⁸

The CCPA has also reported on wealth accumulation in Canada. A 2018 report found that the average net worth of Canada’s 87 wealthiest families, each with over \$1 billion,

increased by 37% between 2012 and 2016—a gain of \$806 million per family—while the net worth of middle-class families increased by only 16%—a gain of only \$41,000 per family—over that time frame.⁴⁹ These super-rich families hold 4,448 times more wealth than the average family, accumulating more wealth than the bottom 12 million Canadians combined. These figures are staggering, especially as working Canadians face a rising cost of living and insecurity.

Furthermore, the report finds that in addition to higher incomes and wealth inheritance, a primary factor contributing to this wealth accumulation is taxation: “Canada’s tax system is set up to encourage concentration of wealth at the very top.” This is the combined result of lower tax rates on both employment income and income from wealth (i.e., capital gains and dividends). Money earned from capital gains is taxed at 50% lower than employment income, and dividends are taxed at 25% lower.⁵⁰

Although tax cuts and tax credits are often sold as a means to return money to Canadians, a theme evident in the recent federal election, research shows they have limited and uneven impacts. Offering so-called boutique tax credits appeals to certain segments of the population, but ultimately they have limited impact on affordability. For example, according to a study by University of Alberta researchers, the Children’s Fitness Tax Credit disproportionately benefited wealthier families, with 70% of the benefit going to the top one-quarter of families. It cost the federal government revenue, and did little to increase youth fitness participation.⁵¹

The failure of wealth and benefits to trickle down has had negative effects on people’s well-being and access to resources.⁵² Furthermore, poverty and inequality have uneven effects across groups of people. The unequal effects of regressive tax policy, therefore, are particularly harmful to women, racialized, and Indigenous people in Canada.⁵³ It is not only that men outnumber women amongst the super-rich and the CEOs that run the top companies,⁵⁴ but that poverty disproportionately affects women, particularly those who are racialized, transgender, (im)migrants, or living with disabilities.

Not only has economic growth disproportionately benefited high-income groups, but income inequality, in turn, hurts economic growth.⁵⁵ Rather than fueling prosperity for all, Canada’s tax policy has resulted in weakened, underfunded, or eliminated public services, social programs, and infrastructure due to lost government revenues.⁵⁶ For example, according to the Parliamentary Budget Officer, the GST cuts under Stephen Harper—to 6% in 2006, and to 5% in 2008—cost the government about \$14 billion in lost revenue.⁵⁷

Despite massive profits, corporate taxes in 2015 only accounted for about 14% of federal government revenues, compared to over 20% before 1970, meaning corporate tax cuts have cost billions in foregone revenue.⁵⁸ A study tracking data from nearly 200 of the top Canadian companies between 2000 and 2009 found that by 2009 these companies were obtaining 50% more profit, but paying 20% less tax than they were in 2000.⁵⁹ Under

Stephen Harper, cuts to GST and the corporate tax rate shrank government revenues, and paved the way for gutting social programs.⁶⁰

Canada's tax system also allows for tax avoidance. Tax havens have received much attention in recent years. The Panama Papers investigation illuminated the massive number of offshore companies, the growth of tax havens in recent decades, and the amount of tax revenue lost as a result.⁶¹ Scholars estimate that the equivalent of 10% of global GDP is held offshore in low-tax or zero-tax jurisdictions known as tax havens.

Data also shows that the use of tax havens varies across the globe.⁶² Canada loses over \$15 billion in revenue each year to tax evasion facilitated by tax havens.⁶³

Furthermore, tax havens obscure the picture of inequality, as wealth held offshore cannot be reflected in income or wealth inequality figures. Scholars have found that when you account for offshore wealth, inequality is higher, particularly in those regions where the use of tax havens is high.⁶⁴ With income and wealth inequality already at staggering levels in Canada and around the world, the presence of tax havens means that wealth inequality is even greater than we can presently measure.

What Would Actually Work?

Not only is there a great deal of evidence debunking the myth that low taxation spurs economic growth, job creation, and rising income, but evidence and case studies show that fairer taxation systems are the key to more widespread benefit.

In fact, numerous studies have found that higher taxes are associated with stronger economic performance when the resulting revenues are invested in things like public education and infrastructure.⁶⁵ Therefore, scholars point to progressive tax systems as an important tool for tackling inequality.⁶⁶ Tax experts have illustrated that fair taxation is crucial to increasing governments' ability (i.e., revenue) to fund public services, infrastructure, and environmental action.⁶⁷

Recent IMF reports identify the declining progressivity of tax systems in some advanced economies over recent years as a key driver of inequality and point to progressive tax systems and public spending as redistributive policy tools.⁶⁸ Some researchers have gone further to crunch the numbers to determine how much more funds could be raised with a higher income tax rate on the wealthiest.⁶⁹ Establishing wealth taxes and eliminating tax breaks for capital gains and dividends would raise billions of dollars that could be used to fund public services and to foster a more equitable society.⁷⁰

In addition to progressive income tax, scholars highlight the value of corporate taxes and wealth taxes. The latter has increasingly received positive reception, including being featured in the 2019 Canadian federal election campaign and the ongoing U.S. Democratic primaries. In his work on inequality, Piketty proposed a global wealth tax as a key tool for governments to reign in inequality and to prevent economic instability.⁷¹

Scholars and advocates have developed detailed recommendations for improving the tax system. According to the CCPA's 2019 Alternative Federal Budget, closing unfair and ineffective tax loopholes by eliminating or restricting stock option deductions, capital gains, TFSAs, RRSPs, corporate meals and entertainment expense deductions, and fossil fuel subsidies would raise an additional \$18 billion in revenue, without raising taxes for 90% of Canadians.⁷² Canadians for Tax Fairness has developed a Platform for Tax Fairness that outlines comprehensive, progressive tax reform.⁷³

In addition to tax reform, public spending, particularly investment in public and social services like health care and education, is shown to address inequality.⁷⁴ Indeed, these can and must go hand in hand: fair taxation is a key redistributive tool, as funds can be invested in public and social services. Again, various calculations and case studies illustrate this point.

For example, Jim Stanford has illustrated the greater economic benefit of government investment in public services and amenities compared to funding tax cuts. Compared to a \$6 billion tax cut, direct public investment of the same amount also elicits an additional \$520 million in new private investment. Therefore, the combined economic gain of the direct public investment and the additional private investment as a "spin-off effect" are greater than funding a tax cut alone.⁷⁵

In a 2009 report, the CCPA calculated the benefits of public services compared to the benefits of tax cuts. They found that not only do Canadians depend on public services but their benefit is much greater than that from tax cuts. According to the report, most (2 of 3) Canadians benefit from public services, funded by their taxes, at a value of more than half of their household-earned income.⁷⁶ Their analysis shows that over 75% of Canadians would have been better off if the federal and provincial governments had not implemented tax cuts in the late 1990s and early 2000s, and instead had invested in public services. In short, public services are "the best deal" for the majority of people in Canada.

The value of public sector investment is evident in both past and present cases. The postwar period in Canada and the US is cited as the golden age of the welfare state. Higher taxes and government spending, and a strong social safety net, contributed to more equal distribution of income and wealth. In an international study of 13 developing countries, spending on health and education made up for nearly 70% of the total reduction of inequality.⁷⁷

Progressives have long cited the Nordic countries as exemplary models of egalitarian societies. The social democratic economies of Sweden, Denmark, Finland, Norway, and Iceland are characterized by strong welfare states, large public sectors, and higher tax rates,⁷⁸ known as the Nordic model,⁷⁹ and often rank relatively high on indicators of development, income equality, gender equality, union density and strength of trade unions, and democratic and civil society engagement.⁸⁰ Interestingly, even mainstream economic actors like the World Economic Forum and *The Economist* have begun to take

note of the Nordic countries for their equality and democracy, as well as economic competitiveness.⁸¹

While imperfect, and experiencing rising inequality and anti-immigrant sentiment in recent years,⁸² these economies have demonstrated the equity and public service outcomes fostered by progressive taxation.

Conclusion

Much evidence and analysis has shown that low taxation does not lead to widespread benefits for all people. In fact, evidence shows that decades of low taxation, coupled with government spending cuts, the rollback of public services, privatization, and wage stagnation have only exacerbated inequalities.

Despite the failure of this model, proponents and policymakers continue to tout the need for tax cuts. Jason Kenney campaigned on making lives better for Albertans. Instead, he has brought in tax cuts that will hurt working people. According to Canadians for Tax Fairness,

the corporate tax cut will cost the Alberta government \$1.7 billion every year – the equivalent of \$1,000 per household. Most businesses in Alberta, which are small and have annual profits below \$500,000, won't benefit at all and there's little evidence that tax cuts create jobs in the first place.⁸³

In fact, we are already seeing cuts to public services, job loss, and the threat of wage rollbacks.⁸⁴

Notably, Canadians support the notion that paying taxes is part of being a good citizen.⁸⁵ Polling shows that Canadians support increasing taxes on the rich, on large corporations, and on capital gains.⁸⁶ Given the disconnect between this support and the narrative that elicits hostility for taxes, there continues to be work to do to highlight the link between the tax system, and inequality and the rising cost of living. It is also necessary to underline the benefits of fair taxation for providing the necessary resources to fund important public and social services and programs, and in turn, to foster a more equitable society.

Notes

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