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Why Charity Isn't Enough

THE CASE FOR RAISING TAXES ON CANADA'S RICH

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Summary

Several recent studies point to troubling new income and taxation trends in Canada. The income gap between the rich and the rest of us keeps growing, at breakneck speed. While the majority of Canadians are working harder and smarter, contributing to a growing economy, most are running faster just to stay in place. Their wages have been stagnant for the last 30 years. Meanwhile, the top 5% of income earners in Canada — are getting richer by leaps and bounds.[1] Incomes of the very richest — the top 0.01%, the millionaires in our midst — have doubled since 1992. Canada's richest citizens are enjoying an explosion in their market income that the majority of Canadians have not seen. At the same time, Canada's richest citizens have been bestowed another, generous gift: They have been the biggest beneficiaries of a decade's worth of federal and provincial tax cuts. While their effective tax rate shrinks — disproportionately compared to the majority of Canadians — Canada is quickly moving away from a progressive tax system where those who have more contribute more.

Instead, our governments are leading the nation towards a regressive tax system where the rich are asked to contribute less, despite their ability to pay their fair share. This paper makes a clear and simple case for raising taxes among the richest of Canadians, to fund the kinds of things Canadians say they want and need to continue to be productive citizens: public health care, affordable housing, reasonable university tuition, better public infrastructure, public transit, and affordable quality child care. It finds that progressive taxation of income plays an important role in reducing income inequality in Canada, but the progressivity of our system has been diminishing under the tax cut agenda. The paper concludes that a basic increase in the personal income taxes paid by our richest citizens would put the progressivity back into Canada's tax system, funding high quality public services and social programs that improve the life chances of all Canadians. To those who say Canada cannot afford fair taxes for the rich, this paper provides useful comparisons and finds Canada has room to grow on the taxation front. Total Canadian tax revenues as a percentage of GDP — 33.6% in 2004 — are a little higher than in the U.S. (25.9%) — but well

below the near 50% of GDP level in social democratic Sweden and Denmark, and the approximately 40% of GDP level in the European Union. This paper draws on studies that show higher tax levels do not affect economic performance but those countries with fairer tax systems do achieve more desirable social outcomes, such as reduced income inequality.

If Canadian governments are going to get serious about achieving greater income equality, then the most potent initiative would be to raise the top personal income tax rate and to make capital gains income, which is heavily concentrated in the hands of the most affluent, fully liable to the personal income tax.

Progressives and Tax Progressivity

While most Canadians work hard in hopes of getting ahead, many also envision a better world for their neighbours. Most support a system that helps to equalize the life chances of all citizens. In fact, 86% of Canadians tell Environics Research they would like their governments to reduce the growing gap between rich and poor. Traditionally in Canada, this has been accomplished through public investment in high quality public services and social programs which minimize dependence on market income, and through a fair distribution of the tax burden needed to pay for these programs.

Income transfers and progressive taxes both play a significant role in the redistribution of income, which helps equalize every Canadian's life chances. But until recently, little attention has been paid to the diminishment of Canada's income tax progressivity. This is all the more important today, given the steep increase in incomes among Canada's richest citizens is the key driving force of rising income inequality in Canada.

Policies to raise low incomes through fairer income transfers, a minimum wage that lifts full-time workers out of poverty, and access to collective bargaining, are needed and should be pursued. But these alone will not directly address the reality that only the richest of Canadians have seen their incomes explode into new all-time highs within a labour market that is rewarding those already well-placed and ignoring the majority of workers who have contributed to Canada's growing economy. Canada's tax system is, without doubt, the most powerful tool at our disposal to ensure the system works for all Canadians, and not just those already at the top. Tweaking the tax rate for the richest among us would be the most effective way to prevent the very richest of Canadians from breaking away from the middle and the bottom of the income spectrum.

While effective tax rates at the upper end of the income spectrum are still higher than at the middle and lower end, their equalizing effect has been diminishing — thanks mostly to a tax cut agenda heavily weighted in favour of already rich Canadians.

The Case for Progressive Taxes

The conventional economic case for progressive taxation is based on the well-known argument that total utility is maximized by taxing the incomes of the affluent more heavily, since an additional dollar in the hands of the less affluent is worth more to general well-being than an additional dollar in the hands of the more affluent.

Frank (1995 and 2000) adds the important corollary that progressive taxation can increase well-being significantly since individuals value general well-being a great deal, and since equalizing taxation can help limit costly positional wars of excessive consumption. Rising income inequality is one factor behind increasing consumer debt, as middle and lower income households attempt to match the consumption and lifestyles of the more affluent.

It could also be argued the rich can afford to be taxed more heavily since the link between individual incomes and individual effort, which is assumed by liberal economics, is weak and tenuous at best. This is especially true in the context of inherited wealth and economic advantage which reproduces high incomes between generations.

It's also true for those wealthy elites who use their own economic and political power to maximize their own income at the expense of others. For example, soaring senior corporate executive pay relative to average worker pay reflects, to a significant degree, self-serving insider compensation practices and cannot be justified on the basis of improved financial performance of firms. In the U.S., senior executive pay has doubled from 5% to 10% of profits since the mid-1990s, far in excess of what could be justified by superior CEO performance (Bebchuk and Grinstein, 2005).

Here in Canada, the highest paid 100 CEOs now make 240 times more than the average wage for Canadian workers. The gap hasn't always been this big. In just under a decade, their take has doubled: they used to make 104 times more, in 1998.

Frank (1995 and 2000) has detailed the growth of "winner take all" labour markets in which very small numbers of top performers have seen their relative pay soar, even though their performance is only marginally superior to that of lower-ranked workers. What has changed is not the distribution of human talent but the structure of job opportunities.

Many Canadians are concerned about income inequality, not just poverty and the absolute incomes of those at the lower end of the income spectrum. The central arguments for a concern with income inequality are that relative income matters a great deal for economic well-being. The degree of income and wider economic inequality in a society, and not just absolute deprivation, matters for a range of cherished social outcomes, such as health status. It also matters for a fundamental Canadian value: equality of individual opportunity as measured by inter-generational income mobility. Most Canadians hope, and expect, their children will do better than the generation that came before them. They see it as a problem when the evidence starts piling up that the hope is turning into a far away dream for many.

Excessive income inequality also has adverse implications for democracy, as Canadians shut out of the benefits of economic growth — which their work contributes to — feel less engaged in a system that isn't working for the majority in the way it used to.

Ultimately, the case for progressive taxation is part and parcel of an ethical, or values-based, commitment to greater after-tax income equality. Even among those who see the distribution of market income as reflective of individuals' relative productive contribution to society, it does not follow that such a distribution is fair in ethical terms. (For a discussion of economic perspectives on taxation of the rich and highly affluent, see Slemrod, 2000.)

What is less clear is the appropriate division of redistributive labour between the two key levers of income equalization — progressive taxes on the one hand, and social transfers (plus public services) on the other. Canadian social democrats have tended to be strong supporters of progressive taxation. For example, the Alternative Federal Budgets of the Canadian Centre for Policy Alternatives have usually included a "fair tax" package, calling for greater progressivity of rates and credits in the personal income tax system, and less lenient tax treatment of capital income in the hands of individuals. The New Democratic Party has often called for higher taxes on the relatively affluent to finance new and improved social programs.

However, as documented below, many social democratic countries — notably the Scandinavian countries — have equalized pre-eminently on the spending side, financing relatively high social and public expenditures through a relatively flat personal tax system.

Here in Canada, the transfer system plays about twice as great an equalizing role as the tax side of the tax/transfer system. The spending side is the most important in achieving a flatter distribution of after-tax income. Further, high levels of spending require some considerable reliance on non-progressive but effective sources of revenue generation, such as payroll and consumption taxes as part of the overall tax system.

However, Canada needs to pay much more attention to income tax progressivity given the steep increase in top incomes, which is now the key driving force of rising income inequality in Canada and other 'neo-liberal' advanced capitalist countries. Transfers counter inequality by raising the lower end of the income distribution, compared to the middle and the top, while progressive income taxes counter income inequality mainly by closing the gap between the top end and the middle and bottom of the distribution. If inequality is now being largely driven by the growth of the income share of the very top, progressive income taxes must play a larger role in our redistributive policy arsenal.

Canadian Taxes and Social Spending in Comparative Context

Total Canadian tax revenues as a percentage of GDP — 33.6% in 2004 — are higher than in the U.S. (25.9%) — but well below the near 50% of GDP level in social democratic Sweden and Denmark, as well as the approximately 40% of GDP level in the European Union (EU 15) (see **Table 1**). Unsurprisingly, the continuum from low to high tax levels is mirrored in levels of public social spending as a share of the economy.

The continuing very wide range of taxes and public social expenditures as a share of national income between the neo-liberal (U.S.) and social democratic (Scandinavian) poles of the OECD countries confirms the "varieties of capitalism" perspective. The pole political economies of contemporary advanced capitalist countries remain quite distinct in terms of the level of taxation and public spending, and also in terms of the extent of regulation of the labour market.

There is no systematic relation between the neo-liberal and social democratic models/poles with respect to economic performance, but the latter countries clearly do better in terms of achieving key social outcomes, including greater income equality. (For elaboration and references, see Jackson, 2005: Chapter 11; Pontusson, 2005; Smeeding, 2003.) Brooks and Hwong (2006) show that the quality of life of the average citizen measured by 50 key indicators is much higher in fair-tax countries than low-tax countries.

In recent years, Canada has moved much closer to the neo-liberal pole, as both taxes and social spending have been cut relative to GDP. Total Canadian government revenues have fallen by almost 4 percentage points of GDP, from a peak of 44.2% of GDP in 1992 to an estimated 40.5% of GDP in 2006. On this front, Canada is out of step with major OECD nations. Over the same period, total government revenues actually rose slightly as a percentage of GDP in the OECD (from 37.8% to 38.6% of GDP), in the Euro area, and even in the U.S. (from 32.8% to 34.2% of GDP). Total Canadian government spending has fallen by an astonishing 10 percentage points of GDP, from a (recession-influenced) high of 53.3% in 1992 to an estimated 39.5% of GDP in 2006. For the OECD as a whole, the decrease was far smaller: from 42.4% in 1992 to 40.6% in 2006.

Spending cuts in Canada have been much deeper than in the U.S., where total spending has fallen from 38.5% of GDP in 1992 to 36.5% in 2006. In fact, by one recent calculation, government income transfers to persons are now actually higher in the U.S. than in Canada — 11.9% vs 10.1% of GDP in 2004 (Ferris and Weiner, 2007). Canadian transfers to persons have fallen from a peak of 13.5% of GDP in 1993. This massive retrenchment in transfers, driven in part to pay for tax cuts that went disproportionately to the richest of Canadians, has been an important factor behind rising levels of family income inequality, as noted below with respect to the declining offsetting impact of transfers on the distribution of market income.

The social democratic countries have a much more equal distribution of disposable (after-tax and transfer) income than do the neo-liberal countries. As shown in **Table 2**, the Gini co-efficient for disposable income (adjusted for family size) is much lower in Sweden and Denmark than in the U.S. and the U.K., with Canada sitting between, but tilted towards, the U.S. pole.[2] The same is true of the P90/P10 ratio, the minimum ratio or gap between the after-tax and transfer incomes of the top and bottom 10% (deciles) of all households — which is about 3 to 1 in the Scandinavian countries compared to almost 6 to 1 in the U.S. There, is in turn, a strong correlation between taxes as a percentage of GDP, public social spending as a percentage of GDP, and the level of disposable income inequality (Smeeding, 2003; Picot and Myles, 2005).

Table 3 further shows that Sweden and Denmark are more equal than Canada and the U.S. partly because market income is more equally distributed. This reflects the more equal wage structure produced by high levels of collective bargaining coverage. However, the tax/transfer system also promotes greater income equality significantly, as shown by the differences of the Gini for (standardized) working-age households as calculated for market income, and for disposable income. Disposable income reflects the effects of income transfers plus taxes on household income but understates the equalizing effects of public social expenditures on economic well-being since spending on universal public services is not taken into account. In fact, **Table 3** shows that the reduction in income inequality brought about by the tax/transfer system is greatest in the Scandinavian countries, and lowest in the U.S.

More surprisingly, Pontusson calculates that the equalizing effect of the tax/transfer system in the Scandinavian countries is entirely attributable to transfers, with progressive taxation playing no role. This likely reflects the combined impacts of relatively flat social security contributions, and the fact that capital income in the hands of individuals is lightly taxed in the Scandinavian 'dual tax' system (Zee, 2005; OECD, 2006). Also, the Scandinavian countries tend to levy flat income taxes at the local level (Kesselman and Cheung, 2006). Thus the overall impact of taxes on the income distribution seems to be actually flat or even slightly regressive.

By contrast, the tax side of the tax/transfer system plays an important role in Canada, and the dominant role in the U.S.

As shown in **Table 1**, differences between countries in terms of their overall tax levels are much reduced if we look only at taxes on *personal* income — the most directly progressive element of the total tax system. (Progressivity means that the effective tax rate is higher for higher income groups, ie, those who have the ability to contribute more for the greater good, do.) Taxes on personal income as a percentage of GDP are actually higher in Canada than the EU 15 (11.7% vs 10.1%), though not nearly as high as in Sweden (15.8%) and, especially, Denmark (24.7%). Even the U.S. taxes personal income at nearly as high a level as the EU 15. In short, a very high proportion of higher public social expenditure in Europe, especially continental Europe, is financed from relatively flat social security and payroll taxes, and from flat consumption (goods and services) taxes, as opposed to progressive personal income taxes. (Note, however, that Denmark has very high rates of taxation of personal income, combined with low reliance on social security and payroll taxes.)

Looking at the trend since 1990 (see **Table 4**), there has been a general decline in taxes on personal income as a percentage of GDP, and also as a percentage of total tax revenues. This trend is quite apparent in Sweden, but barely detectable in the case of Denmark. In short, the overall tax systems of advanced capitalist countries have become somewhat less progressive in terms of the overall mix of major tax bases. Also, the international trend has been towards somewhat lower top income tax rates, and somewhat lower progressivity of the personal income tax system (OECD, 2006).

The Progressivity of Personal Income Taxation

Generally speaking, progressive tax systems rely more on personal income taxes as opposed to sales and payroll taxes which are flat or regressive in their incidence, and have progressive personal income taxes. It is, however, difficult to compare the progressivity of distinct national income tax and social security regimes given the many factors at play (Zee, 2005; Kesselman and Cheung, 2006). The personal income tax rate structure is the most obvious contributor to progressivity, but it does not always play the dominant role. The complexities of different rate structures interact with different national definitions of taxable income (such as wage vs capital income); different sets of allowances and deductions which reduce taxable income compared to pre-tax income in distinct ways; different ways of treating individual as opposed to household income, and so on. A flat income tax rate can, in fact, be progressive across much of the income spectrum if combined with generous allowances. An apparently progressive rate structure can have its impacts offset by generous tax treatment of the affluent in the form of deductions and special treatment of capital income (Wagstaff and Van Doorslaer, 2001).[3]

The OECD usefully calculates standardized tax plus social security contributions on gross labour income at three levels of income for a wage-earner in defined family circumstances. As shown in **Table 5**, the effective tax rate rises between two-thirds and 167% of average production worker earnings in all countries shown. Total taxes and contributions are greatest in the Scandinavian countries at all three income levels. However, the ratio of the effective tax rate on the higher to the lower paid worker is greatest in Canada and the U.S., indicating both nations have a more progressive tax system.

Another key indicator of tax progressivity is the top personal income tax rate. As shown in **Table 6**, this varies in a range between 41% and 56% for the six countries shown, and the top tax rate generally kicks at roughly 1.5 to 3 times average production worker earnings. The U.S. stands out as a major outlier, with the top income tax rate applying at a very high multiple of average earnings (10.6 times the average).

To summarize, progressive taxation of personal income is not a dominant feature of the European social democratic model. To be sure, social democratic countries do rely quite heavily on personal income taxes, especially Denmark, but they rely on other tax bases, redistribute much more through spending than progressive taxation per se, and do not have especially progressive personal income tax systems. Indeed, again with the partial exception of Denmark, the Scandinavian countries are notable for their light taxation of capital income in the hands of individual taxpayers.

By contrast, the U.S. and Canada rely quite heavily on personal income taxes as part of the overall tax mix and have relatively progressive personal income tax systems. While Canadians might want a more equal distribution of wages and an increased set of income transfer programs, the fact remains that the progressivity of Canada's personal tax system is of much greater consequence for the overall level of income equality than in the European countries which we often wish to emulate.

Tax incidence studies for Canada for the late-1980s showed that the total tax system was actually quite flat, with different income groups paying effectively the same rate of tax when all taxes and their incidence were taken into account. The progressive nature of Canada's tax system was due to the personal income tax, which resulted in somewhat higher than average effective tax rates at the very high end of the income spectrum, and somewhat lower than average effective rates at the low end when all taxes are taken into account (Vermaeten et al, 1995; Kesselman and Cheung, 2006). But an updated tax incidence study by Marc Lee (2007) shows the last decade of federal and provincial personal income tax cuts have combined to make Canada's tax system less progressive. In summary, progressive personal income taxes are very important to realizing greater after-tax income inequality in our specific context.

The Case for Higher Taxation of High Incomes in Canada: Rising Relative Incomes

As suggested above in **Table 3**, progressive taxation of income plays an important role in reducing income inequality in Canada. Statistics Canada calculates that the income share of the top 20% of economic families falls from 46% of market income, to 43% of total income (market income plus transfers), to 40% of after-tax income (total income minus income taxes). This indicates that progressive taxes play a similar overall role as do income transfers in putting a cap on the income share of Canada's richest 20% (see Statistics Canada Cat. 75-202-XIE Income in Canada, 2004. **Table 8**).

Heisz (2007) calculates the role of taxes and transfers on Canadian after-tax household income inequality by adjusting household income for family size. As shown in **Table 7**, transfers reduced inequality of market income by about twice as much as progressive taxes in 2004 (by -0.075 compared to -0.038).[4] This tells us that income transfers play a greater role than progressive income taxes do in reducing income inequality because they buffer the effects of market income, especially for lower-income Canadians. That said, progressive income taxes on high-income Canadians still play a role in reducing after-tax income inequalities in Canada.

Social democrats and progressives would certainly argue that we can, and should, tackle growing inequality through increased income transfers (as in Alternative Federal Budget proposals for higher income-tested child benefits, low income tax credits and more generous Employment Insurance benefits). But these initiatives would need to be financed, especially in the context of an ambitious progressive agenda for greater spending on public services like child and elder care. This paper argues that we can, and should, combine arguments for increased, equalizing social spending with arguments for reform of the personal income tax system to make it more progressive.

The argument for a more progressive personal income tax stems from the fact that market income has become steadily more concentrated in the hands of very high income earners and families, especially in neo-liberal countries such as Canada.

Redistributive income transfers financed from taxes can help ensure the economic and social well-being of low-income Canadians. But only progressive taxes can effectively limit the very richest in our nation from growing so far removed from their fellow middle- and low-income Canadians that they are living in separate universes: one for the rich, the other for everyone else. Similarly, Canadians would benefit from policy initiatives to raise low incomes such as minimum wages and to expand access to collective bargaining, but these do nothing to address the disproportionate growth of incomes at the very top. They also do nothing to speak to the enhanced capacity of the richest among us to contribute more to vital social programs and public infrastructure which benefit all Canadians and are key elements of a healthy, prosperous nation. If "top tail" driven income growth is a key driver in Canada's growing gap problem, progressive income taxation is a solution whose time has come.

One major study, closely documenting the rise of 'top tail' driven income inequality in Canada, found that the share of the richest 1% of Canadian taxpayers rose sharply over the 1990s, as in the U.S. and the U.K. In contrast, high incomes have been held more closely in check by social norms in continental European countries for which data exist (Saez and Veall, 2003). The most recent Statistics Canada study of high incomes found the income share of Canada's richest 1% soared from 8.6% to 12.2% of pre-tax income between 1992 and 2004, while incomes for 80% of individuals increased only marginally.[5] The average income of the top 1% rose from $268,000 to $429,000 between 1992 and 2004, the incomes of the top 1% rose from 601 to 737 times the income of the median taxpayer (the person in the exact middle of all income earners in Canada). At the very, very top, the richest 0.01% — which represents about 15,000 Canadians with an average income of $5.9 million in 2004 — amassed 1.7% of all earned income in Canada. That's 11,522 times more than the median taxpayer earned in 2004. (See Murphy, Roberts and Wolfson, 2007; and **Table 8.**) The trends are similar for pre-tax family income.

It's not just the richest 1% and .01% taking home a bigger share of Canada's income pie since the 1990s — though their take over the past decade has been astronomical. Another Statistics Canada study shows the income gains of the 1990s went disproportionately to the richest 5% of Canadians, with no end in sight. Their real incomes rose by 15% over the 1990s, while the real incomes of the bottom half of Canadian families actually stagnated. The authors conclude that "the rise of inequality (of family pre-tax income in the 1990s) was primarily the result of faster-rising incomes at the top of the income distribution." (Picot and Myles, 2005 p.9.) Heisz (2007, Figure 7) also shows a very sharp increase in the average after-tax incomes of the richest 5% of families in the 1990s.

Armine Yalnizayan's recent study (CCPA 2007) on growing income inequality at the family level[6] also finds that the earnings share of the richest 10% of families raising children under the age of 18 rose from 26.1% to 30.2% of Canada's total income pie between 1995 and 2004 (see **Table 9**). Virtually all income growth for Canadian families over the past decade has been concentrated among the rich, almost entirely in the richest 20% — though the higher up the income spectrum you go, the greater the income gains. In stark contrast, the real incomes of about 80% of families have stagnated during this, one of the longest, strongest periods of economic growth Canada has experienced.[7]

Looking at the data in **Table 9** on the earnings and after-tax income shares of the richest 10% of families with children, it can be calculated that both shares rose by about 15% between 1995 and 2004. Heisz (2007) shows that the Gini-reducing role of taxes fell from 1996 to 2004 (see **Table 7**). What's important here is this likely reflects changes in Canada's personal income tax structure, since the soaring growth of incomes for the richest of Canadians should have made the overall personal income tax system more progressive simply by pushing relatively more taxable income into the top tax bracket. Stunningly, the opposite is true.

Table 10 further shows that the median after-tax income within the richest 10% of families raising children actually rose at a faster rate than median pre-tax income, and that the effective tax rate for the richest 10% of Canadians fell from 25.6% in 1995, to 24.1% in 2000, to 22.0% in 2004.

At the individual level, Canada Revenue Agency data (Income Statistics) show that the effective tax rate for all taxpayers (total income tax paid to federal and provincial governments divided by total income) fell from 18.2% to 16.3% between 2000 and 2004. However, for very high income taxpayers earning more than $250,000 (roughly the top one half of one percent), the effective tax rate fell from 34.6% to 31.8% over the same period.

Murphy, Roberts and Wolfson (2007; Chart H) find the average effective income tax rate fell only marginally (from 18% to 17%) for 95% of taxpayers, but the average effective tax rate of the top 1% fell from 33% to 31%, and that of the top 0.01% (with average incomes of $5.9 million in 2004) fell very sharply, from 42% to 31%.

At the federal government level, the key structural personal income tax changes impacting very high income earners were announced by former Finance Minister Paul Martin in the 2000 Budget and Economic Statement. (There were effectively two budgets in that pre-election year, both focusing on tax reduction after seven years of deficit and debt reduction.) The most significant change in that budget focused on the inclusion rate for capital gains income, reducing it from 75% to 50%, since capital gains income is overwhelmingly concentrated in the hands of the very affluent. In 2001, the 5% high income surtax was eliminated — dropping the effective top federal tax rate from 30.45% to 29%. This top rate was also applied from a higher income threshold, resulting in tax savings on income earned below the $100,000 level. The threshold keeps getting raised — for the top federal tax rate of 29% it has now risen to almost $116,000. Mackenzie (2004) calculates that about one-third of the value of the 2000 tax cuts went to the top 5% of taxpayers. Provincial tax changes have also added to these relative tax cuts for the very affluent, as Lee (2007) reveals in his update of tax incidence in Canada.

Real Tax Reform

To conclude, Canada's income tax system used to offset Canada's growing gap between the rich and the rest of us but it isn't as progressive as it used to be. In fact, the past decade of federal and provincial tax cuts have made the tax system less progressive, at the very time that the richest of Canadians have seen their incomes soar far above the majority of Canadians. Heisz (2007) clearly shows that Canada's tax/transfer system, as a whole, offset rising market income inequality in Canada in the 1980s, but has since failed to do so. The current dynamic of fast-rising incomes for the very affluent is largely a function of the labour market — and is beyond the control of the transfer system. It must be directly addressed through the progressive income tax system.

The explosion of incomes at the very top of the pay scale, at the expense of average worker pay, and the growth of after-tax household income inequality should prompt some serious thinking about how to increase the progressivity of Canada's personal income tax system.

Data in **Table 11** profile very high income Canadian taxpayers. Just over one in every 200 tax filers declared income of more than $250,000 in 2004 but this tiny group accounted for over 9% of all income assessed, rising to above 9.5% if you factor in the reality that only half of capital gains income is counted as taxable income. The effective combined federal-provincial rate on this group was about 32%, but it is less than 30% if you factor in the special tax treatment of capital gains income. Those making more than $250,000 in 2004 declared almost 7% of all employment income, fully 36% of dividend income and 43% of all capital gains income.

Significant additional tax revenues could be gained by introducing a higher personal income tax rate on these very high income earners and by fully including capital gains income in taxable income. The current top federal income tax rate is 29% on incomes of over $116,000. If we introduced even a modestly higher new top tax rate of 31.5% on taxable income of more than $250,000, it would raise $1 billion in new revenues.[8] Full inclusion of capital gains income in taxable income at the current top marginal federal rate of 29% for those making more than $250,000 would increase federal revenues by an additional $1.8 billion.

A federal revenue increase of some $3 billion from these two measures would be a useful, if modest, addition to Canada's ability to invest in social programs and public infrastructure that would benefit all Canadians, helping to ensure the fruits of prosperity are broadly shared. A higher tax rate would also help shrink the after-tax income gap between the richest of the rich and the rest of us.

One can expect reactions of outrage from the very affluent and claims that it would drive our talented CEOs and other stars to the U.S. Hidden within these threats, however, is a little known but important fact: Federal personal income tax rates on very high incomes in the U.S. are actually higher than in Canada. The U.S. top rate is still 35% on incomes of over $326,000 and 33% on incomes over $150,000. State income taxes in the U.S. are generally lower than provincial income taxes, but the heavy hitters on Wall Street have to pay a 6.7% New York City income tax as well as the New York state top tax rate of 7.7% — which adds up to a 50% top marginal tax rate.

It also has to be taken into account that the U.S. may well shift to more progressive taxes to deal with rising income inequality and large deficits. Former U.S. Treasury Secretary Robert Rubin — now a leading Wall Street investment banker — heads the Hamilton Project, which is defining a new centrist Democratic agenda. A paper for the project co-authored by Rubin's successor as Treasury Secretary, Larry Summers, argues that with only the rich making income gains from globalization, "progress" could be sustained by transferring income from the 'winners' to everybody else. The authors advocate raising top tax rates back to Clinton administration levels (http://www1.hamiltonproject.org/views/papers/furman/200706summers_bordoff.htm). It should be recalled that President Clinton fought the U.S. deficit in large part on the tax rather than spending side, including through higher taxes on the very affluent, as opposed to former Finance Minister Paul Martin here in Canada, who relied almost exclusively on cuts to spending, including income transfers to the relatively less well-off.

Mainstream economic literature is, somewhat surprisingly, heavily at odds with the mainstream media pundit view that higher tax rates on the affluent would come at the cost of reduced economic efficiency. In fact, it is clearly the case that very high marginal tax rates on the very affluent coincided with the peak period of productivity growth in the Golden Age of post-war capitalism. The combined top federal-provincial marginal income tax rate in Canada was over 80% in 1971, when the income tax system had a series of rising rate brackets at the very high end of the income spectrum (Smith, 1995).

Detailed empirical analysis finds that top tax rates have no impact on the labour supply of the highly affluent, not least because they are driven by a desire for higher relative, as opposed to absolute, income. They also enjoy their work. The empirical economic evidence also suggests no serious adverse impacts on aggregate savings if the very affluent are taxed more heavily (see Slemrod, 2000, especially the contributions of Frank, and Moffitt and Wilhelm).

So let it be said, simply and clearly: Canada can, and should, tax top incomes much more heavily to counter growing income inequality.

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Notes

1 Top income earners are often referred to as the rich. Those with high incomes also control the most wealth, and in fact inequality of wealth, especially financial wealth, is even more extreme than income inequality.

2 The Gini is a commonly used summary statistical measure of inequality. It under-states inequality generated by changes in the extreme ends of the income distribution, which are better captured by ratios of deciles or other fractions of units in the distribution

3 One also has to note that differences in the family income distribution between countries are affected by a wide range of factors other than the wage distribution, taxes and transfers, since patterns of family formation and earnings within families vary a great deal. One reason for the high proportion of family income flowing to the top 10% in North America compared to most of Europe is that high income men are significantly more likely to live with high income women due to higher employment rates among women, and a growing layer of high income women earners.

4 The role of taxes is somewhat greater if calculated as the percentage change reduction in the Gini from total to after-tax income, compared to the change from market to total income.

5 Adjusted for inflation.

6 Based on customized Statistics Canada data.

7 It should be noted that the sample surveys used by Yalnizyan and Heisz to chart trends in family incomes under-state the growing income share of the top compared to studies like that of Murphy, Roberts and Wolfson which use tax data. This is because the top 0.1% and top 0.01% of tax filers are very unlikely to be caught in a sample survey because their numbers are so small). In sum, studies clearly show that the key driving force of greater income inequality in Canada in the recent past has been the soaring market incomes of those at the very top. Available evidence further suggests that the Canadian income tax system, has failed to offset the recent growth of upper-tail driven market income inequality. While effective tax rates at the high end are certainly higher than at the middle and lower end, their equalizing effect has been diminishing.

8 The revenue gain is based on my calculation that $40 billion of the $73 billion in total income for those making more than $250,000 in 2004 was above the $250,000 threshold.

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TABLE 1 Tax Structure of Selected OECD Countries for 2004 Major Tax Sources of Revenue as % GDP

	U.S.	Canada	EU 15	Sweden	Denmark
Income and Profits	11.1%	15.6%	13.4%	19.0%	29.5%
(Personal Income)	(8.9%)	(11.7%)	(10.1%)	(15.8%)	(24.7%)
Social Security + Payroll Taxes	6.7%	5.8%	11.5%	16.7%	1.4%
Goods & Services Taxes	4.7%	8.7%	12.1%	13.0%	14.0%
Property Taxes	3.1%	3.4%	2.1%	1.6%	1.1%
Total*	**25.9%**	**33.6%**	**39.8%**	**50.1%**	**48.1%**
(Public Social Exp. As % GDP**)	16.2%	17.3%	23.9%	31.3%	27.6%

SOURCE OECD Revenue Statistics, 2006. Table 5, 6, and 10. Includes other sources of tax revenue. 3 year moving average.
OECD Social Indicators, 2006.

TABLE 2 Taxes, Social Spending and After-Tax Income Inequality

	U.S.	Canada	UK	Germany	France	Sweden	Denmark
Taxes as % GDP[1]	25.9%	33.6%	35.6%	35.2%	43.3%	50.1%	48.1%
Public Social Expenditure as % GDP[2]	16.2%	17.3%	20.1%	27.6%	28.7%	31.3%	27.6%
Gini Co-Efficient for Adjusted Disposable Income[3]	0.372	0.305	0.344	0.261	0.288	0.221	0.253
P90/P10 Ratio[3]	5.57	4.13	4.57	3.18	3.54	2.61	3.15

1) OECD Revenue Statistics 2) OECD Social Indicators 2006 Indicator EQ5.1 3) Luxembourg Income Study Database

TABLE 3 Tax/Transfer System and Income Inequality Among Working Age Households
Social Democratic vs. Neo-Liberal Countries (late 1990s)

	Gini Co-Efficient Market Income	Gini Co-Efficient Disposable Income	% Reduction of Gini	(of which, due to transfers)	(of which, due to taxes)
Sweden	0.375	0.238	36.5%	38.0%	-2.4%
Denmark	0.345	0.237	31.3%	32.5%	-0.1%
Canada	0.390	0.298	23.6%	17.9%	6.9%
U.S.	0.436	0.363	16.7%	7.9%	9.6%

SOURCE Luxembourg Income Survey, Data from Jonas Pontusson, Inequality and Prosperity: Social Europe vs. Liberal America.
Cornell University Press, 2005. Table 7.3 p.154.

TABLE 4 Taxes on Personal Income

		As % GDP	As % Total Taxation
U.S.	1990	10.1%	37.1%
	2004	8.9%	34.7%
Canada	1990	14.7%	40.8%
	2004	11.7%	35.1%
EU 15	1990	10.8%	27.0%
	2004	10.1%	24.6%
Sweden	1990	20.3%	38.5%
	2004	15.8%	31.4%
Denmark	1990	24.8%	53.2%
	2004	24.7%	50.7%

SOURCE OECD Revenue Statistics, 2006. Tables 10 and 11.

TABLE 5 Tax Progressivity Average Personal Income Tax and Social Security Contribution on Gross Labour Income, Year 2000, % Average Production Worker

	67%	100%	167%	Ratio of 167/67
Canada	19.6%	25.4%	29.6%	1.51
U.S.	21.4%	24.1%	29.8%	1.39
France	25.7%	28.8%	32.5%	1.26
Germany	38.0%	44.5%	49.1%	1.29
Denmark	40.8%	44.1%	51.4%	1.26
Sweden	31.7%	33.7%	41.1%	1.30

SOURCE OECD Tax Database: Table 1.2 (All levels of government)

TABLE 6 Progressive Taxation of High Income Earners Year 2005

	Top Statutory Income Tax Rate (central and sub-central governments)	Top Rate Threshold as Multiple of Average Production Worker Annual Earnings
U.S.	41.4%	10.6
Canada	46.4%	2.9
U.K.	40.0%	1.3
Sweden	56.5%	1.5
Germany	45.2%	1.4
France	55.9%	2.7

SOURCE OECD Tax Database

TABLE 7 Impact (of Transfers and Taxes) on Household Income Inequality

		Gini for	
	Market Income	Total Income	After-Tax Income
2004	0.428	0.353 (-0.075)	0.315 (-0.038)
1996	0.438	0.346 (-0.092)	0.304 (-0.042)
1989	0.381	0.312 (-0.069)	0.277 (-0.036)

SOURCE Heisz, Andrew. "Income Inequality and Redistribution in Canada: 1976 to 2004." Statistics Canada Cat. 11F0019MIE-No. 298 2007. Table A3

TABLE 8 High Income Canadians

Shares of Individual Taxable Income	1992	2004
Top 1%	8.6%	12.2%
Top 0.1%	2.6%	4.7%
Top 0.01%	0.8%	1.7%
Average Incomes (as multiple of Median Income)		
Top 1%	$268,000 (601)	$429,000 (737)
Top 0.1%	$822,000 (1,743)	$1,164,000 (2,644)
Top 0.01%	$2,547,000 (5,723)	$5,920,000 (11,552)

SOURCE Brian Murphy, Paul Roberts and Michael Wolfson "High Income Canadians" Statistics Canada. Perspectives. Income. September 2007.

TABLE 9 Earnings and After-Tax Income Share of Top Decile (families with children)

	1995	2000	2004
Earnings Share	26.1%	28.3%	30.2%
After-Tax Share	21.8%	24.1%	25.1%

SOURCE Armine Yalnizyan "The Rich and the Rest of Us: The Changing Face of Canada's Growing Gap". Canadian Centre for Policy Alternatives. March, 2007.

TABLE 10 Impact of Income Tax on High Income Families with Children (Top Decile)

	1995	2000	2004	Change 1995–2004
Median Total Income	$140,800	$163,763	$174,067	23.6%
Median After-Tax Income	$104,787	$124,262	$135,810	29.6%
Tax as % Total Income	25.6%	24.1%	22.0%	

SOURCE Armine Yalnizyan "The Rich and the Rest of Us: The Changing Face of Canada's Growing Gap". Canadian Centre for Policy Alternatives. March, 2007.

TABLE 11 Profile of High Income Taxpayers in 2004 (A)

	$250,000 plus	$150–250,000
Number	124,380	203,430
% All Tax Filers	0.53%	0.86%
Total Income Assessed	$72,803 Million	$38,183 Million
% Total Income Assessed	9.01%	4.73%
% Total Income PLUS Excluded Capital Gains Income	9.55%	4.85%
% Total Tax Payable	17.37%	7.74%
Effective Tax Rate A	31.95%	27.16%
Effective Tax Rate B	29.66%	26.03%

SOURCE Canada Customs and Revenue Agency, Income Statistics 2006. Basic Table 2
Effective Tax Rate A: Tax Payable ÷ Total Income Assessed
Effective Tax Rate B: Tax Payable ÷ Total Income Assessed + Excluded Capital Gains
Effective Tax Rate A, All Tax Payers: 16.57%

TABLE 12 Profile of High Income Taxpayers in 2004 (B)

	$250,000 plus	$150–250,000
% All Tax Filers	0.53%	0.86%
% All Employment Income	6.95%	3.98%
% All Dividend Income	35.59%	11.35%
(Taxable Dividends minus Dividend Tax Credit)	($6,348 Million)	($2,023 Million)
% All Capital Gains Income	43.05%	12.71%
$ (Taxable Capital Gains)	$5,615 Million	($1,658 Million)
$ (Total Capital Gains)	($11,230 Million)	($3,316 Million)
All Capital Gains plus Dividend Income as % of Total Income of Filers in this Income Group	27.08%	16.03%

SOURCE Canada Customs and Revenue Agency, Income Statistics 2006. Basic Table 2.

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