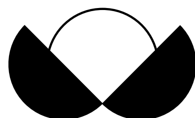
TALL TALES ABOUT TAXES IN BC

BY MARC LEE



CANADIAN CENTRE FOR POLICY ALTERNATIVES

TALL TALES ABOUT TAXES IN BC

by Marc Lee

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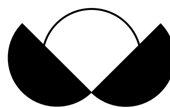

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Summary

Tax cuts have been ascribed magical powers in recent years, and have been touted as the cure for Canada's economic ills. In BC, the chorus of the tax cutters has been especially strong. The promise of more money in one's pocket, while at the same time rebooting the economy, is a tempting message after a difficult decade in the 1990s, which saw real incomes fall in BC and the rest of Canada.

There are plenty of reasons to be skeptical of the promises made by tax cutters. For one, taxes in BC are not out of line with other provinces, the United States, and other industrialized nations. Second, the potency of tax cuts as a cure for our economic ills is not supported by the evidence. And finally, the tax cut drive will deliver few benefits to low and middle income people, while requiring cuts in public services to finance the tax cuts. Much of the debate on tax cuts surrounds the rates paid by the highest income earners.

A Comparative Look at Taxes in BC

Despite frequent claims about the heavy "burden" of taxes, personal and corporate taxes in BC are actually quite comparable to other provinces and other countries:

- ➔ At the broadest level, Canadian taxes as a share of GDP rank in the middle of the industrialized countries, slightly lower than the average. To the extent that taxes have increased, they have done so at a slower rate than the average OECD country over the past 25 years.
- ➔ For the vast majority of people, BC has the second lowest total personal taxes (including income, sales, property and other taxes combined) in Canada after Alberta. Only at very high levels of income are taxes in BC higher than other provinces. As a result, calls for tax cuts have often focused on the "top marginal income tax rate", which is indeed among the highest in Canada (though not very far out of line). However, because only income in excess of $80,000 is taxed at this rate, its application is limited to the top 4% of taxpayers in BC.
- ➔ When compared to the US (our real competition according to the tax cutters), taxes are only significantly higher in Canada than the US at high income levels. Most working Canadians would not be better off in terms of after-tax incomes by moving south, and if we take into account labour markets and social programs, the Canadian advantage is even greater. The major difference is that Canadian provincial taxes are higher than US state taxes largely due to public provision of health care and education. Differences in overall tax levels, however, also reflect higher debt service costs in Canada.
- ➔ For corporate taxes, BC tax rates are similar to other provinces. Internationally, the effective rates paid by companies in Canada are quite low, even compared to the US, due to Canada's system of tax credits, including generous research and development (R&D) tax credits. A new provincial R&D tax credit adds to this for BC companies.

The Tax Cut Arguments are Flawed

The strongest argument in favour of tax cuts is that they will spur economic growth and productivity, while ending the supposed "brain drain" to the US. At the most extreme, claims are made that tax cuts will stimulate so much economic activity that tax revenues will actually rise and public programs will not have to be cut. None of these arguments holds up to scrutiny.

At best, the link between tax levels and growth rates is inconclusive. In the post-war era, across the industrialized countries, there is no connection between tax levels and economic performance. Interestingly, the highest productivity and economic growth rates in Canada and the US over the past century came in the 1950s and 1960s, and were accompanied by top marginal income tax rates in excess of 80%.

Tax cuts, in theory, will stimulate economic growth. In practice, however, the impact is likely to be disappointingly small compared to investment in public services. In particular, tax cuts for the well-off will have a more modest impact than tax cuts for low and middle income earners because the additional income is less likely to be spent in the local economy.

For companies, tax cuts are also unlikely to spur economic growth and attract new investment. Taxes rank far down the list of the important factors for companies making location and investment decisions—behind labour costs, availability of skilled labour, energy costs, climate, and availability of natural resources. Growing demand for a company's output is a much larger determinant of new investment than cost considerations like taxes, especially given that tax rates in BC are not out of line.

The argument that tax cuts lead to increased government revenues has been largely discredited by the economics profession. These claims are often based on a selective use of the evidence (for example, by looking at provinces like Ontario and Alberta in the late 1990s that cut taxes during times of economic growth). Increased government revenues have been falsely attributed to tax cuts, rather than the much more significant role of exports to a booming US economy.

While newspaper anecdotes report a "brain drain" to the US, there is surprisingly little evidence to suggest that this has actually occurred. Canadian emigration levels to the US in recent years have been very low by historical standards, and the proportion of Canadians living in the US is at an all-time low. In contrast, Canada benefits from a "brain gain" when international migration is taken into account.

Within Canada, BC has been the primary beneficiary of interprovincial migration. Over the 1990s, BC was the only province to receive a net inflow of migrants with a university degree. BC also led all other provinces by a large margin for positive net inflows of both knowledge workers and high income individuals, even while taxes were increasing in the early 1990s.

The Real Price of Tax Cuts

Most calls for tax cuts tend to be vague and non-specific, pandering to angst and resentment in the middle class. 1998's BC Business Summit (BS) was a rare exception, in that it spelled out what dramatic tax cuts in BC might really look like.

On closer examination, the BS plan looks like Robin Hood in reverse. The vast bulk of benefits go to those at the top of the income ladder. Tax savings for less well-heeled British Columbians are very small indeed, and are likely to be offset by increased out-of-pocket expenses resulting from diminished public services.

The BS recommendations would also have dampening effect on the provincial economy. Based on forecasting models, the proposed combination of tax and spending cuts would slow economic growth, lower employment growth and put upward pressure on total public debt and the provincial debt-to-GDP ratio. Requiring a balanced budget at the same time would be a recipe for recession.

The cost to the Treasury of the BS proposals is significant, and would squeeze the provincial government's ability to pay for a wide range of public services. Together, health care, education, and social assistance make up 80% of the provincial budget; a variety of other important services (from law enforcement to environmental protection) make up the difference. The BS recommendation to privatize public services and Crown assets to pay for tax cuts for the wealthy is dangerously short-sighted (see the CCPA's companion study "Are spending cuts and privatization the answer for BC?" by Donna Vogel).

Alternatives and Conclusions

While the tax cuts promoted by the business community are a bad idea, this does not mean there is no scope for reform. A number of improvements could be made that would increase the fairness, progressivity, and "green-ness" of the tax system. An agenda for federal and provincial reform should include elements to:

- ➔ Expand the tax base by counting income that is currently untaxed (such as fringe benefits) and eliminate preferential treatment of certain types of income (such as dividends and capital gains);
- ➔ Implement an inheritance tax at the same rate as the US;
- ➔ Enhance the progressivity of the tax system by lowering taxes for low and middle income earners while adding new tax brackets for high incomes;
- ➔ Move away from regressive taxes like the GST;
- ➔ Establish a minimum corporate income tax, and limit the deductibility of excessive corporate executive salaries; and,
- ➔ Move towards "green taxes".

The great debate on taxes is unlikely to subside in the near future, if only because the main proponents of tax cuts are closely linked to the mainstream media. Yet, when asked, most Canadians would rather have restored investment in social programs than tax cuts.

In BC, a provincial election in 2000 or 2001 is sure to feature tax cuts as a core issue. But in many ways, tax cuts are destined to fail because the promises made in their favour cannot deliver the goods. Tax cuts are not the path to prosperity, but rather a loop back to the days before Canadians won the long fight for quality social programs.

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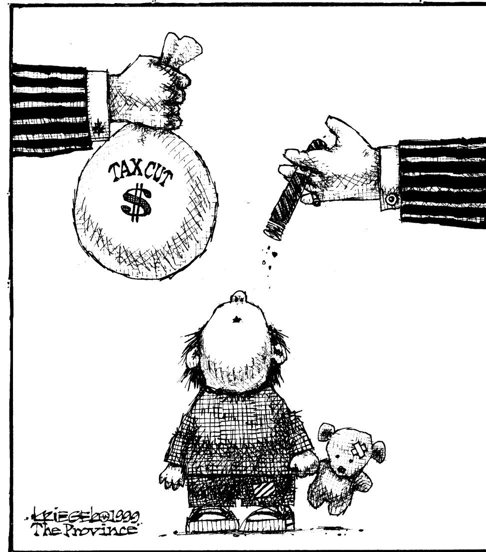


1 Introduction: The Tax Cut Siren Song

THE CALL FOR TAX CUTS IN CANADA has taken on a mantra-like quality in recent times. The editorial chorus in the media and from business commentators has been remarkably consistent. Ailing economy? Tax cuts are the answer. Flagging investment and productivity? Tax cuts will do the trick. Stemming the flow of our best and brightest to the US? Tax cuts, yet again. The claims have yet to spill over to alleviating bad breath and hair loss, but presumably a tax cut would boost disposable income, thus freeing up dollars for the appropriate pharmaceutical products.

Nowhere has the chorus of the tax cutters been as strong as in BC. The BC media frequently (and inaccurately) report that BC has the highest taxes in Canada, while the national media report (also inaccurately) that Canada has the highest taxes in the industrialized world. Little wonder that in a poll by the *National Post*, BC came out in top spot in terms of "tax rage".

The calls tap a familiar Western Canada distrust for government, while promising glory days

ahead, where everyone has more money in their pockets, and the economy is booming as a result. Tax cuts are touted as being "good for what ails ya" (according to the Globe and Mail). To call for tax cuts is the epitome of policy trendiness.

But there is good reason to believe that tax cutters are the modern day equivalent of snake oil salesmen—hawkers of a simple formula touting miraculous economic powers to fix every dimension of our supposed economic funk. Their claims, while tempting, deserve to be treated with a great deal of skepticism.

Canadians have heard this story before, and should remember well the promises of conservatives past: free trade will boost economic growth and international competitiveness; fighting inflation with high interest rates will reap great rewards to the Canadian economy; slashing government is needed to attack the deficit. Unfortunately, the promised prosperity from these sacrifices never seems to materialize for the majority of Canadians, as the goalposts keep moving.

The tax cut drive, on closer examination, is all about reducing taxes for high income earners. Having benefited from the Canadian system, those at the top now renounce any connection to the rest of society and insist on withdrawing from their responsibilities and obligations. Those at the middle or bottom of the income ladder are unlikely to receive a tax cut of any great magnitude—perhaps the equivalent of a cup of coffee a day—and insufficient to compensate for increased out-of-pocket costs to pay for eroded public services.

To sell the message of tax cuts, appeals must be made to the tax rage of the masses. Armed with the solution, the problem must be manufactured. For this reason, reports about high taxes in the media are frequently overstated and misleading. Business commentators make it seem like tax revenues end up buried deep in a distant silo called government. These attacks on taxes mask the connection between the taxes that people pay and the wide variety of public services that taxes pay for (and that most Canadians support and value).

Tax cuts are touted as being "good for what ails ya." But there is good reason to believe that tax cutters are the modern day equivalent of snake oil salesmen—hawkers of a simple formula touting miraculous economic powers to fix every dimension of our supposed economic funk.

How We Got Here: A Look Back at the 1990s

It is hard to blame some Canadians for being tempted by the promises of tax cuts. While bank profits and CEO salaries are at all-time highs, the typical family has been squeezed. From 1989 to 1997, the average market income for families in Canada declined by 6.4% (after accounting for inflation). The story in BC is similar, with a decline of 5.2%.[1] However, BC has fared much worse than the rest of Canada since 1997 due to the added fallout of economic troubles in Asia in 1997-98 and low international commodity prices.

One of the main reasons for declining incomes in the 1990s was the recession in the early part of the decade. Because of a near-religious zeal by the Bank of Canada to seek the holy grail of zero inflation, higher interest rates prevailed in Canada than the US. This had the desired effect: inflation fell close to zero and has remained much lower than US inflation. But the cost was a longer and deeper recession in the early 1990s, accompanied by a slow recovery.

For most Canadians, the benefits of low inflation were elusive—it is hard to be concerned about inflation eroding your wealth when you have little wealth to lose and are more worried about losing your job. Economic growth was further

undermined mid-decade by a fiscal policy that emphasized cuts to social programs (and yes, some tax increases). This helped undermine the connection people feel between the taxes they pay and the services they receive.

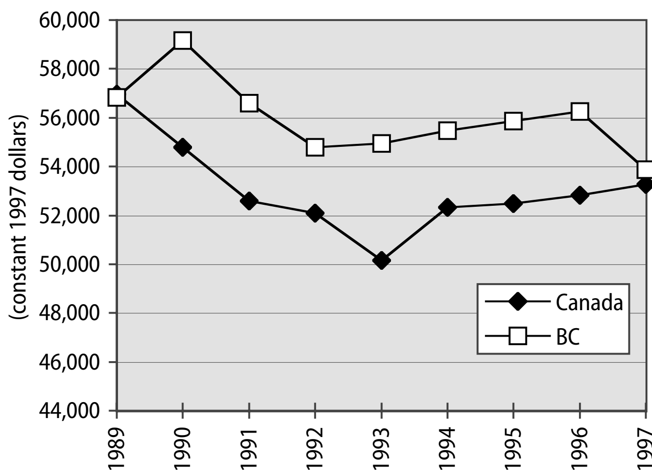
The resulting decline in disposable incomes stems largely from lower market incomes, accompanied by a work climate that is more precarious and insecure, than from the "rising burden of taxes". Roger Sauve, in a report on family incomes for the Vanier Institute of the Family, notes: "Viewed from the perspective of the decade as a whole, it seems that the tax revolt may be due more to a shrinkage of real money incomes rather than to rapidly rising real taxes per family."[2]

It is hard to blame some Canadians for being tempted by the promises of tax cuts. While bank profits and CEO salaries are at all-time highs, the typical family has been squeezed.

As Figure 1 shows, average incomes for families with children in Canada declined from the 1989 business cycle peak until 1993, then remained flat through the middle of the decade. BC fared better than the rest of Canada in the early 1990s, but the impacts of the economic downturn (though not outright recession in BC) still led to a decline in incomes until 1992. BC had flat income growth through the middle part of the decade, and the Asian Crisis and low international commodity prices for BC's exports meant that incomes have remained flat in the latter part of the decade (not shown), while Canadian overall incomes have made a greater recovery.

Figure 1: Tax Rage or Wage Rage?

Average Market Income for Families, 1989-97



Note: Figures are for families with children under age 18, with head of household less than age 65.
Source: Statistics Canada, Survey of Consumer Finances, unpublished data

What tax increases have come in the 1990s have been brought largely by stealth. A hidden tax increase afflicted Canadians in the middle and bottom of the income ladder, rooted in a move by the Mulroney government in 1986 to partially de-index the income tax system. What "partial de-indexation" meant was that the income brackets within which Canadians pay income tax no longer fully accounted for inflation.[3]

The resulting "bracket creep" meant billions of dollars in additional tax revenue for governments. It hit hardest at around $30,000 of income, where the federal tax bracket jumped from 17% to 26%. For example, someone making $31,000 would pay $260 on their last $1,000 of income instead of $170 if taxed at the lower rate. This spilled over onto provincial taxes, which are calculated as a percentage of federal tax.

Also directly affected were those at the bottom of the income ladder. The effect of partial de-indexation was to lower the threshold at which people began to pay tax. The Caledon Institute estimates that the threshold has fallen in real terms from $10,505 in 1980 to $7,112 in 1998.[4] For the people that most need the income, taxes have

been creeping upwards.

Fortunately, the 2000 federal budget made a commitment to full indexation to address "bracket creep" beginning in the 2000 tax year. The federal government will also increase the personal exemption to $8,000, and will raise the thresholds for reaching the second and third brackets over the next five years.

Overall, the 2000 federal budget was a "tax cut budget" that provided big gains to upper income earners. It showed a government that caved in to the tax cut siren song, even though public opinion overwhelmingly supported increased social spending over tax cuts as a priority. Adding on provincial tax cuts in many provinces, including BC, the campaign of the tax cutters has been very successful. But they still crave more—shortly after the ink was dry on the 2000 federal budget, the Business Council on National Issues staged a major event to whine that the tax cuts were just not enough.

Overall, the 2000 federal budget was a "tax cut budget" that provided big gains to upper income earners. It showed a government that caved in to the tax cut siren song, even though public opinion overwhelmingly supported increased social spending over tax cuts as a priority.

The Case Against Tax Cuts

The rest of this paper looks in more detail at the case for tax cuts made by business commentators and the mainstream media. Each of the subsequent sections take a detailed look at the claims made about tax levels and tax cuts, and what the evidence says.

Section II examines the proposition that personal and corporate taxes in BC are unduly high compared to other jurisdictions. A closer look at the evidence suggests taxes in BC are not as high as the tax cutters like to claim, and are far from being out of line with other provinces, the United States, or other nations.

Section III examines the arguments that tax cuts will improve BC's economic performance, and whether tax cuts can actually lead to increased government revenues. As a remedy for our economic ills—whether boosting economic growth, increasing productivity, or stemming the alleged tide of Canada's best and brightest south of the border—the tax cut cure is not nearly as potent as advocates like to claim, and is a poor basis for an economic development strategy.

Section IV looks at the specific tax cut proposal coming from the influential BC Business Summit, and at the likely winners and losers from the package. "Tax rage" is being sold to the masses, but a closer look reveals that those at the middle or bottom of the income ladder are unlikely to receive a tax cut of any significant magnitude, while the package delivers the most relief to the highest income earners. And because taxes are the means by which Canada and BC support popular social programs, cuts to these programs will represent the true cost of tax cuts.

The final section revisits why we pay taxes at all, and puts forward a number of alternative ideas for tax reform that would improve the fairness and progressivity of the tax system. With an election expected in 2000 or 2001, British Columbians need to have an informed debate about the role of taxes and social programs in building a better society.

2

A Comparative Look at Taxes in BC

DESPITE FREQUENT COMMENTARY about how onerous taxes are in BC, there is little evidence to support these claims. Calls for tax cuts (and the evidence presented) tend to narrowly focus on the taxes paid by the highest income earners in the province. However, the taxes paid by most British Columbians are quite comparable to, and are often lower than, other provinces and other countries.

This section looks in detail at comparative tax rates in BC compared to other provinces, Canadian taxes relative to other industrialized countries, and differences between Canada and the US. BC tax levels are used where appropriate—mostly with regard to comparisons with other provinces. International comparisons, however, are generally made at the national level. To the greatest extent possible, this section uses the most recent data available.

The International Backdrop

Before looking at the level of BC's taxes compared to other provinces or to the United States, an international context is useful. Some caution, however, is required when making international comparisons: different countries rely on sales, income, and other taxes to different degrees; some countries charge user fees for what, in another country, might be fully funded by tax measures; and, there are numerous differences in labour markets, public institutions, and so on.

The most general comparisons look at total tax revenues as a share of a country's GDP. In 1996 (the last year for which comparable data is available), this amounted to 36.8% of GDP in Canada, when federal, provincial, and municipal taxes were included. This placed Canada in 15th spot out of 29 countries in the OECD (considered the rich, industrialized nations), ranked from highest tax share to lowest. Canada is also right in the middle of the G7 countries by this same measure, with higher tax revenues than the US, Japan and the UK, but lower tax revenues than Germany, Italy or France.

Canadian tax revenues are below the OECD average of 37.7% of GDP by almost a full percentage point, and are much lower than the European Union average of 42.4%. Belgium, Denmark, Sweden, France, and Finland each have total tax revenues in excess of 45% of GDP. These countries have yet to "hit the wall". In fact, the nations with the highest productivity growth in the 1990s—Norway, Sweden, Denmark, and Germany—are among the "high tax" countries. As will be discussed in the next section, there is no connection between the level of taxation and economic performance—countries with rapid rates of economic growth are just as likely to be "high tax" as "low tax".

What is important is not the level of taxes, but the value provided to citizens in terms of services paid for by those taxes. High taxes are not a death knell, but rather are a political, democratic choice on the part of these nations. Like prices in the market, taxes are the price paid for publicly-provided goods and services.

Increases in Canadian taxes over the past few decades as a share of GDP have been at a slower rate than other OECD countries. Figure 2 shows that in 1974 total taxes in Canada amounted to 33.7% of GDP, 2.9 percentage points lower than in 1996. Over this same timeframe, the OECD average increased by 7.2 percentage points. The increase over the 1990s has been even more modest. In 1990, total taxes amounted to 36% of Canada's GDP. By 1996, this had increased by only 0.8 percentage points. The OECD average, on the other hand, increased 1.6 percentage points between 1990 and 1996.

The OECD statistics also break down these tax revenues by type of tax. Table 1 shows the breakdowns for Canada, the US, the European Union

Governments make policy choices about what elements are most important in the tax base. A higher reliance on income taxes, as in Canada, is not necessarily a bad thing because the income tax system is progressive. This means the tax system can better offset the much more unequal distribution of incomes that springs from the market.

Table 1: Tax Revenues by Source (as a percentage of GDP)

	Personal Income Tax	Corporate Income Tax	Social Security	Taxes on Goods and Services	Other Taxes	Total Tax Revenue
Canada	13.9	3.3	5.9	9.1	4.6	36.8
United States	10.7	2.7	6.7	4.9	3.5	28.5
European Union	11.0	3.2	11.2	13.3	3.7	42.4
OECD Average	10.1	3.1	8.4	12.3	3.8	37.7

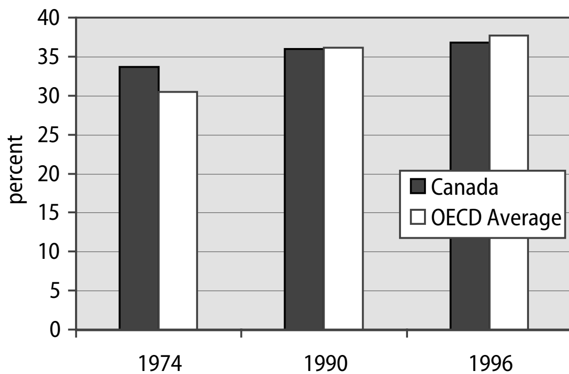
Note: Data are for 1996 year.
Source: OECD Revenue Statistics, 1965-1997

average, and the OECD average. At 13.9% of GDP, Canada relies more on income taxes than do other OECD countries (thus the focus on personal income taxes by tax cutters). However, Canada has lower social security taxes (also known as payroll taxes) than Europe, the US or the OECD average, and typically has lower property taxes.

This is further illustrated by OECD comparisons of income and social security taxes for the average production worker. As shown in Table 2, for Canada this amounts to a combined 32% of labour costs, equivalent to the UK and slightly higher than the US (31%). Canada fares comparably well because both employee and employer social security contributions are relatively small, even though income taxes may be higher.

Governments make policy choices about what elements are most important in the tax base. A higher reliance on income taxes, as in Canada, is not necessarily a bad thing because the income tax system is progressive. This means the tax system can better offset the much more unequal distribution of incomes that springs from the market. Sales and social security taxes, on the other hand, are regressive, placing a higher burden on those less able to pay.

Figure 2: Tax Revenues as a Percent of GDP, Canada and OECD Average



Source: OECD Revenue Statistics, 1965-97

Table 2: Income Tax and Social Security Contributions

	Income Tax	Social Security Contributions Employee	Social Security Contributions Employer	Total	Labour Costs
	(percent of labour costs)				($)
Canada	20	5	6	32	32,211
France	10	9	28	48	28,198
Germany	17	17	17	52	35,863
Italy	14	7	26	47	32,351
Japan	8	7	7	22	27,664
UK	15	8	9	32	29,277
United States	17	7	7	31	31,300

Notes: Figures are for 1998 year.
Labour costs equal gross wage for a single individual at the income level of the average production worker plus employer's social security contributions. Labour costs are measured in US dollars of equal purchasing power.
Totals may differ due to rounding.
Source: OECD, Taxing Wages in OECD Countries 1998/99

Personal Taxes in BC

While international comparisons provide a useful backdrop, tax levels in a Canadian or North American context are clearly the most relevant to the debate. To understand whether BC's personal taxes are high or not, we must make comparisons to other provinces, and to the United States. This comparison ultimately must take into consideration the value of services provided by tax revenues. It is important not to lose sight of this in the minutia of tax statistics.

Provincial Comparisons

It is often claimed that BC suffers from "big government". Table 3 sets out provincial government revenues for Canadian provinces, and shows that BC government revenues are far from the highest in Canada. BC's provincial government revenues as a share of GDP amount to 18.5%, third lowest in the country, after Alberta and Ontario. And many provinces have much higher levels of revenues to GDP, the highest being Newfoundland at 29.7%.

Revenues have grown in BC at a relatively slow annual rate. BC had the second lowest compound annual growth rate of provincial revenues from 1994/95 to 1998/99. Alberta had the slowest revenue growth of all provinces. Ironically, the growth of revenues in Alberta is used by some commentators to "prove" that cutting taxes increases provincial revenues.

Income Taxes

Income taxes are at the centre of calls for tax cuts. They are the primary source of tax revenue for both federal and provincial governments, and as such, are the most visible to Canadians. However, a closer look at the debate shows an extreme bias toward the tax rates paid by only the highest income earners, rather than the low and middle income taxpayers that make up the bulk of the tax base.

Business commentators are fond of pointing to the top marginal income tax rate. BC does have one of the highest top marginal tax rates in Canada, although a combination of provincial and federal income tax cuts at the high end have lowered this top rate in recent years—a response to the cries of the tax cutters. For the year 2000, BC's top rate is 51.3%, and is further scheduled to fall to 49.9% by 2001. As Table 4 shows (see next page), top rates in BC are only modestly higher than other provinces.

It is often claimed that BC suffers from "big government," but BC government revenues are far from the highest in Canada. BC's provincial government revenues as a share of GDP amount to 18.5%, third lowest in the country, after Alberta and Ontario.

Table 3: Provincial Government Revenues

	Provincial Government Revenues, 1999/00 ($millions)	Revenues as % of GDP	Compound Annual Growth Rate, 1994/95 to 1998/99 (% change)
BC	20,385	18.5	2.4
Alb	16,888	15.8	1.9
Sask	5,579	19.1	3.7
Man	6,082	19.5	4.3
Ont	58,150	15.2	4.7
Que	45,192	22.6	4.6
NB	4,657	25.7	2.5
NS	4,728	21.7	3.4
PEI	828	26.7	2.9
Newf	3,532	29.7	2.5

Source: TD Economics, Report on Canadian Government Finances

Table 4: The View from the Top

	Top Marginal Tax Rate (percent)	
	2000	2001
BC	51.3	49.9
Alb	43.7	41.2
Sask	49.0	46.2
Man	48.1	47.8
Ont	47.9	47.6
Que	50.7	50.4
NB	48.8	48.0
NS	48.8	48.5
PEI	48.8	48.5
Newf	51.3	51.0

Note: As of April, 2000
Source: BC Ministry of Finance and Corporate Relations.

WHAT DO WE MEAN BY…

top marginal income tax rate—the percentage of income paid in the highest tax bracket. In BC, this is generally payable only on income over $80,000 (depending on RRSP and other deductions). For example, a person making $100,000 would pay the top rate only on the last $20,000 of income, not on their entire income. Only the top 4% of taxpayers earn enough to be affected by the top rate.

progressivity—the principle that the percentage of one's income paid to a tax increases as one's income rises. Income taxes in Canada are generally progressive through higher tax rates that kick in as income rises into higher tax brackets (see section "Canada and the United States: In Search of Greener Grass" for more detail on different tax rates for different income bracktes). On the other hand, a sales tax is an example of a *regressive* tax, meaning lower income people pay a greater share of their income to the tax than higher income people.

high income—this term (and similar terms, like upper income earners) can be somewhat vague. In this paper, it generally refers to the top 10% of taxpayers that make over $60,000 per year, and more specifically to the 4% that make over $80,000 per year.

Top marginal rates can be deceptive, however, because they only apply to a select few fortunate enough to earn more than $80,000 a year. The typical taxpayer is more concerned about the percentage of total income that goes to taxes, or the average tax rate. Tables 5a and 5b show the percentage of income that would be paid in combined federal and provincial income taxes at various income levels in 1998.

For unattached individuals, BC has among the lowest taxes in Canada at almost every income level specified:

- Single individuals earning between $20,000 and $75,000 would pay less income tax only in Alberta and Ontario, but more tax in every other province.
- After about $80,000, BC's top marginal rate kicks in. But an individual earning $100,000 still pays taxes that are in the middle of what would be paid in other provinces.
- Only at a $200,000 income does BC's top marginal tax rate make taxes as a percentage of income rise beyond the average for the provinces. At this level, income taxes are third highest of Canadian provinces, after Newfoundland and Quebec. About 0.4% of taxpayers earn more than $200,000 per year.

For families in BC, a similar story emerges:

- In the $50,000 to $100,000 range, income taxes for families in BC are third lowest after Ontario and Alberta.
- At $200,000, BC still has the fourth lowest income taxes of the provinces.

Both cases suggest that there is some room for lowering taxes at the bottom end, a move that would increase the progressivity of the provincial income tax system. At a time when the market is producing greater income inequality, any tax reforms should be targeted to benefit those with low and modest incomes.

Table 5: Federal and Provincial Income Taxes as a Percentage of Income

5A: Unattached Individual with No Dependents

	Federal and Provincial Income Tax as a % of Income						
	$10,000	$20,000	$35,000	$50,000	$75,000	$100,000	$200,000
BC	5.1	15.1	21.7	27.0	34.6	39.3	46.7
Alb	2.9	14.9	21.3	26.4	33.0	36.1	40.9
Sask	5.5	16.9	24.0	29.9	37.2	40.8	46.2
Man	4.4	17.0	24.1	29.9	36.8	40.1	45.1
Ont	4.8	14.3	20.6	25.6	33.2	37.5	43.9
Que	1.8	17.9	26.8	32.4	39.5	42.8	47.7
NB	6.1	16.2	23.3	29.0	35.8	39.2	44.9
NS	3.9	15.8	22.7	28.2	35.0	38.5	44.1
PEI	6.0	16.0	23.0	28.6	35.9	39.5	44.9
Newf	6.5	17.0	24.3	30.3	37.8	41.7	47.5

5B: Two-Income Family of Four

	Federal and Provincial Income Tax as a % of Income				
	$35,000	$50,000	$75,000	$100,000	$200,000
BC	9.3	15.7	22.9	27.3	39.2
Alb	8.7	15.5	22.4	26.6	36.1
Sask	9.9	17.6	25.6	30.2	40.9
Man	9.2	16.7	25.0	29.8	40.1
Ont	8.5	14.8	21.8	25.9	37.5
Que	3.8	17.0	27.3	32.1	42.5
NB	10.3	17.0	24.6	29.1	39.3
NS	8.2	15.8	24.0	28.4	38.5
PEI	10.1	16.8	24.3	28.9	39.5
Newf	11.1	17.9	25.7	30.4	41.7

Notes: figures are for 1998 tax year.
For families, the next lowest income level for which there is data is $25,000. At this level, income tax is not applicable.
Source: Canadian Tax Foundation

Both cases [single individuals and families] suggest that there is some room for lowering taxes at the bottom end, a move that would increase the progressivity of the provincial income tax system. At a time when the market is producing greater income inequality, any tax reforms should be targeted to benefit those with low and modest incomes.

Other Personal Taxes

Income taxes, of course, do not tell the entire story. A more detailed analysis must include the impact of all taxes paid, including sales, property, fuel and payroll taxes. A more detailed table on specific rates in each province is available in the Appendix.

When all direct taxes, federal and provincial, are considered, BC ranks as one of the lowest tax jurisdictions in Canada. Because BC's rates on other personal taxes are comparable to, or lower than, other provinces, BC is almost consistently the second lowest tax jurisdiction after Alberta.

There is some variation from province to province in these other taxes:

➔ **Property taxes**—Based on estimates by the Canada Mortgage and Housing Corporation (CMHC) of the property taxes payable on a "starter home", BC has the second lowest property taxes in Canada. In part, this is due to grants by the provincial government for principal residences, which substantially reduces the tax bill for most home owners. However, despite the lower rate, the level of BC property taxes is affected by high housing prices relative to other provinces (particularly in the Lower Mainland).

➔ **Provincial sales taxes**—These vary across provinces, but are largely clustered between 7-8%. BC's PST of 7% is consistent with Saskatchewan and Manitoba. All other provinces have higher general rates, with the exception of Alberta, which only charges sales tax on accommodation. PEI has the highest sales tax of any province at 10%.

➔ **Fuel taxes**—BC's fuel taxes are also among the lowest in Canada. As a major oil and gas producer, Alberta has the lowest fuel taxes in the country (and receives over 20% of provincial budget revenues in resource royalties from the oil and gas sector, which obviate the need for taxes elsewhere). BC's fuel taxes are moderately higher than in New Brunswick, but lower than the remaining seven provinces. (Whether low fuel tax rates truly represent good news is debatable. Many environmentalists have been calling for increases in fuel taxes to reduce carbon dioxide emissions and air pollution.)

➔ **Health care premiums**—Alberta and BC are the only provinces to charge individual Medical Service Plan premiums. Alberta rates are slightly lower than BC for most groups. However, MSP premiums are lower in BC for some groups due to premium assistance for lower income individuals and families. Of note, about half of MSP premiums in BC are paid by employers.

➔ **Provincial payroll taxes**—Manitoba, Ontario, Quebec and Newfoundland are the only provinces that levy payroll taxes. Payroll taxes are paid by employers but are typically reflected in lower wages and salaries paid to employees (the same is true for MSP premiums paid by the employer).

When all direct taxes, federal and provincial, are considered, BC ranks as one of the lowest tax jurisdictions in Canada.

Table 6: Total Taxes by Province (as a percentage of total income)

	Single Individual		Two Income Family of Four			Senior Couple
	$25,000 income	$80,000 income	$30,000 income	$55,000 income	$90,000 income	$30,000 income
BC	20.0	34.1	17.5	23.4	26.2	6.0
Alb	18.4	32.0	16.6	22.6	25.1	5.4
Sask	20.2	37.4	22.7	25.9	28.7	7.1
Man	21.5	39.1	23.5	27.5	30.8	6.3
Ont	19.8	36.6	23.6	26.5	28.2	6.6
Que	26.6	44.4	20.3	30.9	35.2	7.2
NB	20.6	35.5	20.4	24.1	27.5	6.3
NS	20.5	35.6	21.7	24.6	27.6	6.7
PEI	20.5	36.1	21.2	24.3	27.5	6.4
Newf	22.8	38.2	22.6	26.0	29.6	6.3

Note: Figures are for 2000 tax year. Full tables and notes are included in the Appendix.
Source: BC Budget 2000

Table 6 (facing page) presents a number of scenarios that estimate total taxes payable for different demographic and income groups as a share of income (the full tables upon which these numbers are based are available in the Appendix). Because BC's rates on other taxes are comparable to, or lower than, other provinces, BC is almost consistently the second lowest tax jurisdiction after Alberta:

- A single, unattached individual earning $25,000 in BC would pay 20% of income in total taxes, third lowest in Canada after Ontario and Alberta. At the $80,000 income level, this is 34.1% of income, second lowest in Canada after Alberta.
- A two income family of four earning $30,000 would pay 17.5% of income in total taxes. This rises to 23.4% at the $55,000 level, and 26.2% at the $90,000 level. Tax savings could be realized only by moving to Alberta—the $55,000 income family would save $443; the $90,000 income family, $998.

The "Alberta advantage", however, is based only on taxes paid, and is somewhat of an illusion. Higher out-of-pocket costs in Alberta are an important consideration. For example, if a family had one child in university, higher tuition in Alberta would cost the family about $1,000 more, a sum that would eat up the bulk of tax savings, even for the $90,000 family.[1]

A senior couple in BC with $30,000 in pension income would pay 6% of that income in taxes. This is also lower than every province but Alberta.

Putting all of this together, the weight of evidence suggests that BC has among the lowest taxes in Canada. Existing tax rates certainly do not justify the hysteria that has been fanned by the media campaign for tax cuts. However, if there are to be future reductions in taxes, they should be directed to those with low and modest incomes.

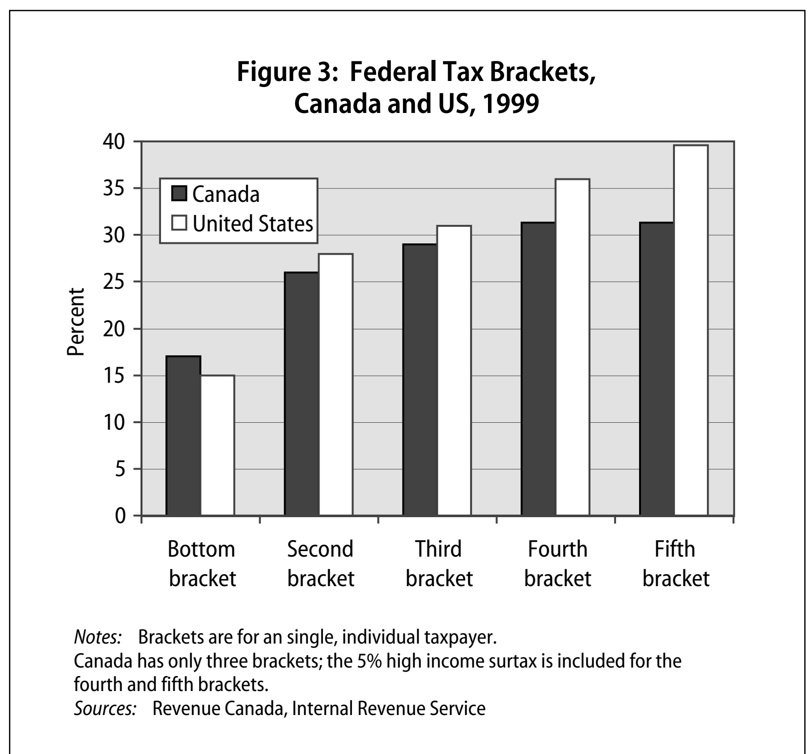
Canada and the United States: In Search of Greener Grass

The economic darling of business commentators is the United States, because it does have lower overall taxes than Canada. Because of Canada's proximity to the US—in terms of geography, culture and language, as well as trade and economic relationships—it is argued that the US is the true competitor in terms of tax levels.

The usual implication is that a move south of the border would result in a windfall through lower taxes. But more detailed comparisons to the United States suggest that the tax differential is overstated for the vast majority of Canadians. At the federal level, rates are comparable. Where Canadian taxes are higher is at the provincial/state level, but only significantly so for the well-off.

Federal Income Taxes

Both Canada and the US have rising marginal tax rates set out in tax brackets. As Figure 3 shows, 1999 federal income tax brackets in



Notes: Brackets are for an single, individual taxpayer.
Canada has only three brackets; the 5% high income surtax is included for the fourth and fifth brackets.
Sources: Revenue Canada, Internal Revenue Service

Canada and the US for a single individual taxpayer are surprisingly similar (US figures in US dollars, Canadian figures in Canadian dollars):

- The bottom bracket for US taxpayers is 15% on the first $25,350 of income. This is similar to the Canadian rate of 17% on the first $29,590. (Both have basic personal exemptions.)
- In the second bracket, the US marginal rate rises to 28% for income between $25,351 and $61,400. Canada's marginal rate rises to 26% on income between $29,591 and $59,180.
- In the third bracket, the US marginal rate rises to 31% for income between $61,401 and $128,100, while Canada's rises to 29% for income over $59,181.
- The US has two additional tax brackets that apply to high income earners. From $128,101 to $278,450, the US marginal tax rate rises to 36%, and all income over $278,451 is taxed at the top rate of 39.6%. The top federal rate in Canada stays at 29% all the way up, but the federal government also levies a 5% surtax on tax payable in excess of $12,500. This effectively raises the top federal marginal tax rate to 31.3% for income over $65,000.

The 2000 Federal Budget will result in some adjustments to the Canadian figures. The budget lowers the middle bracket rate to 24% effective July 1, 2000, and to 23% over the next five years. The thresholds for the second and third brackets will also be raised over the next five years to $35,000 and $70,000 respectively. As of July 1, 2000, the 5% surtax will be eliminated for those earning less than about $85,000, and is scheduled to be phased out altogether over the next five years.

The usual implication is that a move south of the border would result in a windfall through lower taxes. But more detailed comparisons to the United States suggest that the tax differential is overstated for the vast majority of Canadians. Where Canadian taxes are higher is at the provincial/state level, but only significantly so for the well-off.

Both the Canadian and American income tax systems are progressive, and because of the additional brackets on high income earners, federal income taxes in the US are somewhat more progressive than in Canada. In this area, Canada would do well to imitate the US, by adding a couple of brackets that raise tax rates for high income earners.

Upper income Americans, however, get a number of large tax deductions that offset the progressivity built into US tax brackets:

- US tax treatment of capital gains is more generous, with gains taxed at a rate of 28%. In Canada, two-thirds of the value of the capital gain is taxed as income (as of the 2000 federal budget). If taxed at the top marginal rate in Canada, this amounts to a rate of about 33% (depending on province).
- The US offers a tax deduction for interest paid on mortgages.
- The US allows tax deductions for state and property taxes.

The structure of these tax deductions disproportionately benefits those who have expensive houses and large stock holdings, and who pay a lot of state taxes—in other words, the already well-off.

There are other differences in how the US and Canadian federal governments take in tax revenues. One major difference is in federal sales taxes: Canada has the 7% GST, while the US has no federal sales tax.

On the other hand, payroll taxes in the US are much higher than in Canada. Combined Social Security and Medicare taxes amount to 15.3% of income in the US, whereas Canadian CPP and EI amount to 9.62% (counting both employee and employer shares in both countries). Both nations' payroll taxes are capped at specified maximum contributions, but the US maximum is more than double Canada's—a tax benefit for high income Canadians.[2]

The US also has an inheritance tax of 30%. Canada eliminated its version of this tax in 1970, and is now one of only three OECD countries that do not have an inheritance or wealth transfer tax (the others are Australia and New Zealand).

State and Provincial Taxes

State income taxes in the US are lower than Canadian provincial income taxes, although this varies greatly from state to state. While some states, like Washington, have no state income tax at all, most states do, with top marginal tax rates that range from 6-10% of total income. According to the US Tax Foundation, for 1999, average state and local taxes combined amount to 11.3% of income, ranging from highs of 14.4% in Hawaii and 14.2% in New York to 7.3% in Wyoming and 7.6% in Alaska.[3]

Beyond these broad comparisons, the task of comparing taxes in Canada and the US becomes much more difficult. Rolling together federal and provincial/state income, sales, payroll, and property taxes adds a great deal of complexity. As a result, whether taxes are lower generally depends on the individual: what state they live in; how much their income is; whether they are a home owner; if their employer pays for private health insurance premiums; etc.

A study by the Conference Board of Canada compared total income, sales, property and payroll taxes for six cities in each of Canada and the US.[4] Unfortunately, the study restricts itself to the 12% of Canadians that earn $50,000 or more, and only to unattached individuals. A person earning $50,000 (Canadian dollars for Canada, US dollars for the US) would pay 34.7% of that income in total taxes in Canada compared to 28.1% in the US, a gap of 6.6 percentage points. At $100,000, the Canadian effective rate goes up to 37.4%, and the American rate up to 29.6%.

According to the Conference Board study, only at the high end do American taxes look substantially cheaper. At a $250,000 income level, Canadian taxes amount to 47.7% of income, compared to 34% in the US. However, it is useful to keep in mind that only 0.3% of Canadians make this kind of money.

An anecdotal comparison between Washington state and BC by research firm KPMG comes to a similar conclusion. The windfall for those wishing to move south really only kicks in at very high income levels. The typical working family will not necessarily gain by moving to the US. Looking at sample tax returns for a two income family of three, KPMG finds that with a more than respectable combined income of $107,700 (again Canadian dollars for Canada, US dollars for the US), the total tax bill in BC is $22,845, or 21.2%, while in Washington it is $20,950, or 19.5%. This gap shrinks if Canadians are assumed to make their maximum RRSP contributions.[5]

Importantly, states like Washington have highly regressive tax systems because they rely on sales and property taxes for the bulk of their revenues. A report by the US group Citizens for Tax Justice found that a family in the bottom fifth of income earners would pay an average of 17% of their income in state taxes. This percentage decreases over the income range, to 12.4% for the next fifth, to 10.7% in the middle fifth, and down to only 3.9% of income for the top 1% of income earners.[6]

WHAT DO WE MEAN BY…

capital gain—income gained through the buying and selling of assets, or the difference in the value of an asset from the time it is purchased to the time it is sold. For example, if a person buys a share of Microsoft stock for $80, and later sells the share for $100, they will receive a capital gain of $20. About half of all capital gains in Canada go to those earning more than $100,000 per year.

The Bottom Line for Upper Incomes

For most taxpayers, this means that income tax rates are indeed lower in the US, but not by enough to justify "tax rage". The "tax gap" only really applies to high income earners. The middle class generally benefits from the Canadian tax structure and would not be better off moving south.

A Statistics Canada study comparing after-tax (or disposable) incomes for families in Canada and the US makes this clearer.[7] As Table 7 shows, average family disposable income in the US is $35,300 per person (in Canadian dollars), compared to $35,200 per person in Canada—a modest $100 advantage in favour of the Americans.[8]

Averages can be deceiving, however, because a concentration of income at the top pulls the average up, distorting what is happening in the middle. A different picture emerges if we look at median family incomes, a better indicator of how middle class families are actually doing.

In Canada, median after-tax family income is $30,200, some $2,700 more than the median $27,500 in the US. The Canadian advantage holds up to the 61st percentile (that is, lined up from lowest income to highest, the bottom 61% are better off in Canada than the US. And even in the fourth quintile, the gap in favour of the US is relatively small, at $2,250.

What is not evident in the table is that tax money is handed back to Canadians in the form of services, such as public health care, education and so on. If the value of these services was added to disposable income, the gap in favour of Canada would be larger. This is because Americans have to dip into their disposable income to purchase these services.

The US has a mostly private health care system and a larger private education sector than Canada. Noting these differences, a study by Standard and Poor's DRI Canada found that: "Once private medical

WHAT DO WE MEAN BY…

median income—the median income of a group of income earners is where half of the income earners have a higher income, and half have a lower income. This is different from *average income*, which is the total income of the group divided by the number of income earners. Averages can be deceiving because a few people with very high incomes pulls the average up, distorting what is happening in the middle.

quintile—a quintile represents one-fifth (20%) of the total number of people being studied. In the context of incomes, a population (say British Columbians) can be broken down into five income quintiles, representing the bottom 20% up to the top 20% of income earners.

Table 7: Average Family Disposible in Canada and US

	Average Disposable Income by Quintile (dollars)			Share of Total Disposable Income (percent)	
	Canada	United States	Difference (Can. minus US)	Canada	United States
Top quintile	72,250	88,000	(15,750)	38.1	44.2
Fourth quintile	43,000	45,250	(2,250)	23.5	23.7
Middle quintile	30,250	29,500	750	17.8	16.5
Second quintile	20,250	18,500	1,750	13.1	10.9
Bottom quintile	10,250	7,250	3,000	7.5	4.7
Average Income, all quintiles	35,200	35,300	(100)	n/a	n/a
Median Income	30,200	27,500	2,700	n/a	n/a

Notes: US numbers have been converted to Canadian dollars at purchasing power parity. Figures are not adjusted for family size. 1995 numbers.
Source: Wolfson and Murphy, 1998

and education expenditures are added to total government receipts, the difference between Canada and the United States vanishes."[9] That is, when private costs are accounted for, the overall tax gap in favour of the US is largely eliminated.

Canada also has a more equitable distribution of disposable income. This reflects the stronger role played by taxes and transfers in mitigating market income inequality. The difference is particularly striking for the bottom 20%, who receive 7.5% of total disposable income (i.e. after taxes and transfers) in Canada compared to 4.7% in the US. Similarly, for the next 20%, Canadians also take a bigger share of the pie. In contrast, the top 20% in the US receive six percentage points more of total disposable income that their Canadian counterparts.

Dealing with Debt

One other factor is important in explaining differences between Canada and the US in terms of government tax revenues and expenditures. Canada is living with the legacy of high interest rate policies that had the double impact of slowing down the economy (thereby undercutting the government's fiscal position) and increasing the costs of servicing government debt.

These misguided monetary policies, which were strongly supported by conservatives, came with a price. In terms of overall debt, total public debt-to-GDP will be 82.5% in Canada in 2000, compared to 57.1% in the US. The result is that Canada pays a greater share of the budget to interest on government debt than the US (in 1997, the difference was 19.8 cents per dollar of expenditures in Canada, compared to 12.2 cents in the US).[10]

The situation for the provinces is not as severe. BC, in particular, has one of the lowest debt service costs of any provincial government, at only 8.3 cents per revenue dollar. BC's debt-to-GDP ratio is also comparatively low at 22% (as of March 31, 2000), third lowest in Canada.

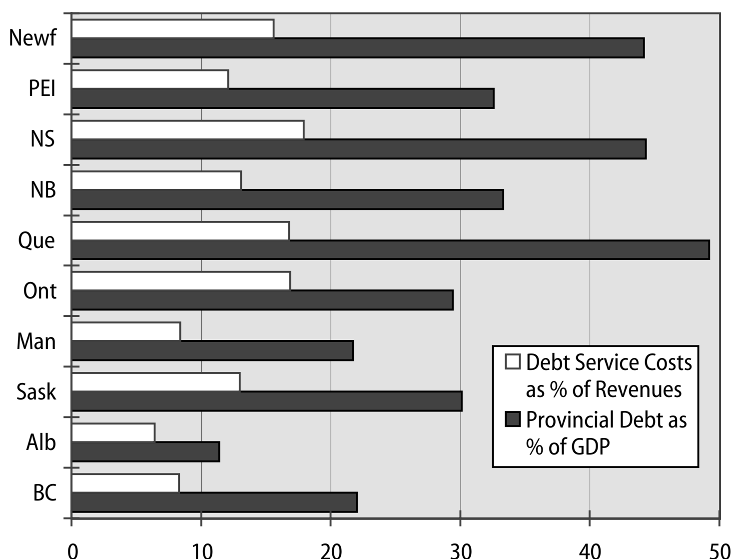
Tax revenues that go towards paying interest on debt represent dollars that could be used to fund social programs. For this reason, lowering Canada's debt-to-GDP ratio is important, and is a goal that can be readily accomplished by running balanced budgets in the context of a growing economy.

It is important to understand that the bad policies of the 1980s and 1990s—cutting upper income taxes and maintaining higher interest rates—were advocated for, and benefited, upper income earners. To now cut their taxes, when the pain of spending cuts was borne by the poor, students and the unemployed, would be a moral outrage.

WHAT DO WE MEAN BY…

***debt-to-GDP ratio*—**this refers to the size of public debt (federal, provincial or total) relative to the size of the overall economy (measured by GDP). This is a better way of assessing debt levels than just looking at absolute numbers. In personal terms, for example, whether someone who owes $25,000 is in financial trouble depends on whether they are a young student or a bank CEO.

Figure 4: Provincial Fiscal Comparison, 2000



Notes: Numbers are for the 1999/00 fiscal year.
Debt-to-GDP numbers reflect fiscal position as of March 31, 2000.
Source: TD Economics, BC Budget

tax facts

THE TAX FREEDOM DAZE

It is hard to argue against freedom. After all, no one wants to be constrained from doing what they want to do. Free marketeers are particularly adamant about their freedom to choose in the marketplace, and about how to spend their incomes.

Every year, the ultra-conservative Fraser Institute pronounces Tax Freedom Day—the day when Canadians (finally) stop "working for the government" and start "working for themselves".

Tax Freedom Day is, without a doubt, a clever and media-savvy ploy. That people actually derive benefits from government services in exchange for the taxes they pay is conveniently swept under the ideological carpet. Instead, the Fraser Institute suggests that up to a certain date, the government takes all of your income, burying it in some distant mineshaft never again to see the light of day, and thus stripping away your ability to be truly free.

In 1999, Tax Freedom Day in BC fell on July 1, leading readers to believe that the typical British Columbian pays about half their income in taxes, and thus works for half the year to pay the government. But wait, total tax revenues amount to around 37% of Canada's GDP. Why the discrepancy?

The Fraser Institute ostensibly calculates total taxes paid divided by total income. Simple enough, it would seem, but there is a great deal of arbitrariness to what gets included as "income" and "taxes". On the income side, certain types of income are not counted, including employer-provided fringe benefits, capital gains, and gifts and bequests. On the tax side, however, everything that even resembles a tax is counted (including natural resource royalties), and these taxes are all completely assigned to families. This way, corporate income taxes paid are included in the family tax bill, but corporate income in the form of retained earnings is not. Counting in this way tips the scales, pushing Tax Freedom Day ahead in the calendar.

The Fraser Institute calls its version of income for Tax Freedom Day "cash income". However, they also calculate "total income before tax", which includes other income such as fringe benefits and investment income from trusteed pension plans, plus the value of taxes paid on property, corporate income tax and indirect taxes (why these taxes are deducted to come up with "cash income" is a mystery). Re-calculating Tax Freedom Day based on "total income before tax" would make it fall about two months earlier.

Another reason why taxes appear higher is that the Fraser Institute figures are taken as an average for all Canadians. The trouble with averages is that they get pulled up by big numbers at the high end. For example, a room full of five people, with four making $20,000 per year and one making $220,000 per year, has total income of $300,000—or an "average income" of $60,000. In the same way, if each of the four making $20,000 paid 15% of that income in taxes, and the person making $220,000 per year paid 40% of that income in taxes, then the total tax paid among the five is $100,000, for an average tax rate of 33%—even though four of the five really paid only 15%.

It is possible to nit-pick even more about how Tax Freedom Day is calculated. But methodological qualms aside, there is a misleading premise embodied in the tax freedom concept that should not be ignored: that taxes restrict freedom. As tax lawyer Neil Brooks points out: "Even with a tax on income, individuals are still free to make whatever career or investment choices they wish, and free to choose whatever goods and services they wish to consume." [1]

On the other hand, public expenditures enhance people's freedom to travel on public roads, to learn in public schools and libraries, and to enjoy public spaces. Redistributive taxation can also increase overall freedom because of the income provided to low income earners. This expands their ability to make choices and take advantage of opportunties. In a market economy, the Fraser Institute's much-cherished "economic freedom" only matters for those that have enough cash.

1. Brooks,1997

Corporate Taxes in BC

Much of the media's attention has been on personal taxes, probably because there is little public desire to reduce corporate taxes. Aside from complaints by the business community about the "burden" of taxes (it is, of course, in their financial interest to lobby for substantially lower taxes), the real public policy issues are: how rates compare across jurisdictions; and, whether tax rates in a province like BC are sufficiently high to adversely affect location and investment decisions.

Provincial Comparisons

Corporate taxes in BC are not out of line with those in other provinces, as can be seen in Table 8. The general corporate income tax rate in BC is 16.5%, fourth highest in Canada. Quebec has the lowest rate at 8.9% (although this applies to a larger income base), followed by Newfoundland at 14%. The remaining eight provinces (including BC) all have rates between 15.5% and 17%. It is highly unlikely that such small differences in tax rates have a noticeable impact on company decisions to invest or locate (what drives these decisions will be discussed in the next section).

All provinces also have a lower income tax rate applicable to small business. The 1999 and 2000 BC Budgets announced cuts in the small business tax rate. The current rate of 4.75% is the lowest in the country, with other provincial rates ranging from 5% to 8.9%. New small businesses in BC incorporated between May 1, 1996 and March 31, 2001 also receive a two-year tax holiday.

In addition to income taxes, most provinces (except for Alberta, PEI and Newfoundland) impose capital taxes (taxes on a company's accumulated stock of physical capital equipment and machinery). The BC rate of 0.3% is slightly higher than Nova Scotia (0.25%), but the same as Manitoba, Ontario and New Brunswick. In BC, however, this tax is applicable only for those companies with capital in excess of $2.5 million, and this threshold will rise to $5 million as of Jan. 1, 2001. Thus, 80-90% of companies in BC do not pay the capital tax.

All provinces also levy a separate capital tax

Table 8: Provincial Corporate Tax Rates, 2000

	Corporate Income Tax (%) [1]		Capital Tax (%)		Payroll Tax (%)
	General Rate	Small Business Rate	General Rate [2]	Financial Institutions [3]	
BC	16.5	4.75	0.3	1.0/3.0	nil
Alb	15.5	6.0	nil	0.7/1.0	nil
Sask	17.0	8.0	0.60	0.7/3.25	nil
Man	17.0	7.0	0.3/0.5	3.0	2.15
Ont	15.5	7.0	0.30	0.6/0.99	1.95
Que	8.9	8.9	0.64	1.28	4.26
NB	17.0	6.0	0.3	3.0	nil
NS	16.0	5.0	0.25	3.0	nil
PEI	16.0	7.5	nil	3.0	nil
Newf	14.0	5.0	nil	4.0	2.0

Notes:
1. Alberta, Saskatchewan, Ontario, PEI and Newfoundland have lower corporate income tax rates for manufacturing and processing. Also, various provinces have lower rates for the oil and gas sector and the high tech sector. Quebec rate applies to all business income and includes a surtax of 2.8%.
2. BC's general corporate capital tax rate applies only to corporations with paid-up capital of more than $2.5 million (rising to $5 million in 2001); Ontario has lower rates for corporations with less than $2.3 million in taxable capital; Manitoba has a $5 million exemption level and the higher rate applies to paid-up capital in excess of $10 million; Saskatchewan has a $10 million deduction.
3. BC Capital Tax for financial institutions is 1% for corporations with less than $1 billion in net paid-up capital, and 3% otherwise.

Rates are as of April 2000.

Source: BC Budget 2000

A KPMG study, *The Competitive Alternatives,* examined business costs in eight industrialized countries. According to the study, Canada has one of the lowest effective corporate tax rates, after the various deductions available to business are accounted for.

on financial institutions. BC's rates of 1% for institutions with less than $1 billion in capital, and 3% for those with greater than $1 billion, are comparable to rates in other provinces. The lowest rates are in Ontario, Quebec and Alberta.

Some companies may not find BC to be the most tax friendly jurisdiction in Canada, but neither are taxes unduly high. All things considered, BC compares well to other provinces, about the middle of the pack in terms of overall corporate taxes.

US and International Comparisons

Canadian governments in recent decades have strived to make Canada a hospitable environment for business and for new investment. Thus, corporate taxation is at similar levels, or is lower than, other industrialized countries.

A KPMG study, *The Competitive Alternatives*, examined business costs in eight industrialized countries. According to the study, Canada has one of the lowest effective corporate tax rates, after the various deductions available to business are accounted for. For manufacturing, the average of seven industry sectors is 32.6%, comparable to Austria and the UK, and less than the 36% in the US.[11]

For software and services, Canada's effective rate is higher, at 42.7%, though still less than 47.8% in Italy and 64.4% in Germany. The 2000 federal budget set out a five-year plan to reduce Canada's federal corporate income taxes to the same rate as manufacturing and processing.

Rates also vary in the US, with a band that is generally lower than Canada for general corporations and higher than Canada for manufacturing. The UK also has corporate rates similar to Canada's, but other G7 countries have higher rates. However, corporate tax rates should be taken with a degree of caution, due to differences in tax bases, depreciation rules, exemptions and allowances, etc.

One reason for Canada's good performance is a generous system of research and development (R&D) tax incentives. As a separate Deloitte and Touche study

Table 9: International Corporate Comparison

	Effective Corporate Income Tax Rate (%)	**Average Property Taxes** ($ per square foot)	**Index of Location-sensitive Costs**	**Rank** (1 = lowest cost)
Canada	32.6	2.31	92.2	1
France	38.9	3.64	104.2	5
Germany	64.4	2.22	108.0	7
Italy	47.8	nil	104.2	6
Austria	32.4	0.17	104.1	4
Japan	49.0	14.54	121.9	8
United Kingdom	31.4	4.50	94.8	2
United States	36.0	1.76	100.0	3

Notes: Figures are for 1998.
Canadian and US corporate taxes vary by province/state. Income tax rate for Japan is based on a three city average and may not reflect true effective rates nationally.
Index of location-sensitive costs are for a nine-industry average and includes: labour; lease; electricity, transpotation and telecommunications; interest; depreciation; and taxes. Higher values of the index represent higher costs.
Source: KPMG Canada, *The Competitive Alternatives: A Comparison of Business Costs in North America, Europe and Japan* , 1999

notes: "The Canadian system provides Canadian corporations with a significant advantage over US firms when vying for research and development work in the US."[12]

The KPMG study also considers a number of other factors that influence business location and investment decisions. The study finds that property taxes in Canada are moderate compared to other countries. The highest property taxes are in Japan and the UK, due to a combination of high tax rates and above average property values. Capital taxes in Canada are also highly comparable to other nations.

Overall, the KPMG study found that Canada is the lowest cost location of the eight studied. Canada's advantage is bolstered by low initial investment costs (such as land acquisition and building construction), low electricity and telecommunications costs, and low total labour costs.

Another approach is to look at total corporate income taxes paid in Canada and other industrialized countries relative to the size of the economy. As Table 10 shows, Canada's corporate income tax as a share of GDP is not out of line with other G7 countries. Canada's 3.3% of GDP

Table 10: Corporate Taxes as a Percent of GDP

	Corporate Income Tax	Employers' Social Security Contributions	Total
Canada	3.3	3.9	7.2
France	1.7	12.2	13.9
Germany	1.4	7.8	9.2
Japan	4.7	5.3	10.0
United Kingdom	3.8	3.5	7.3
United States	2.7	3.7	6.4
EU Average	3.2	6.9	10.1
OECD Average	3.1	5.5	8.6

Note: Figures are for 1996 year.
Source: OECD Revenue Statistics, 1965-1997.

Table 11: Corporate Tax Comparisons for BC and Three US States

	BC	Washington	Oregon	California
Corporate Income Tax (% of Taxable Income)	38.62 – 45.62	34.0 – 35.0	40.6 – 41.6	42.84 – 43.84
Gross Receipts Tax (% of sales)	nil	0.471 – 2.0	nil	nil
Social Security (% of gross pay)	6.98	16.09	16.85	17.35
Workers' Compensation (% of gross pay)	0.47	US$0.2139 per hour	1.79	1.72
Property Tax (% of Assessed Value)				
Land and Buildings	2.63	1.57	1.41	1.1
Machinery and Equipment	nil	1.57	1.41	1.1

Notes: Figures are for 1998 year.
Corporate income tax includes federal and provincial/state. Canada has lower rates for manufacturing/processing. Property taxes are representative for a manufacturing firm in Vancouver, Seattle, Portland and Los Angeles.
Source: BC Trade and Investment Office, British Columbia Investment Climate -- Business Taxes

is slightly higher than the OECD average of 3.1% and the EU average of 3.2%. Corporate income tax is lower in the US, France and Germany, but is higher in Japan and the UK.

When employers' social security contributions are added to the mix, Canada drops close to the bottom in terms of taxation, comprising 7.2% of GDP, compared to an 8.6% average for the OECD. The US is still lower, but rates in other G7 countries and the EU average are notably higher.

A final point of comparison brings the corporate tax issue back to BC. The BC Trade and Investment Office studied corporate taxes in BC, Washington, Oregon and California. They found that a BC firm pays less in total "tax burden" (defined as total taxes paid as a proportion of revenues less all non-tax expenses except depreciation) than their American counterparts in the 3 US states. Furthermore, taxes that are unrelated to profitability are much higher in the US than in BC.

As Table 11 shows (see page 23), corporate income tax rates are slightly higher in BC than Washington, but are comparable to Oregon and California. Nominal tax rates in Canada are higher than in the US, but fall by a greater amount after accounting for tax deductions and credits. BC companies, however, enjoy a much larger cost advantage with regard to payroll taxes compared to their US counterparts.

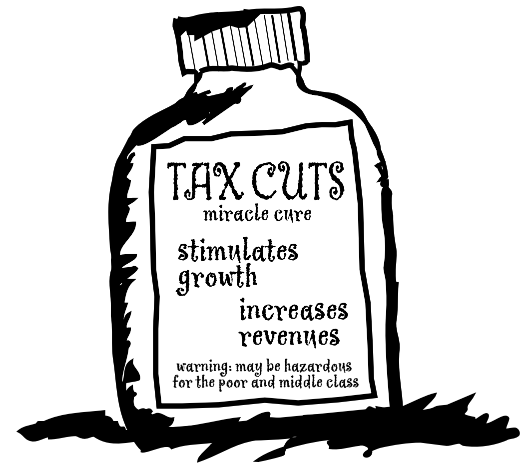
Concluding Remarks

The analysis in this section looked across provinces, US states, and internationally to assess Canadian tax levels. Given the relentless onslaught of media coverage criticizing BC and Canada for high taxes, a comparative look suggests that such claims are overblown.

British Columbians have no reason to feel that they are overtaxed relative to their fellow citizens in other provinces. Indeed, the numbers suggest the opposite, that BC has among the lowest taxes in Canada, except at the top rungs of the income ladder.

Likewise, Canadians should not feel that they are heavily burdened compared to the US or anywhere else in the industrialized world. The vast bulk of people and corporations would not be better off elsewhere. A small few at the upper end may find moving south attractive if all they care about is taxes payable. But reorienting the entire Canadian tax system to appease such a minority would be bad public policy. More importantly, when broader factors beyond tax rates, such as social programs and labour market conditions, are considered, the appeal of Canada, and BC in particular, is compelling.

3 Economic Snake Oil: Why Tax Cuts are no Miracle Cure



THE PREVIOUS SECTION SHOWED THAT taxes in BC are not out of line with other provinces, the US or other industrialized countries. There are certainly issues and concerns about BC's economy, but taxes are very low down the list. Still, the calls continue, because no matter what level taxes are at, they can always be lower. Even in the US, right-wing commentators also argue for more tax cuts. Canada and British Columbia would do well to steer clear of this tax cut blackmail.

This section examines the economic case for tax cuts and why it is flawed. There are a number of core arguments made in favour of tax cuts, each of which rest on questionable assumptions. Tax cuts, it is argued, will dramatically boost economic growth by making workers work harder and by encouraging more business investment. Taken to its extreme, this argument contends that tax cuts will produce no costs to the Treasury in terms of lost revenues because of the economic boom that would be created. Finally, tax cuts will stem a supposed brain drain—the exodus of Canada's best and brightest—to the US. As we will see, each of these assertions is not substantiated by the hard evidence.

The Elusive Economic Boom

> Tax cuts are not likely to deliver the needed [economic] stimulus. Canada would do much better to ensure growth by increasing government spending and reducing interest rates, which are still high by historical standards…Indeed, a major cause of stagnation in employment, wages, and economic growth has to do with the high interest rate policies that have been in place since the 1980s to fight inflation.

The principal argument in favour of tax cuts is that they will spur economic growth. Certainly, the BC economy could use a jolt after enduring a decade that saw real incomes decline. And even though the Canadian economy has fared better overall than BC in recent years, it arguably could also use a boost.

Unfortunately, tax cuts are not likely to deliver the needed stimulus. Canada would do much better to ensure growth by increasing government spending and reducing interest rates, which are still high by historical standards (the very low rate of inflation in the economy just makes interest rates appear low). Indeed, a major cause of stagnation in employment, wages, and economic growth has to do with the high interest rate policies that have been in place since the 1980s to fight inflation.

The argument for tax cut driven growth is multifold. Reducing taxes will increase disposable income for taxpayers, which will be spent in the economy, thereby boosting employment and income. Lower taxes will increase the incentive to work harder, as the after-tax benefit of an extra hour of work increases. Finally, lower taxes will increase the incentives for investment. In this view, taxes are always a distortion of the "natural" functioning of the market.

At the most extreme, these "supply-side" arguments claim that lowering taxes will create such an economic boom that government revenues will actually rise (see the sidebar, *Free Lunch and the Laffer Curve*). These arguments are now invoked in provinces like British Columbia as a way to sell the tax cut message—tax cuts and more funding for social programs are possible at the same time! The mysterious math behind these ideas should be treated with great skepticism.

At the broadest level of international comparison, the link between tax levels and growth rates is inconclusive. Researchers Joel Slemrod and Jon Bakija, in a survey of OECD countries, found that over the 1970-90 period there was no connection between the level of taxes as a percentage of GDP and annual growth rates of GDP. Nor is there a connection between GDP per capita and taxes as a percentage of GDP.[1]

More recently, in a review of OECD data, Andrew Jackson of the Canadian Labour Congress found no correlation between taxes as a share of GDP and either GDP per capita or labour productivity. He notes: "some high tax countries have grown quite rapidly in the 1990s (e.g. Norway, the Netherlands, Denmark) and have achieved higher rates of productivity growth than lower tax countries. Relatively low tax jurisdictions, notably the US, have performed no better in economic efficiency terms than many higher tax countries in the 1980s and 1990s." [2]

The post-war period also provides a useful basis for comparison. In both Canada and the US, top marginal income tax rates were in the 80-90% range during the 1950s and 1960s. In both countries, these earlier periods of high marginal tax rates were accompanied by high rates of productivity growth and GDP per capita growth. This does not necessarily mean that high marginal tax rates cause rapid growth—again, it depends on how that tax revenue is spent. But it does show that the "trickle down economics" proposition—that high marginal tax rates are a death knell for an economy—has little basis in fact.

tax facts

FREE LUNCH AND THE LAFFER CURVE

In the folklore of economics, the famous Laffer curve made its first appearance in the mid-1970's on a dinner napkin. US economist Arthur Laffer was sketching out to his dinner companions the relatively simple proposition that if taxes are raised too high, at some point revenue from taxes will actually fall. With exceptionally high taxes, people will avoid them by cutting back on the activity being taxed or by moving such activities "underground".

Among economists, there is little question that something like a Laffer curve for a given tax exists. If all income was taxed at 95%, this would certainly affect the incentive to work. Similarly, "sin taxes" on goods like alcohol and tobacco are explicitly designed as measures to reduce harmful activities. Set high enough, taxes will discourage the activity being taxed, though by how much depends on what is being taxed. Some goods like insulin or gasoline are considered "inelastic", meaning people will not consume that much less even with a rather large increase in price, for a variety of reasons.

Increasingly, we hear the claim that in BC tax cuts need not have a deep impact on overall tax revenues. The reason is that the tax cut will spur so much economic activity that the taxes collected on this boom will offset, or more than offset, the lost revenue from the original tax cut. Workers will respond to lower taxes by working more. Investors will invest more. And the freed up cash will be spent on goods and services with a ripple (or "multiplier") effect on the economy as money flows from hand to hand. In other words, it is alleged that BC is on the wrong part of the Laffer curve.

We have heard these arguments before. The US Presidential platform of Ronald Reagan in 1980 was steeped in these ideas about the wonders of tax cuts for the economy. That these ideas were not grounded in any evidence did not stop them from being a cunning (and successful) political strategy. As MIT Economist Paul Krugman notes: "The way that a small group of 'supply-siders', preaching a doctrine that even conservative economists regarded as nonsense, came to dominate American economic policy is one of the wonders of our age." [1]

The legacy of the Reagan tax cuts was a huge build-up of debt, with US national debt doubling as a share of GDP from 1982 to 1995 (the legacy of high debt spilled over onto later administrations). Tax revenues turned out to be significantly lower than they would have been had there been no tax cut. Meanwhile, the benefits of the tax cuts disproportionately accrued to the "super-rich", but did not "trickle down" to the masses as predicted. Savings and investment after 1981 fell—the rate of personal saving in the US fell from 5.9% in 1981 to 2.5% in 1987. The US economy actually underperformed relative to the Canadian economy in the 1980s. In short, the US tax cut experiment did not deliver on its promise.

The supply side rhetoric of the Reagan administration (dubbed "voodoo economics" by fellow Republican George Bush) is perfectly analogous to the arguments being made for BC today. Just as the Reagan tax cuts in the 1980s proved there is no such thing as a free lunch, British Columbians should be cautious about these same arguments. If it sounds too good to be true, it probably is.

1. Krugman, 1994, p. xiv

Personal Impacts

In each argument that tax cuts spur economic growth, there is a grain of truth—incentives would indeed be altered by changes in taxes. However, the impact of such changes is likely to be much weaker than tax cut proponents suggest. As prominent economist Pierre Fortin notes: "Mainstream economic thought believes that any effects from a tax reduction are likely to be modest . . . There is no proof that a net reduction in tax levels will necessarily result in added growth."[3]

In part, this is because the magnitude of any tax cuts is likely to be relatively small compared to the size of the total economy. There are also a number of "leakages" associated with tax cuts. Part of any tax cut will be saved, not spent; and of the portion that is spent, some will be spent on imports from abroad or other provinces, leaving the domestic economy. Given the current record high levels of consumer debt, any windfall may well go toward paying down one's Visa bill, rather than being spending on goods and services.

The impact also depends on who benefits from the tax cut. A tax cut for the well-off is less likely to be effective than if tax cuts are channeled toward low and middle income earners. For the rich, any gains from lower taxes are unlikely to affect spending patterns in a meaningful way. The proceeds would probably go into speculative activity in financial markets rather than new investments in the real economy (CAW Economist Jim Stanford estimates that only 1.3% of money in a typical mutual fund actually makes it into the hands of a company raising cash; the rest is simply purchasing a paper asset from the person that last held it).

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Distribution of tax cuts is important because the tax cut initiatives demanded, and already provided in some jurisdictions, concentrate the gains on the wealthy.

The impact on the rich is important because the tax cut initiatives demanded, and already provided in some jurisdictions, concentrate the gains on the wealthy. In Ontario, for example, the 1996 Harris tax cuts alone provided tax savings of over $11,000 to a family with two children earning $200,000. At $30,000 of income, the savings fell to $496. Examples in other jurisdictions tend to follow this pattern: big savings for big incomes; surprisingly little for the vast majority. At a time when income inequality is worsening, a tax reduction policy that primarily benefits the already well-off moves in the wrong direction.

To the extent that tax cuts would stimulate the economy, the optimum (and most equitable) benefit would come from tax cuts provided to low income people. This group would be most likely to spend the proceeds in the local economy. Similar comments can be made for those in the middle. But a meaningful tax cut for the middle class (on the order of several thousand dollars) would cut too deeply into revenues that support social programs. For most people, the out-of-pocket costs of private health care and education alone would be greater than the financial gain of the tax cut. These costs still must be paid, whether through prices in the market for private services, or through taxes to fund a public system.

A look south of the border provides some useful insights into how tax cuts aimed at upper incomes play out. During the 1980s, US income taxes were cut for the highest income earners in society, but provided little real relief for the vast majority of Americans. The Economic Policy Institute (EPI) reports that the top 1% of families benefited from tax cuts made from 1977 through 1985 that averaged $97,250 per year. The same changes in the tax code increased tax payments for the bottom 80% of families by an average of $221 per family. Even after accounting for progressive tax changes in 1986 and 1993, the top 1% still pay an average

of $36,710 less than they did in 1977. In line with tax cuts for the wealthy, income inequality in the US has risen dramatically.[4]

In 1993, when US President Clinton reversed some of the tax cut gains for America's highest income earners, conservatives argued that the tax increase (from 31% to 39.6%) would damage the economy and fail to raise much revenue. After the tax increase, however, the US economy has continued to boom, and almost half of the reduction in the US budget deficit was accounted for by the tax increase on upper income Americans.[5]

Tax cutters argue that people will work more in response to the incentive of lower taxes. There is little evidence, however, that this is the case. High income earners, who generally benefit most from tax cuts, cannot respond with an increase in hours worked because, in most cases, they cannot work any harder than they already are. There is no evidence that such individuals are withholding labour in response to perceived high taxes.

It is also important to remember that people at the top of the income ladder work for a variety of reasons other than take-home pay—power, prestige, ambition, and upward career movement. Their decisions about how much to work are not limited to simplistic economic calculations about monetary rewards. They may dislike paying higher taxes, but tax rates overall do not affect their behaviour in a meaningful way. In fact, if tax rates did affect their behaviour, then good public policy should arguably be to increase top marginal tax rates, thereby encouraging them to work less. This would lower the health care costs associated with high stress, burnout and long working hours (their families would likely approve as well), and possibly result in more sharing of work hours.

Tax cutters argue that people will work more in response to the incentive of lower taxes. The reality for the vast majority of workers is that they have little control over the amount of hours they work, making theoretical trade-offs between work and leisure, as suggested by Laffer curve adherents, irrelevant.

Based on a review of the empirical evidence, US economic researchers Slemrod and Bakija conclude that:

> The responsiveness of labour supply, both in terms of hours worked and the labour force participation rate, has been studied extensively, and is a rare example of a question on which there is a broad consensus among economists. Nearly all research concludes that male participation and hours worked respond hardly at all to changes in after-tax wages, and therefore to marginal tax rates. There is evidence that female labour force participation, and male retirement decisions, are somewhat responsive, but those responses do not contribute enough to total labour supply to alter the conclusion that, overall, labour supply is not greatly affected by taxes.[6]

These results are bolstered by a number of other studies and literature surveys, including those done by institutions like the International Monetary Fund (IMF) and OECD, that tend to have a bias in favour of tax cuts and free markets. The reality for the vast majority of workers is that they have little control over the amount of hours they work, making theoretical trade-offs between work and leisure, as suggested by Laffer curve adherents, irrelevant.[7]

A meaningful tax cut for the middle class would cut too deeply into revenues that support social programs. For most people, the out-of-pocket costs of private health care and education alone would be greater than the financial gain of the tax cut. These costs still must be paid, whether through prices in the market for private services, or through taxes to fund a public system.

Business Impacts

The impacts of a corporate tax cut on the economy are also likely to be small. The Centre for the Study of Living Standards notes that "the potential for lower corporate taxes to generate

additional investment in the Canadian economy appears limited. First, the corporate tax burden in Canada is already low from an international perspective. . . Second, Canada's corporate tax burden is competitive with that of our major trading partner, the United States."[8]

The connection between tax rates and investment decisions by companies is frequently exaggerated by those in favour of tax cuts. An IMF survey found that investment decisions are much more responsive to output levels than to costs (such as taxes)—*that is, companies tend to invest because demand for their product is growing, not because of reductions in corporate income taxes.*

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Where tax cuts may make a difference, it is alleged, is in decisions to locate and invest in a given location. However, a number of other factors play a much more important role than taxes in investment decisions. In a literature survey about the impact of state and local policies (including tax policy) on location decisions and economic development, the Federal Reserve Bank of Boston found that the primary determinants of a state's economic growth are factors such as labour costs, availability of skilled labour, energy costs, climate, availability of natural resources and proximity to markets. These factors generally outweigh tax policy considerations.

The Federal Reserve Bank notes that tax incentives are ambiguous in their impact: "[T]ax incentives, which can foster development by reducing business costs, can also indirectly impede development if they reduce expenditures on public services that businesses value." Similarly, "deregulation may cut the costs of production, but it can also diminish the attractiveness of a location if it causes a deterioration in environmental quality."[10]

The key point is that the competitive advantage of a location may be related to taxes, but that taxes are ultimately only one of many variables that companies must consider, and not the most critical factor at that. Publicly provided services are as much a consideration as tax rates, and this may well be a more effective development strategy.

Another difficulty with an economic development strategy based on tax cuts or tax incentives is the continual risk that neighbouring jurisdictions will respond with a bidding war. The only beneficiaries of such policies are corporations. We need to move beyond a view of public policy that sees each province or state as a competitor for corporate investment. BC should make itself attractive based on other factors.

Warnings about "beggar-thy-neighbour" policies have been made at the international level as well. The OECD has raised a red flag about the dangers of international tax competition—the competitive lowering of taxes by countries bidding to attract investment. This was highlighted in a 1999 report, which warned that "governments may increasingly be forced to engage in competitive tax bidding to attract or retain mobile activities. That 'race to the bottom', where location and financing decisions become primarily tax driven, will mean that capital and financial flows will be distorted and it will become more difficult to achieve fair competition for real economic activities."[11]

Another implication is that lowering taxes for mobile activities by corporations leads to a narrowing of the tax base. To maintain or provide public services, taxes would have to be increased on labour, consumption and other non-mobile

activities. This would produce distortions and make tax systems less equitable. The OECD report goes on to suggest numerous recommendations for a common, collaborative approach against "harmful tax practices."

Government Impacts

The argument that a tax cut will stimulate so much economic growth that tax revenues will actually increase is on shaky ground. Recent Canadian experience bears this out, though the facts are often twisted to tell grand stories about the revenue-generating miracles of tax cuts. Some provinces have cut taxes in recent years and have subsequently experienced revenue growth, but tax revenues tend to increase with or without tax cuts—the result of economic growth and population increases.

Ontario and Alberta are typically cited as examples of provinces where tax cuts have led to increased government revenues. However, both cut taxes during a period of strong economic growth from the mid- to late-1990s, with much of this growth driven externally by exports to the US. Surely, the Harris and Klein tax cuts did not stimulate demand in Mississippi and Ohio.

After the Harris tax cuts in Ontario, personal income tax revenue is estimated to fall by almost $700 million from 1996-97 to 1999-00, according the 1999 Ontario Budget. This decline in revenues comes at a time of economic boom in Ontario: if there was ever going to be the effect predicted by tax cut extremists, this was it. Since 1995, Ontario's domestic economy actually shrunk, once the net impact of international trade is accounted for.[12]

In Alberta, tax cuts have led to slower, not faster, revenue growth. After the Klein tax cuts, government revenues increased at a compound annual growth rate of 1.9% from 1994-95 to 1998-99. This is the slowest rate of revenue growth among Canadian provinces. BC's compound growth rate of revenues was 2.4% over the same period. Another important lesson from Alberta is that lower taxes do not make the costs of education, health care and so on go away. Instead, lower taxes now mean more out-of-pocket costs to purchase services that previously were provided publicly.[13]

Looking at federal taxes, economist Dale Orr of WEFA Inc. notes that: "it is unlikely that the government would ever recover anywhere near all of the revenues originally given up . . . . if [personal income] taxes are cut, over the medium term, the federal government will recover more than 20% but under half the initial revenue lost from the tax cut."[14] Even the BC Business Summit, in its arguments for tax cuts, suggests that about one-third of the value of its tax cuts would come back to the government in tax revenues.

Some cases do exist in the US where a tax cut has been associated with increased revenues. However, several studies find that the change in revenues is primarily due to shifting of compensation among high income earners.[15] That is, executives who received significant stock options as part of their compensation packages cashed in their options in the year before the tax increase took effect, or delayed cashing in options until after a tax rate decrease took effect.

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A new twist on the supply side argument comes from commentators like *Vancouver Sun* columnist Michael Campbell. He asserts that government after tax cuts would look much like government before, because of the efficiency gains that would force departments and programs to do more with less. Again, the intent is to make the tax cut proposition more palatable with a simple proposition that is plausible in theory, but unproven in reality.

The difficulty is that there is no layer of fat in any bureaucracy, public or private, that can simply be cut—to the extent that there is "fat", it is "marbled" throughout the organization. Buy-out packages to induce workers to leave often have the opposite result, stripping the organization of its institutional memory, as well as the intellectual talents of younger professionals who have other opportunities available.[16]

It seems quite clear that cutting taxes does not increase revenues. Claims that they do are merely an attempt to hard sell the tax cut message by suggesting that there is no price to pay in terms of reduced services. This "you can have it all" assertion is as disingenuous as the broader message that tax cuts are the cure for all of our economic ails.

Losing Our Minds: A Closer Look at the "Brain Drain"

The brain drain argument is perhaps the most dubious in the tax cutters' arsenal. The argument, largely based on anecdotes, is that high taxes are causing Canada's best and the brightest to flee to the lower tax US. Canada is thus losing its highly educated and skilled citizens, particularly computer programmers, engineers, medical professionals, and academics.

What makes these arguments so alarming is the gaping absence of hard evidence to prove them. Statistics Canada reports that between 1990 and 1996, 21,700 Canadians per year emigrated to the US. Yet between 1955 and 1969, over 40,000 Canadians per year emigrated to the US. Even before accounting for population growth, the outflow to the US is modest compared to historical standards. Interestingly, despite higher rates of unemployment in Canada over the 1990s, the number of Canadians living in the US fell to 2% in 1997, the lowest level of the entire 20th Century.

Based on a survey of 1995 university graduates, Statistics Canada found that about one in five Canadian émigrés returned to Canada. The reasons cited are largely due to the things that taxes pay for—a more equitable distribution of income, universal health care and education, and lower rates of crime and poverty.

When immigration into Canada is taken into account, the numbers suggest that not only is the purported brain drain a trickle, but that Canada actually benefits from a net "brain gain". From 1990 to 1996, 8,500 university-educated people left Canada for the US, but 32,800 university graduates entered Canada as immigrants, four times as many as those that left. This brain gain holds up for most highly skilled job categories. For example, in 1996, 148 computer scientists emigrated to the US, while 113 immigrated to Canada from the US, but 6,467 immigrated to Canada from other parts of the world.[17]

Only in the area of health care professionals—doctors and nurses—has there been a net loss of people. This is attributable not to high tax levels but to spending cuts in health care that have resulted in higher stress levels for workers and job

losses. Cutbacks in government funding have also provided the impetus for emigration in other areas, like scientific research. A commitment by government to support these areas would do a lot to stem any brain drain that may exist.

The Statistics Canada study concludes:

> There is little statistical evidence in support of a large scale exodus of knowledge workers from Canada to the United States. On balance, Canada does lose a small number of skilled workers in key occupations to the United States, but the numbers involved are: small in an historical sense, [and] small relative to the stock of workers in these occupations.[18]

Even the anecdotal evidence marshaled in the media does not hold up to scrutiny. When asked why they moved to the US, the vast majority of emigrants responded that they did so because of employment opportunities or personal relationships, not because of taxes. In certain sectors, higher salaries in the US are also a factor. In spite of taxes, many expats prefer to return to Canada. Based on a survey of 1995 university graduates, Statistics Canada found that about one in five Canadian émigrés returned to Canada. The reasons cited are largely due to the things that taxes pay for—a more equitable distribution of income, universal health care and education, and lower rates of crime and poverty.[19]

A recent report by PriceWaterhouseCoopers surveyed high tech workers about what the most important factors were when considering a job. Top concerns included: whether they were treated with respect; whether management was supportive and effective; whether the company provided health benefits; and, whether they were able to work with the latest technology. Tax levels were way down the list, at number 18, below the opportunity to have challenging work and a relaxed atmosphere, but above performance pay, stock options and free parking.[20]

The survey also found that most wanted a locally-based job—only 6% in BC said that the US would be their first choice of location for a job (compared to 7% in Ontario, 10% in Quebec and 8% in the Atlantic provinces). The ones that were most likely to move were those with little in the way of family commitments or other ties to keep them in Canada.

A recent report by PriceWaterhouseCoopers surveyed high tech workers about what the most important factors were when considering a job. Top concerns included: whether they were treated with respect; whether management was supportive and effective; whether the company provided health benefits; and, whether they were able to work with the latest technology. Tax levels were way down the list, at number 18, below the opportunity to have challenging work and a relaxed atmosphere, but above performance pay, stock options and free parking.[20]

Migration is not a new phenomenon. People can and will move to the US, an economy ten times larger than ours, for a variety of reasons. But as a percentage of the labour force, the number is relatively small. To assume that taxes are the reason for the move is a big leap unsubstantiated by any available evidence. Even if more than a handful of Canadians are moving to the US specifically because of taxes, it would be perverse public policy to reduce taxes for all high income earners in the faint hope of keeping a small number of Canadians in Canada.

Interprovincial Migration

While most of the discussion about migration focuses on Canadians leaving to the United States, there is a substantial amount of migration within

Canadian provinces that receives much less attention. BC is the single largest beneficiary of this interprovincial migration.

The Royal Bank used census data to look at interprovincial migration of highly skilled workers. They found that, in the 1990s, BC was the "uncontested leader" as a destination. New migrants (over 15 years of age) amounted to 4.4% of BC's population between 1991 and 1996.

Perhaps more importantly, BC was the only province to have a net inflow of interprovincial migrants with a university degree. BC also led all other provinces by a wide margin for positive net inflows of both "knowledge workers" and high income individuals, even while taxes were increasing in the early 1990s. This large net inflow of high income and highly skilled individuals reaffirms the fact that taxes are only a small consideration when migration decisions are made, compared to employment opportunities, quality of life or relationships. Compared to other provinces, BC is in an envious position and benefits from a brain gain.

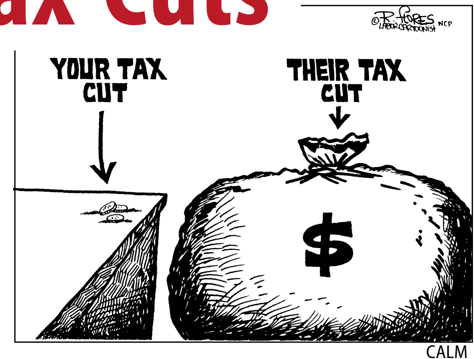
In the past two years, however, BC has seen a net loss of people to other provinces (not counting international in-migration). Statistics Canada reports that in 1998/99, BC lost 21,103 people to other provinces, plus an additional 10,029 in 1997/98. This has provided another occasion for business commentators to blame the exodus on high taxes in BC, particularly compared to Alberta.

A more likely explanation has to do with short-term differences in economic growth. As with international migration, people move for employment opportunities, so this behaviour should be expected at a time of economic downturn. BC's economy has been adversely affected by developments in Asia that deeply reduced demand for BC's staple exports in forestry. Alberta, on the other hand, has benefited from high demand in the booming US economy for its primary exports of oil and gas. Of note, mobile labour of this sort has more to do with gains in "brawn" rather than "brain".

British Columbians should not be overly concerned about recent trends. First, the loss to other provinces is more than compensated for by the net inflow of migrants from other parts of the world. Second, there is every reason to believe that the current slowdown is an historical aberration that will revert to new inflows from other provinces once the economy turns around.

4

Robin Hood in Reverse: The Real Price of Tax Cuts



CALM

CALLS FOR TAX CUTS ARE TYPICALLY made at a broad level: a flurry of general gripes against taxes period, without much in the way of details. A more concrete agenda was proposed in the Fall of 1998, when a report from the BC Business Council's Business Summit spelled out a number of specific tax cut (and other) recommendations. Because the business community has a very influential voice, these recommendations will be taken very seriously by any government contemplating tax cuts, irrespective of the political orientation of the government.

As noted in the previous section, British Columbians should be skeptical about the ability of such recommendations to deliver widespread economic benefits. The Business Summit package, in particular, would concentrate the benefits of lower taxes at the top end of the income ladder, paid for by deep cuts to social programs and privatization of government assets.

This section looks in more detail at the unbalanced nature of this agenda, and how it raises some fundamental questions about the future direction of the BC economy, the role of the public sector, and the consequences of increasing inequality.

The Business Summit Plan

Interestingly, the Business Summit does not invoke the strange supply-side arguments that these tax cuts will increase revenues. They are more realistic about the corresponding spending cuts that would be required to pay for the tax cut.

In a package amounting to $1.5 billion per year in tax cuts, to be phased in over five years, the Business Summit (BS) recommends that BC:

- Eliminate BC's two personal income tax surtaxes by the end of the 2002 fiscal year;
- Reduce BC's personal income tax rate to 46.5% of federal tax by 2002 (these two recommendations combined would reduce the top marginal tax rate to 43%);
- Cut the small business income tax rate to 6.0% by 2002 (this rate has since been lowered to 4.75%);
- Eliminate the provincial sales tax for business expenditures on machinery and equipment;
- Phase out the corporate capital tax over five years;
- Develop a new income tax credit valued at $100 million for low income people;
- Implement a new R&D tax credit incremental to the federal credit;
- Reduce BC's corporate income tax rate to 15.5%; and,
- Instruct BC Hydro to lower its industrial power rates by 15%.

Interestingly, the BS does not invoke the strange supply-side arguments that these tax cuts will increase revenues. They are more realistic about the corresponding spending cuts that would be required to pay for the tax cut. Specifically, the BS recommends:

- A 5% cut in government spending (or $1 billion)
- An aggressive program of privatization of Crown corporations and assets.
- Greater use of outsourcing and external contracting.

In addition, the BS proposal would introduce balanced budget legislation, with the intent of reducing net public debt to 10% of GDP over the next 15 years.

Economic Impacts

A study by the Conference Board of Canada simulated the Business Summit's tax and expenditure recommendations on the provincial economy over the next five years, compared to what is projected by following the status quo. While the tax cuts increase personal disposable income, the Conference Board found that the cuts to government spending have a dampening effect that exceeds the economic stimulus of the tax cuts.

In the first simulation (Table 12a, see facing page), the BS tax and spending cuts are phased in over five years. These measures would lead to a decline in government revenues of 5.8% by fiscal year 2003/04, which exceeds the 5% reduction in government expenditures. As a result, real GDP is reduced by $607 million (or 0.6 percentage points) by fiscal year 2003/04. This in turn reduces employment by 13,000 by 2003/04, and increases the unemployment rate by 0.2 percentage points.

These proposals would also increase the size of the deficit and increase BC's debt-to-GDP ratio by one percentage point by 2003/04. This should be cause for concern among the fiscal conservatives that are advocating tax cuts.

A second, more radical simulation (Table 12b) phases in the BS tax cut proposals while introducing spending cuts more quickly, and holding the debt-to-GDP ratio at the end of the five-year simulation period to the same level as at the outset (and well above the 10% target set out by the BS). This has even more dramatic consequences due to a faster reduction in expenditures. In the first year of cuts alone, real GDP is lower by 0.5 percentage

points, and is 0.8 percentage points lower by the second and third years. In 2001/02, for example, real GDP is $691 million lower than the status quo scenario.

In effect, the BS proposals are a recipe for a recession when BC has only recently recovered from the impacts of the Asian Crisis. While the BC economy is gaining strength, measures that would reduce economic output at this stage are a bad idea.

In this framework, achieving a much lower debt-to-GDP ratio of 10%, as proposed by the BS, along with a huge program of tax cuts, would be devastating for the provincial economy. In effect, the BS proposals are a recipe for a recession when BC has only recently recovered from the impacts of the Asian Crisis. While the BC economy is gaining strength, measures that would reduce economic output at this stage are a bad idea.

Table 12: Conference Board Simulation of Business Summit Tax and Spending Cuts

12A: SIMULATION A					
Economic Indicator	**Difference from Status Quo**				
	1999/00	2000/01	2001/02	2002/03	2003/04
Real GDP [1]	(134)	(250)	(352)	(454)	(607)
percent change	(0.2)	(0.3)	(0.4)	(0.5)	(0.6)
Employment [2]	(3,000)	(6,000)	(8,000)	(10,000)	(13,000)
percent change	(0.2)	(0.3)	(0.4)	(0.5)	(0.6)
Unemployment rate [3]	0.0	0.1	0.1	0.1	0.2
Debt-to-GDP ratio [4]	0.3	0.4	0.6	0.9	1.0
12B: SIMULATION B					
Economic Indicator	**Difference from Status Quo**				
	1999/00	2000/01	2001/02	2002/03	2003/04
Real GDP [1]	(404)	(678)	(691)	(623)	(613)
percent change	(0.5)	(0.8)	(0.8)	(0.7)	(0.6)
Employment [2]	(9,000)	(15,000)	(15,000)	(14,000)	(13,000)
percent change	(0.5)	(0.8)	(0.8)	(0.7)	(0.7)
Unemployment rate [3]	0.1	0.2	0.2	0.2	0.2
Debt-to-GDP ratio [4]	0	0	(0.1)	(0.1)	0

Notes:
1. Figures are in millions of constant 1992 dollars.
2. Figures are in number of persons.
3. Figures are the percentage point increase or decrease.
4. Figures are the percentage point increase or decrease.
Simulations are based on the Conference Board's provincial medium-term economic model over a five-year period. In Simulation A, tax cuts and spending cuts are phased in over the five year period. In Simulation B, spending cuts are introduced more quickly in order to maintain the 2003/04 debt-to-GDP ratio at its 1998/99 level.
Source: Conference Board of Canada, An Analysis of the British Columbia Summit '98 Recommendations.

Whose Tax Cut

Like tax cut experiences in a number of other jurisdictions, the BS package is loaded with gains that accrue mainly to upper income earners. This is in stark contrast to the rhetoric of tax cuts, which promises to put money back in the pockets of the average working person.

BC Ministry of Finance estimates suggest that the proposal to eliminate BC's individual surtaxes would cost $450 million per year in forgone revenues. This tax reduction—which accounts for almost a third of the total tax cut package—would apply exclusively to those earning over $60,000 per year (or about the top 10% of tax filers). Arguably, the BC government has already caved in too much by lowering the second surtax from 26% in 1998 to 19% in 1999, and to 15% in 2000.

Eliminating BC's surtaxes would also reduce the progressivity of the provincial income tax

Like tax cut experiences in a number of other jurisdictions, the BS package is loaded with gains that accrue mainly to upper income earners. This is in stark contrast to the rhetoric of tax cuts, which promises to put money back in the pockets of the average working person.

system, because the surtaxes effectively create two high income tax brackets (as of the 2000 tax year, BC is moving to a tax-on-income system, but the new brackets in this system mirror the old system, which bases provincial income tax as a percentage of federal tax owing).

Lowering the BC personal income tax rate from 49.5% to 46.5% would cost $330 million per year in forgone revenues. While this reduction is proportionate, the bigger the income, the bigger the tax reduction in dollar terms.

If we look at the tax savings that would accrue to taxpayers at different income levels, the distributional aspect of the tax cut proposals becomes clear.[1] As shown by Table 13, at low incomes of $10,000 and $20,000, the provincial income tax bill falls by very small amounts, $7 and $47 per year respectively. In the middle income range, tax savings grow in proportion to income. But even at $60,000 of income, savings amount only to $276, less than a dollar a day. However, those with incomes less than $60,000 are the main beneficiaries of public services like health care and education. Thus, the savings they would receive under the BS plan would hardly compensate for losses in these public services.

At higher income levels, the savings really start to materialize. A taxpayer earning $80,000, high enough to be in the top 4% of taxpayers, would save $827, and at $100,000, the savings would be $1,552. At the lofty height of $150,000, the savings are almost $5,000. In the low stratosphere, approximately $250,000 in annual income, savings are about $11,300—well over the *total income tax bill* of someone making $40,000.

A substantial portion of the savings for high incomes is derived from removing the provincial surtaxes. For the $150,000 earner, over $4,000 of the total $5,000 tax cut is due to elimination of the surtaxes, as is $9,700 of the $11,300 payable in provincial income taxes for the $250,000 earner. The end result is that tax savings as a percentage of income rise in proportion to income. So much for tax savings for the masses.

To be fair, the BS also proposes a $100 million tax credit for low incomes. Without any more specific detail on implementation, it is impossible to assess just how this would affect those at the bottom end. As a proxy, consider that in 1996, just over 707,000 people in BC earned less than $10,000. Applying the $100 million tax credit equally to

Table 13: Business Summit Proposed Tax Cuts

Income Level ($)	1999 Federal Income Tax	1999 Provincial Income Tax (existing)	1999 Provincial Income Tax (BS)	BS Tax Savings	Savings as a Share of Gross Income
$10,000	$222	$110	$103	$7	0.07%
$20,000	$1,573	$779	$731	$47	0.24%
$40,000	$5,126	$2,537	$2,383	$154	0.38%
$60,000	$9,187	$4,548	$4,272	$276	0.46%
$80,000	$13,542	$7,125	$6,297	$827	1.03%
$100,000	$17,523	$9,700	$8,148	$1,552	1.55%
$150,000	$30,143	$19,008	$14,017	$4,992	3.33%
$250,000	$53,267	$36,063	$24,769	$11,294	4.52%

Notes: Federal taxes are calculated after accounting for standard deductions, based on average deductions from the 1996 tax year (last data year).
Provincial taxes are calculated based on federal tax payable at existing rates.
Business Summit estimates include elimiation of provincial surtaxes and reduction of the general rate from 49.5% to 46.5%, but do not include a proposed $100 million low income tax credit.
Sources: Author's calculations; BC Business Summit 98 report; Revenue Canada, Tax Statistics on Individuals, 1996 Tax Year.

each of these low income people would be a bonus of $141 each—not exactly enough to lift them out of poverty, and rather pale in comparison to the tax savings for the well-off.

Perks for Business

The government has already implemented a number of changes designed to make BC an attractive place to invest. This is particularly true from the perspective of small business. These changes include:

- The 1999 Budget announced a cut in the small business income tax rate to 5.5%, lower than the BS recommendation. And the 2000 Budget reduced this further to 4.75%, the lowest in the country.
- New small businesses in BC incorporated between May 1, 1996 and March 31, 2001 receive a two-year tax holiday.
- Small businesses may also qualify for the Small Business Venture Capital Tax Credit, a tax credit valued at 30% of investment. This supports venture capital investments in manufacturing R&D, tourism, aquaculture, film and publishing.
- In 1999, the BC government announced a new 10% R&D tax credit applicable to both large and small companies (the initiative is directed at the high tech sector, which is largely composed of small companies), effective September 1, 1999. The credit is incremental to the federal government's R&D tax credit, thereby building on the most competitive R&D tax credit program in the world. The new BC R&D tax credit has an estimated value of $30 million per year, making it more generous than the BS proposals.
- Finally, the 2000 Budget announced a new 3% tax credit for manufacturing and processing investments.

In contrast to changes made to benefit small business, the BC government has held the line on tax cuts for the biggest companies. The cost of implementing the BS corporate tax cuts would not be trivial:

- Lowering the general corporate income tax rate to 15.5% would cost $50 million per year in forgone revenues;
- Eliminating the corporate capital tax would cost $240 million per year;
- Reducing BC Hydro industrial power rates by 15% would cost $100 million per year;
- Exempting purchases of machinery and equipment from provincial sales taxes would cost $160 million per year.[2]

Summed together, the BS package for big corporations represents a $550 million loss in provincial revenues. While this would undoubtedly make large BC businesses happy, it is hard to see what the economic benefits would be, given that BC corporate taxes are not out of line with other jurisdictions (see previous section). Like citizens, companies in BC benefit from public expenditures, so it is only fair that they too pay taxes to support these services.

Particularly fierce opposition arises from the business community over the capital tax, because it is not profit-sensitive. However, it is important to note that the corporate capital tax is a relatively modest tax that represents a tiny share of total business costs. And corporations with net paid-up capital less than $2.5 million are exempt from the tax (this includes 80-90% of corporations in BC). In 2001, this threshold will rise to $5 million in net paid-up capital. In addition, financial institutions with over $1 billion in net paid-up capital are taxed at a rate of 3%, and those with less than $1 billion at 1%.

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tax facts

A FLAT TAX FOR FAT CATS

The latest mantra of the tax cut crusaders is "flat tax." While "flat" usually has a negative connotation—like flat tires or flat beer—somehow in the context of taxes the term appeals to conservatives. What could be more fair than taxing everyone's income at the same rate? It turns out there is lot more to this seemingly simple proposition than meets the eye.

While the idea has not generated much interest in the US (witness Steve Forbes's poor presidential showing), Canada's conservatives have embraced it. The 1999 Alberta budget announced that the province will move next year to a tax on income of 11% all the way up. Now the flat tax is being touted for the federal level by the Canadian Alliance (the party formerly known as CCRAP).

The flat tax represents a huge windfall for upper-income earners, since it removes progressivity from the income tax system (that is, the notion that tax rates should increase along with one's ability to pay). At the other end, however, tax rates will actually increase for low and middle income people—the latter due to the fact that the new system will not pass on the recent federal income tax cuts, something that was not planned for when the flat tax proposal came out last year.

Yet, even in Alberta, the home of Canada's cowboy capitalism, polling reveals that there is little appetite for tax cuts for the well-off. To deflect attention, the government came up with a shrewd political manoeuvre: in addition to the flat tax, the basic threshold at which low income people begin to pay tax will also be raised. This will lift 78,000 low income people off the tax rolls, claims the government.

While raising the tax threshold is admirable, it acts as camouflage for the real objective: lowering taxes for upper income earners. When this policy move is questioned by those that oppose lower taxes for the wealthy, the tax cutters simply respond: but what about the 78,000? In a nutshell, 78,000 people are being used as a battering ram to push through tax cuts for those that least need them.

The flat tax of 17% being proposed by the new federal party would be of little benefit to the majority of Canadians, most of whom already pay only 17% (a majority of Canadian taxpayers make less than $30,000, the income at which the current second tax bracket kicks in). Moreover, in order to finance what amounts to a huge tax cut for Canada's wealthiest income earners, the flat tax would put many of the public programs Canadians cherish at serious risk.

Progressive taxation recognizes that the market, left to its own devices, does a poor job of distributing incomes. Given the fact that the market is producing more and more inequality, we need a progressive tax system to mitigate the growing gap between society's haves and have-nots more than ever before.

While dreams of flat taxes have conservatives frolicking with joy, something has been missed in the discussion so far. Though it may sound surprising, research suggests that Canada's tax system is already quite flat. A detailed study by Vermaeten, Gillespie and Vermaeten (1994) comprehensively examined taxes paid at different income levels in Canada after accounting for all forms of income received, including non-taxed items like gifts and bequests, and employer-provided fringe benefits. They found that when looking at effective tax rates, the overall Canadian tax system is only slightly progressive up to middle-income ranges, then basically flat the rest of the way up the income ladder. Federal taxes (primarily income taxes) are the only source of progressivity, barely offsetting provincial taxes that are about proportional to income and local taxes that are actually regressive.

Policy changes that move toward flat income taxes would actually make the overall tax system regressive in nature—this, to conservatives, constitutes a level playing field.

The Other Side of Tax Cuts

The BS report recommends that tax cuts be paid for by cuts to spending, matched with greater privatization and contracting out. To their credit, at least the BS is honest that spending cuts would be required—too many commentators are limited to preaching the tax cut gospel without specifying where they would cut spending, and some claim that there need not be any revenue impact whatsoever (see previous section).

The big question is where spending cuts would come from. In the BC Budget, 80% of expenditures go towards health care, education and social assistance, with a variety of other public services, from law enforcement to environmental protection, vying for the remaining 20%. Thus, a 5% overall cut in spending would not come without significant pain. Choices would have to be made that would leave most British Columbians questioning whether their share of the tax cut pie was really worth the corresponding losses in public services.

The threat of privatization to BC is even more daunting. BC is in the privileged position of publicly owning 90% of its timberlands, and of having an array of effective Crown corporations in areas like insurance and hydro. Putting these assets on the auction block to pay for tax cuts for high income earners is dangerously short-sighted and irresponsible. Experience in other jurisdictions suggests that even on their own terms, these initiatives have failed to deliver on their promises.

Privatization and spending cuts would dramatically change the mix of public and private services in the economy, and hence the kind of society we live in. (For a more detailed look at the potential impacts of a privatization and "small government" agenda on BC, see "Are Spending Cuts and Privatization the Answer for BC?", a companion piece to this paper, by Donna Vogel of the CCPA.)

Towards a More Unequal Society?

Canadians may look south of the border with envy due to stories of lower US taxes and faster economic growth. Not many Canadians, however, want to emulate the unenviable social conditions in the US: high levels of poverty and crime, a more unequal distribution of wealth and income, serious problems with homelessness, and functional illiteracy. These elements are all ultimately linked to taxes: it is through the tax system that we address the inequalities produced by the market by redistributing income and by providing public services.

An essential question for British Columbians to ask about proposed tax cuts is: will they increase inequality? While there are some tax cuts, such as those targeted at low and modest income people, that might decrease inequality, tax cuts at the high end are a different story. In a survey of OECD countries, Andrew Jackson found a very strong empirical relationship between the level of taxes and income inequality because higher taxes tend to be associated with tax and transfer systems that mitigate market income inequality.[3]

There are good reasons why we should avoid moves that exacerbate inequality in Canada. The gap between rich and poor has already been growing over the past two decades. Moral objections aside, there are a number of reasons why increasing inequality can actually have serious negative consequences for the economy:

- Higher rates of poverty, with associated costs in terms of addiction, social break-

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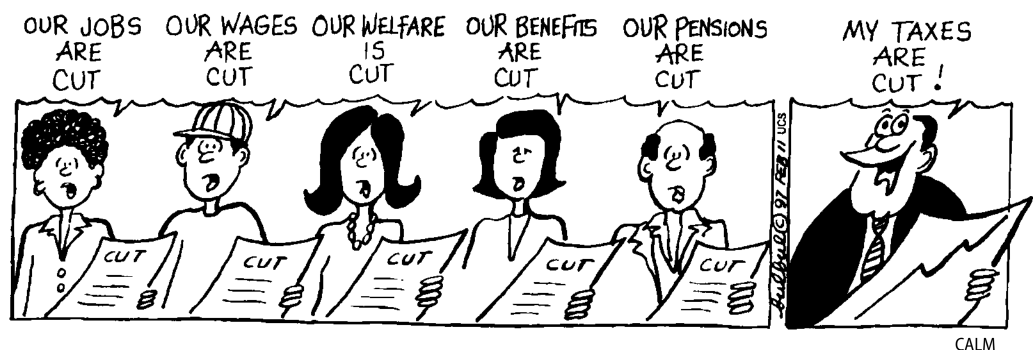
down, etc.

- Higher crime rates, resulting in a diversion of societal resources towards policing, criminal courts, and defensive expenditures (such as security guards and alarm systems), and away from more productive uses;
- Less investment in human capital because low income individuals will often be unable to borrow to finance their training and education, particularly if privatized;
- A reduction in the general health, and therefore productivity, of lower income families—a sick worker is not a productive worker;
- Political instability and unrest, which discourages investment, and leads to more coercive use of the police and more repressive laws;
- An unwillingness of workers to risk their economic security by engaging in innovative and entrepreneurial behaviour
- Low levels of trust and weakened norms of civic cooperation—the decline of social capital that underpins a market economy.[4]

For reasons like these, a growing literature finds that higher degrees of income inequality are associated with lower economic growth. This is contrary to the conventional wisdom that prevailed in the 1970s and 1980s of a trade-off between economic efficiency and equity objectives. Dalhousie economist Lars Osberg notes that: "a major theme of the recent literature on endogenous growth is that this trade-off does not exist. Many articles, both theoretical and empirical, lead to the conclusion that countries characterized by greater equality grow *faster*, other things equal." [emphasis in original][5]

Tax cuts do not come without a price. Ultimately, these decisions are a matter of democratic debate and choice. But British Columbians would do well to keep in mind the factors that maintain a strong social fabric (and how they have already deteriorated) when entering these debates. The lure of tax cuts may be strong, but their costs may be much steeper than most realize.

5 Alternatives and Conclusions



CALM

TRUTH BE TOLD, A REALLY MEANINGFUL tax cut for the middle class—on the order of several thousand dollars—would cripple public services in BC. For the very well-off, the absence of public health care and education, among other public services, is of little consequence. The rich can afford, and may indeed prefer, private alternatives. For the middle class, this is not the case. Despite more money in their pockets, they may quickly find that an even greater sum is required to pay for more expensive private alternatives.

Intuitively, many Canadians know this. Many people would like to have lower taxes and public debt, but many also agree that they want more money to support public education, to improve health care, and to address poverty, among other things. Indeed, public policy is about reconciling these conflicting choices. When the connection is made between taxes and services, most Canadians feel they are getting good value for their money.

Interestingly, in spite of tremendous media column inches in support of tax cuts, Canadians

Taxes do not actually reduce real incomes because of the economic and social value provided by the services they pay for. Taxes are a price, not a burden. Frequently, many services provided by government would not be provided by the market at all, or would be provided by the market at much greater cost than when provided publicly.

retain a surprising amount of resilience to the tax cut siren song. When asked, Canadians repeatedly want more spending on social programs, not tax cuts. In a June 1999 Ekos poll, Canadians were asked where the government should place the most emphasis in planning for the next budget. Most, about 55%, favoured investment in social programs. The second choice, 24% of respondents, was to reduce federal debt. Only 19% wanted "some" personal income tax cuts, with support limited to tax cuts for low and middle income earners. Still, tax cuts won the day in the 2000 federal budget.

Taxes do not actually reduce real incomes because of the economic and social value provided by the services they pay for. Taxes are a price, not a burden. Frequently, many services provided by government would not be provided by the market at all, or would be provided by the market at much greater cost than when provided publicly.

Health care is a perfect example of how a market-driven system costs a great deal more. Both Canada and the US spend about the same on public health care as a share of GDP—in fact the US spends slightly more at 6.3% of GDP compared to 6.2% in Canada. But public health care in the US only covers a small portion of the population—the very poor, the elderly and veterans—while Canada has a universal system. Some 43 million Americans, a full 15% of the population, go without any health coverage at all.

In the absence of universal public care in the US, private health care plays a much larger role. The US spends 7.2% of its GDP on private health care, compared to 2.7% in Canada (in Canada, the private component is for things not covered by public plans, such as prescription drugs and eye care). Combining public and private spending, the US spends 13.5% of its GDP on health care, compared to 8.8% in Canada.[1]

For all of this extra spending, the US system is neither more effective or more efficient. Health outcomes on all major indicators are better in Canada than the US. And as a recent Newsweek cover story (called "HMO Hell") points out, many Americans that belong to a Health Maintenance Organization (HMO) are far from satisfied with the quality of their service. In 1999, the prestigious New England Journal of Medicine sharply criticized the US health care system, calling it "the most expensive and most inadequate in the developed world."[2]

This is not to say that governments are perfect or that bureaucracies function with supernatural efficiency. Governments can make mistakes and departments can be bureaucratic. But at least public institutions offer a degree of accountability to the public. The solution is not to abandon public services in the hope that the market will make things better. Instead, what is needed are innovative ways of delivering services and administering processes. There are many examples of Crown corporations that do a very good job, such as the Insurance Corporation of BC and BC Hydro. These corporations are highly efficient in sectors of the economy where a publicly controlled and regulated monopoly makes sense.

If the public sector is not entirely perfect, neither is the private sector. The market, left to its "invisible hand", inevitably leads to underprovision of public goods, greater income inequality, pollution and depletion of natural resources, and tendencies toward monopolization, just to name a few of the perverse outcomes that are well recognized by economists and others.

Private companies can be just as bureaucratic as the public sector (have you had to deal with your cable company lately?). The cubicle culture parodied by the cartoon Dilbert is so popular precisely because it only slightly exaggerates the world inside a corporation. Slick message tracks about the ruthless efficiency of the private sector are more myth than reality.

Looking for Alternatives

While tax cuts, as promoted by the business community, are a bad idea, this does not mean there is no scope for reform of the tax system. Calls for reforming the system go back to the Carter Commission report in 1967. Kenneth Carter, a conservative accountant from Bay Street, was hand-picked by the Diefenbaker government, at the request of the business community, to lead a Royal Commission on improving the tax system. Carter shocked his colleagues when, after a thorough review of tax data, he recommended dramatic changes that would enhance the fairness of the tax system—to the detriment of the vested interests of the well-off.[3]

Among Carter's recommendations was the principle that a dollar earned should be fully taxed no matter what the source of that income. This was a blow to wealthy families that paid no taxes on capital gains, the major source of their income.

Fierce opposition arose to the Carter proposals from a well-organized business community. Changes were made in 1971 to enhance the fairness of the tax system, but were greatly watered down. A decade later, the MacEachen budget of 1981 attempted to make progressive changes in the tax system, only to be abandoned when business threatened and engaged in a capital strike (cranes were literally pulled off of work sites).

The spirit of the Carter Commission's recommendations, however, is still with us today. It is reflected in works like the Ontario government's Fair Tax Commission in the early 1990s and the CCPA's Alternative Federal Budget (AFB). A number of alternatives have been suggested by the AFB to enhance the fairness and progressivity of the tax system.

An agenda for reform would:

- Improve the progressivity of the tax system by returning "ability to pay" as the core principle. New tax brackets at $100,000 and $150,000 could emulate the US system, which has two additional brackets for upper income earners. At the same time, this should be offset by lower taxes for low and middle income earners. More progressivity also means moving away from regressive sales taxes, like the GST.
- Expand the tax base by counting income that is currently untaxed or that is currently treated preferentially. This includes: fringe benefits such as additional medical insurance premiums paid for by the employer; the deductibility of entertainment and travel expenses for those with business income; and, the deductibility of interest expenses to earn investment income.
- Tax capital gains at 100% of their value and eliminate the dividend tax credit. The reason cited for this preferential tax treatment is to improve incentives for investment. However, most of the money that goes into stock markets is not investment in any real sense, but speculation. A dollar earned should be treated the same regardless of how it was earned.
- Implement wealth, wealth transfer and/or inheritance taxes in accordance with those in other industrialized countries, or at a minimum, at US levels. Canada is one of only three industrialized countries that does not have these taxes.
- On the corporate side, bring in a minimum corporate income tax, so corporations cannot stack their deductions and eliminate their taxable income. Also, put a cap on the deductibility of corporate

executive salaries at ten times the average worker wage.
- Enhance "green taxes". For example, the AFB would create an Atmospheric Fund of $1 billion supported by revenue from a carbon tax and by canceling existing tax preferences for the oil and gas industry. Governments should also consider a "fee-bate" model, where additional levies are charged (or rebates provided) on vehicles, based on energy efficiency ratings. This would increase the cost of the gas-guzzling sport utility vehicles that now make up half of all new car sales. The proceeds of levies on fuel/energy inefficient vehicles could then be used to provide a rebate on vehicles that have high fuel efficiency. Finally, tax incentives could also be used to encourage the building and retrofit of residential and small business buildings to increase energy efficiency.

While not comprehensive, these ideas suggest many avenues for progressive change in the tax system. The AFB outlines some of these initiatives at the federal level in much greater detail than presented here.

Concluding Remarks

The great debate on taxes is unlikely to subside in the near future, if only because the main proponents of tax cuts are so closely linked to the mainstream media. To some extent, these voices have already been successful. Tax cuts have been announced in recent federal budgets and in a number of provinces as well, including BC. The debate has shifted from whether there should be tax cuts at all to how big the cuts should be.

Ironically, when the choices available to governments at all levels are greater than they have been in a long time, the chorus of the tax cutters has been louder than the opposition's, even though their choir is much smaller. The impact has been to restrict the range of legitimate debate over how surpluses should be spent. Spending options are increasingly driven off the table.

In BC, the tax debate will continue to rage. A provincial election in 2000 or 2001 is sure to feature tax cuts as a core issue. As in the 1999 elections in Saskatchewan and Manitoba, the political debate has become uncomfortably narrow, with one side arguing for massive tax cuts, and the other arguing for modest tax cuts with greater protection for social programs. In this kind of debate, when the real issues of how to build a better society are not part of the platform, British Columbians will be the ones to lose.

The sad part is that the debate on taxes is largely a false one. Most British Columbians that vote for tax cuts are unlikely to receive more than a token reduction, while high income earners will capture almost all the benefits. At the level of the overall economy, tax cuts are also destined to fail, if only because the promises made in their favour cannot be met. Tax cuts are not the path to prosperity, but a loop back to the days before Canadians won the long fight for quality social programs.

Appendix: Additional Tax Data for BC

Table 14: Provincial Tax Comparisons for Various Income Groups, 2000

	BC	Alb	Sask	Man	Ont	Que	NB	NS	PEI	Newf
Two Income Family of Four: $90,000 total income										
Provincial Income Tax [1]	$6,234	$6,000	$8,308	$8,027	$4,888	$10,327	$7,617	$7,300	$7,427	$8,136
Property Tax [2]	$1,168	$1,352	$2,347	$2,331	$2,801	$2,078	$1,205	$1,564	5/30/00	$1,110
Sales Tax [3]	$984	$6	$832	$1,136	$1,461	$1,577	$1,652	$1,665	$1,541	$1,631
Fuel Tax [4]	$165	$135	$225	$173	$221	$288	$161	$203	$195	$248
Health Care Premiums/Payroll Tax [5]	$864	$816	$0	$1,935	$1,755	$3,375	$0	$0	$0	$1,350
Total Provincial Tax	**$9,415**	**$8,309**	**$11,712**	**$13,602**	**$11,126**	**$17,645**	**$10,635**	**$10,732**	**$44,377**	**$12,475**
Federal Income Tax [6]	$12,695	$12,695	$12,695	$12,695	$12,695	$12,695	$12,695	$12,695	$12,695	$12,695
Net Federal GST [7]	$1,476	$1,584	$1,445	$1,443	$1,543	$1,347	$1,446	$1,457	$1,410	$1,427
Total Tax [8]	**$23,586**	**$22,588**	**$25,852**	**$27,740**	**$25,364**	**$31,687**	**$24,776**	**$24,884**	**$58,482**	**$26,597**
% of Income	**26.2%**	**25.1%**	**28.7%**	**30.8%**	**28.2%**	**35.2%**	**27.5%**	**27.6%**	**65.0%**	**29.6%**
Rank	**9**	**10**	**4**	**2**	**5**	**1**	**7**	**6**	**7**	**3**
Two Income Family of Four: $55,000 total income										
Provincial Income Tax	$2,901	$2,983	$4,007	$3,506	$2,296	$4,280	$3,578	$3,428	$3,488	$3,835
Property Tax	$1,168	$1,352	$2,347	$2,331	$2,801	$2,078	$1,205	$1,564	$1,486	$1,110
Sales Tax	$731	$5	$632	$872	$1,083	$1,243	$1,252	$1,258	$1,166	$1,241
Fuel Tax	$165	$135	$225	$173	$221	$288	$161	$203	$195	$248
Health Care Premiums/Payroll Tax	$864	$816	$0	$1,183	$1,073	$2,063	$0	$0	$0	$825
Total Provincial Tax	**$5,829**	**$5,291**	**$7,211**	**$8,065**	**$7,474**	**$9,952**	**$6,196**	**$6,453**	**$6,335**	**$7,259**
Federal Income Tax	$5,963	$5,963	$5,963	$5,963	$5,963	$5,963	$5,963	$5,963	$5,963	$5,963
Net Federal GST	$1,097	$1,172	$1,098	$1,108	$1,143	$1,063	$1,095	$1,101	$1,067	$1,086
Total Tax	**$12,889**	**$12,426**	**$14,272**	**$15,136**	**$14,580**	**$16,978**	**$13,254**	**$13,517**	**$13,365**	**$14,308**
% of Income	**23.4%**	**22.6%**	**25.9%**	**27.5%**	**26.5%**	**30.9%**	**24.1%**	**24.6%**	**24.3%**	**26.0%**
Rank	**9**	**10**	**5**	**2**	**3**	**1**	**8**	**6**	**7**	**4**
Two Income Family of Four: $30,000 total income										
Provincial Income Tax	$268	$61	$1,154	$687	$91	($964)	$1,262	$1,259	$1,281	$1,383
Property Tax	$1,168	$1,352	$2,347	$2,331	$2,801	$2,078	$1,205	$1,564	$1,486	$1,110
Sales Tax	$486	$3	$457	$615	$756	$936	$883	$888	$823	$997
Fuel Tax	$165	$135	$225	$173	$221	$288	$161	$203	$195	$248
Health Care Premiums/Payroll Tax	$691	$816	$0	$645	$585	$1,125	$0	$0	$0	$450
Total Provincial Tax	**$2,778**	**$2,367**	**$4,183**	**$4,451**	**$4,454**	**$3,463**	**$3,511**	**$3,914**	**$3,785**	**$4,188**
Federal Income Tax	$2,190	$2,190	$2,190	$2,190	$2,190	$2,190	$2,190	$2,190	$2,190	$2,190
Net Federal GST	$275	$431	$436	$420	$440	$442	$411	$416	$390	$391
Total Tax	**$5,243**	**$4,988**	**$6,809**	**$7,061**	**$7,084**	**$6,095**	**$6,112**	**$6,520**	**$6,365**	**$6,769**
% of Income	**17.5%**	**16.6%**	**22.7%**	**23.5%**	**23.6%**	**20.3%**	**20.4%**	**21.7%**	**21.2%**	**22.6%**
Rank	**9**	**10**	**3**	**2**	**1**	**8**	**7**	**5**	**6**	**4**

continued on next page

Table 14 Continued **(Provincial Tax Comparisons for Various Income Groups, 2000)**

	BC	Alb	Sask	Man	Ont	Que	NB	NS	PEI	Newf
Unattached Individual: $25,000 income										
Provincial Income Tax	$1,235	$1,239	$1,715	$1,381	$837	$2,051	$1,528	$1,464	$1,490	$1,659
Sales Tax	$390	$3	$340	$495	$606	$660	$674	$677	$694	$668
Fuel Tax	$110	$90	$150	$115	$147	$192	$107	$135	$130	$165
Health Care Premiums/Payroll Tax	$432	$408	$0	$538	$488	$938	$0	$0	$0	$375
Total Provincial Tax	**$2,167**	**$1,740**	**$2,205**	**$2,529**	**$2,078**	**$3,841**	**$2,309**	**$2,276**	**$2,314**	**$2,867**
Federal Income Tax	$2,547	$2,547	$2,547	$2,547	$2,547	$2,547	$2,547	$2,547	$2,547	$2,547
Net Federal GST	$285	$325	$289	$299	$316	$264	$287	$290	$268	$281
Total Tax	**$4,999**	**$4,612**	**$5,041**	**$5,375**	**$4,941**	**$6,652**	**$5,143**	**$5,113**	**$5,129**	**$5,695**
% of Income	**20.0%**	**18.4%**	**20.2%**	**21.5%**	**19.8%**	**26.6%**	**20.6%**	**20.5%**	**20.5%**	**22.8%**
Rank	**8**	**10**	**7**	**3**	**9**	**1**	**4**	**5**	**5**	**2**
Unattached Individual: $80,000 income										
Provincial Income Tax	$8,010	$6,950	$10,067	$9,378	$6,610	$12,330	$8,975	$8,601	$9,105	$10,038
Property Tax	$1,168	$1,352	$2,347	$2,331	$2,801	$2,078	$1,205	$1,564	$1,486	$1,110
Sales Tax	$884	$7	$733	$1,065	$1,366	$1,350	$1,485	$1,503	$1,519	$1,434
Fuel Tax	$165	$135	$225	$173	$221	$288	$161	$203	$195	$248
Health Care Premiums/Payroll Tax	$432	$408	$0	$1,720	$1,560	$3,000	$0	$0	$0	$1,200
Total Provincial Tax	**$10,659**	**$8,852**	**$13,372**	**$14,667**	**$12,558**	**$19,046**	**$11,826**	**$11,871**	**$12,305**	**$14,030**
Federal Income Tax	$15,305	$15,305	$15,305	$15,305	$15,305	$15,305	$15,305	$15,305	$15,305	$15,305
Net Federal GST	$1,331	$1,469	$1,275	$1,294	$1,395	$1,159	$1,299	$1,315	$1,249	$1,255
Total Tax	**$27,295**	**$25,626**	**$29,952**	**$31,266**	**$29,258**	**$35,510**	**$28,430**	**$28,491**	**$28,859**	**$30,590**
% of Income	**34.1%**	**32.0%**	**37.4%**	**39.1%**	**36.6%**	**44.4%**	**35.5%**	**35.6%**	**36.1%**	**38.2%**
Rank	**9**	**10**	**4**	**2**	**5**	**1**	**8**	**7**	**6**	**3**
Senior Couple: $30,000 pension income										
Provincial Income Tax	$495	$92	$828	($58)	($427)	$457	$661	$633	$644	$688
Property Tax	$893	$1,352	$2,347	$2,331	$2,801	$2,078	$1,205	$1,564	$1,486	$1,110
Sales Tax	$608	$7	$510	$718	$865	$1,128	$1,141	$1,127	$1,004	$1,144
Fuel Tax	$110	$90	$150	$115	$147	$192	$107	$135	$130	$165
Health Care Premiums/Payroll Tax	$768	$816	$0	$0	$0	$0	$0	$0	$0	$0
Total Provincial Tax	**$2,874**	**$2,357**	**$3,835**	**$3,106**	**$3,386**	**$3,855**	**$3,114**	**$3,459**	**$3,264**	**$3,107**
Federal Income Tax	$1,101	$1,101	$1,101	$1,101	$1,101	$1,101	$1,101	$1,101	$1,101	$1,101
Net Federal GST	$803	$864	$775	$800	$787	$781	$806	$794	$767	$809
Total Tax	**$4,778**	**$4,322**	**$5,711**	**$5,007**	**$5,274**	**$5,737**	**$5,021**	**$5,354**	**$5,132**	**$5,017**
% of Income	**6.0%**	**5.4%**	**7.1%**	**6.3%**	**6.6%**	**7.2%**	**6.3%**	**6.7%**	**6.4%**	**6.3%**
Rank	**9**	**10**	**2**	**6**	**4**	**1**	**6**	**3**	**5**	**6**

Notes:
Rankings are from highest taxes to lowest.
1. "Provincial Income Tax" represents provincial income tax less basic provincial credits and typical major deductions at each income level. Where applicable, it is also net of child benefits. The two-income family of four with $55,000 income assumes one spouse earning $35,000 and the other $20,000. The two-income family earning $90,000 assumes one spouse earning $50,000 and the other $40,000. The family and the senior couple earning $30,000 are both assumed to have two incomes of $15,000 each.
2. Property taxes are net amounts for each province. Property taxes are based on comprehensive reviews of property taxes conducted by the Canada Mortgage and Housing Corporation (CMHC). They are based on property taxes for a "starter home" in major Canadian cities. The individual earning $25,000 is assumed to rent.
3. Sales taxes include taxes on meals, liquor and accommodation, and are based on expenditure patterns from the 1996 *Survey of Family Expenditures* and calculations of disposable income.
4. Fuel tax is based on annual consumption: 1,000 litres of unleaded fuel for the single individual at $25,000, the family at $30,000 and the senior couple; others are assumed to consume 1,500 litres.
5. Health care premiums are levied in BC and Alberta only. Provincial payroll taxes exist in four provinces (Manitoba, Ontario, Quebec and Newfoundland).
6. "Federal Income Tax" represents federal income tax less basic credits. Federal payroll taxes, such as UIC and CPP are not included in this table.
7. "Net Federal GST" represents GST expenditures estimates for each income group based on the *Survey of Family Expenditures,* net applicable GST tax credits.
8. "Total Tax" represents the sum of "Total Provincial Tax" plus "Federal Income Tax" and "Net Federal GST".
Source: 2000 BC Budget

Table 15: Provincial Tax Rates, 1999 (as of March 17, 1999)

	BC	Alb	Sask	Man	Ont	Que	NB	NS	PEI	Newf
Health Care Premiums										
Individual/family ($ per month)[1]	36/72	34/68	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Payroll Tax (percent)[2]	n/a	n/a	n/a	2.15%	1.95%	4.26%	n/a	n/a	n/a	2
Insurance Premium Tax[3]	2-4%	2-3%	2-3%	2-3%	2-3.5%	2-3%	2-3%	3-4%	3.50%	4%
Fuel Tax (cents per litre)[4]										
Gasoline	11.0	9.0	15.0	11.5	14.7	19.2	10.7	13.5	13.0	16.5
Diesel	11.5	9.0	15.0	10.9	14.3	20.2	13.7	15.4	13.5	16.5
Sales Tax										
General	7.0	nil	6.0	7.0	8.0	7.5	8.0	8.0	10.0	8.0
Liquor	10.0	nil	7.0	7.0	12.0	7.5	8.0	8.0	37.5	8.0
Meals	nil	nil	nil	7.0	8.0	7.5	8.0	8.0	10.0	8.0
Accommodation	8.0	5.0	6.0	7.0	5.0	7.5	8.0	8.0	10.0	8.0
Tobacco Tax ($ per carton of 200 cigarettes)[5]	22.0	14.0	20.0	18.82	7.35	8.6	10.8	11.49	13.2	25.96

Notes:
1. BC has a two-person rate of $64. BC and Alberta both offer lower premiums to low income individuals and families.
2. These provinces provide payroll tax relief to small businesses.
3. The lower rate applies to premiums for life, sickness and accident insurance; the higher rate for property. The rate on automobile insurance is 4% in BC and Saskatchewan and 3% in Ontario.
4. Rates do not include regional taxes. The Quebec rate includes estimated sales tax.
5. Includes estimated provincial sales tax where applicable.

Source: BC Budget 2000

Endnotes

Section I

1. Lee, 2000
2. Sauve, 2000
3. The "partial" aspect of de-indexation is that brackets do adjust if inflation is greater than 3% per year, but only by the excess above 3%. So if inflation is 5%, the brackets move up by only 2%. Because inflation has been quite low through the 1990s, the brackets have effectively remained steady.
4. Battle, 1998

Section II

1. For more on the myth of the Alberta advantage, see Klein and Walshe, 1999
2. TD Economics, 1999
3. Tax Foundation, 1999. These numbers are only illustrative. They should not be used for comparisons with Canadian provinces due to differences in methodology.
4. Iqbal, 1999
5. J. Lee, 1999
6. See Citizens for Tax Justice, 1996
7. Wolfson and Murphy, 1998
8. All numbers have been converted to Canadian dollars using the OECD purchasing power parity of 83 US cents to the Canadian dollar. Purchasing power parities reflect the value of the exchange rate that would equalize the cost in both countries of purchasing the same goods and services, and so accounts for the higher cost of living in the US.
9. Cited in Beauchesne, 1999
10. OECD Economic Outlook, 1999b

11. KPMG, 1999
12. Cited in British Columbia Investment Climate—Business Taxes, by BC Trade and Investment Office, 1998

Section III

1. Slemrod and Bakija, 1996, pp. 94-102
2. Jackson, 2000
3. Cited in Vancouver Sun, August 11, 1999
4. Bernstien et al, 1999
5. Brooks, 1999
6. Slemrod and Bakija, 1996, p. 106
7. See Osberg, 1995 and Gerson, 1998
8. Centre for the Study of Living Standards, 1998, p. 42
9. Gerson, 1998
10. Bradbury, Kodrzycki and Tannenwald, 1997
11. OECD, 1999a
12. Robinson, 1999
13. Klein and Walshe, 1999
14. Orr, 1999
15. F — see Slemrod, 1995 and Goolsbee, 1997
16. As a federal bureaucrat during the execution of the federal cuts stemming from the 1995 Martin Budget, I had an insider look at how these processes work. The people that might be deemed the "fat" tend to be the first ones to make moves that entrench their position, while talented people are more inclined to leave. The net result is an overall "dumb-sizing" of the organization, while generally maintaining the same bureaucratic structure. Meanwhile, several months later, the faces of those that took the buy-out mysteriously reappear in the hallways, searching for or doing contract work similar to what they did before leaving.
17. Statistics Canada, 1998
18. Ibid
19. Frank and Belair, Statistics Canada, 1999
20. cited in Drohan, 2000

Section IV

1. Values will differ depending on household characteristics (single individuals, married couples, families with different numbers of children). The dataset used to make the calculations is based on all taxfilers, and so presents averages based on total tax returns. The $100 million low income tax credit proposal is not included because how this would be implemented is not clear.
2. Estimates are from the BC Ministry of Finance and Corporate Relations
3. Jackson, 2000
4. See Brooks, 1998
5. Osberg, 1995

Section V

1. TD Economics, 1999
2. Cited in Emery, 1999
3. For an excellent overview of the Carter Commission, see McQuaig, 1987

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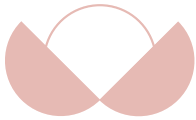

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