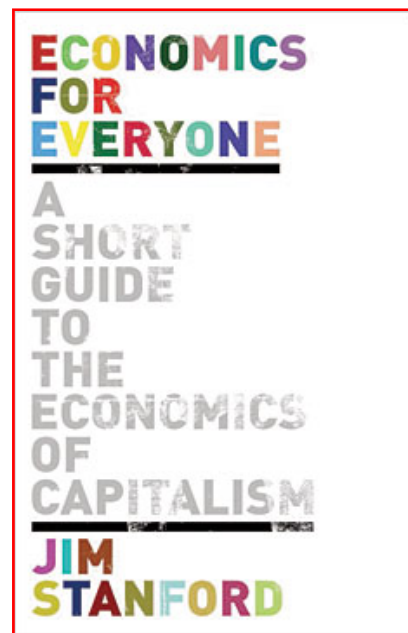




The Economic Costs (and Benefits!) of Taxes

**Presentation by Jim Stanford, CAW Economist
To Nova Scotians for Tax Fairness, May 2013**

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"Tax and Spend"???

...or "Spend and Tax"?

- Conservative epithet:
 - "Politicians tax and spend."
 - Inventing new ways to collect and waste \$\$\$.
- Reality: governments "spend and tax":
 - They are mandated (by public pressure) to perform certain activities.
 - Even in its "purest" form, capitalism has always required a strong, active state.
 - To pay its bills, government then designs revenue tools to meet those needs.
- Takeaway: Can't consider impacts of taxes, without considering the programs they fund.

Government: Contested Terrain

- Natural tendency of government under capitalism:
 - Do the bidding of those with money.
- Initially this was obvious.
 - Democracy did not exist.
- Over time, a skewed democracy evolved.
 - Uneven influence over elections.
 - Constant unelected power in the economy.
- We can fight for and win things from government, but it's always a struggle.

What do Governments Do?

- Protect & enforce rules & rights.
 - Some peoples' rights more than others!
- Regulate overall economic activity.
- Provide direct public services.
- Purchase goods and services from private firms (procurement).
- Supplement incomes of households (income security, transfer payments).

Expenses: Adding it Up

- Debt Service (9%)
- Program Spending (91%)
 - Transfer payments:
 - Individuals (19%)
 - Other (8%)
 - Direct production:
 - Consumption (54%)
 - Wages & salaries (31%)
 - Procurement (23%)
 - Investment (10%)

Revenues: A Broad Portfolio

- Taxes (81%):
 - Income taxes (30%)
 - Progressive: rate rises with income
 - Sales / Value-added taxes (18%)
 - Supposedly "encourages saving"
 - Corporate taxes (8%)
 - Income taxes - Capital taxes
 - Payroll taxes (14%)
 - Wealth taxes (9%)
 - Environmental taxes
- Non-tax Revenue (19%):
 - Investment and business income
 - User fees

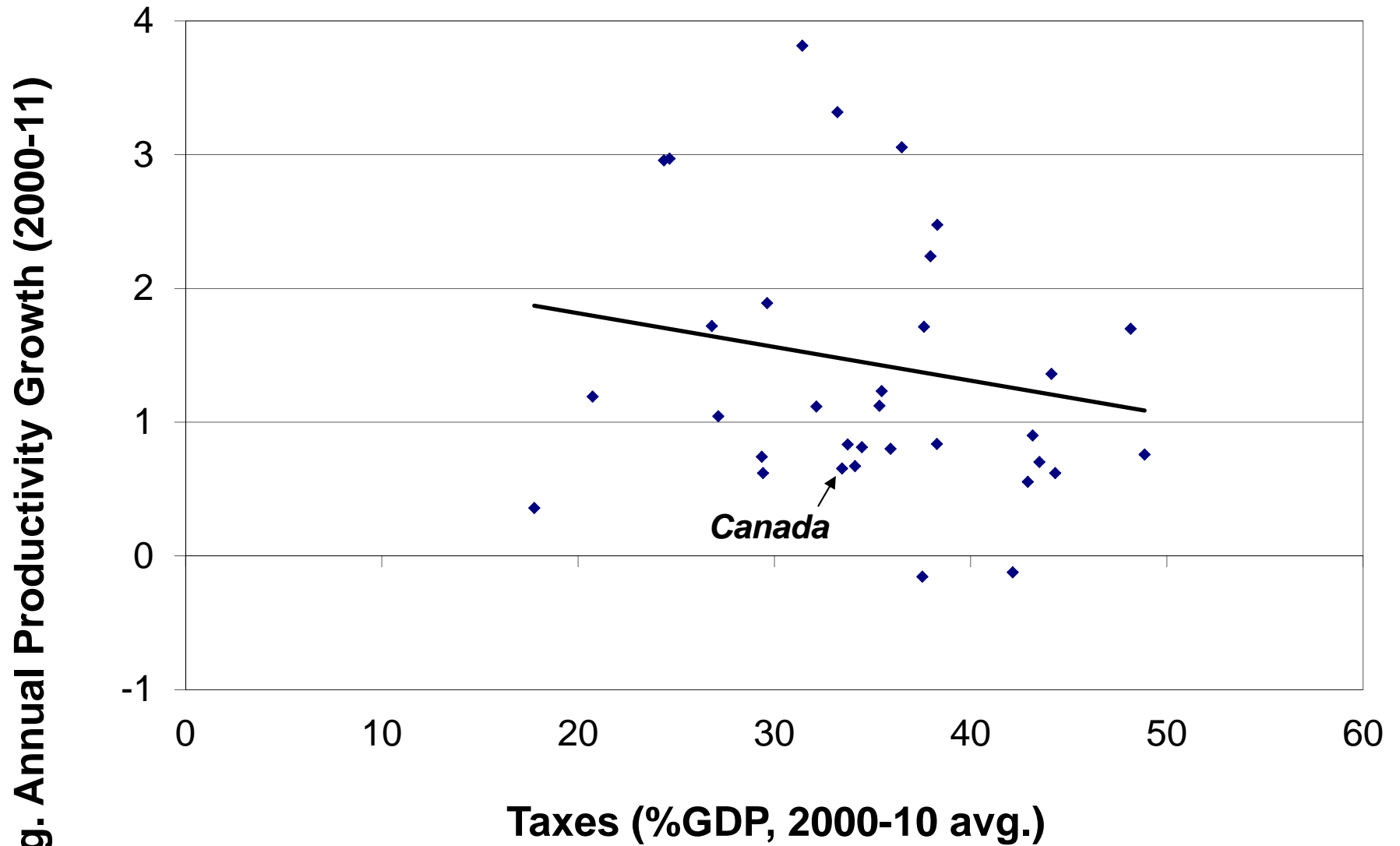
Economic Effects of Taxes (and Spending!)

- Incentive Effects
 - Labour supply (eg. "brain drain")
 - Capital spending
- Incomes
- Production
- Investment and Productivity
- Cyclical Stability
- Employment
- Distribution

Economic Consequences of Taxing (and Spending)

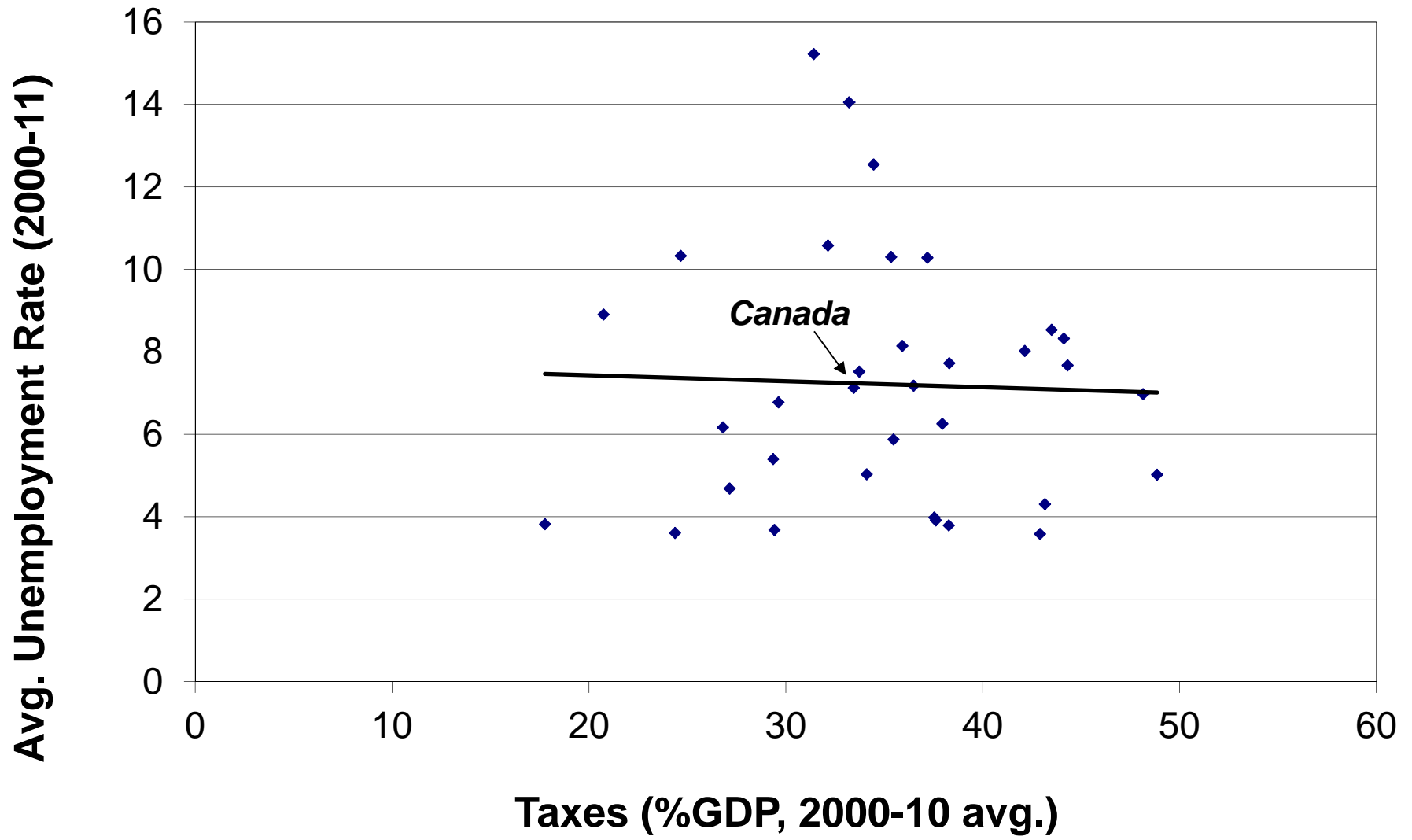
Nature of Effect	Strength and Direction of Effect
<p>Economic Incentives:</p> <p><i>Labour supply</i></p> <p><i>Business investment</i></p>	<p>Negligible impact on work effort.</p> <p>Non-linear and weak negative impact on capital spending; negligible if taxes broadly competitive with other jurisdictions.</p>
<p>Incomes</p>	<p>Transfer payments diversify and stabilize household incomes; support consumer spending.</p>
<p>Production</p>	<p>Government production diversifies and stabilizes total output.</p>
<p>Investment and Productivity</p>	<p>Public capital spending adds significantly to total investment. Public investment and current services can both add to private-sector productivity.</p>
<p>Macroeconomic Stabilization</p>	<p>Automatic stabilizers offset private market cycles. Public sector output and employment are more stable.</p>
<p>Employment</p>	<p>Public sector jobs diversify employment opportunities. Public sector conditions help lift labour standards in the private sector.</p>
<p>Income Distribution</p>	<p>Taxes and transfers substantially reduce inequality in money incomes. The consumption of public services further reduces inequality in final consumption.</p>

Taxes and Productivity Growth



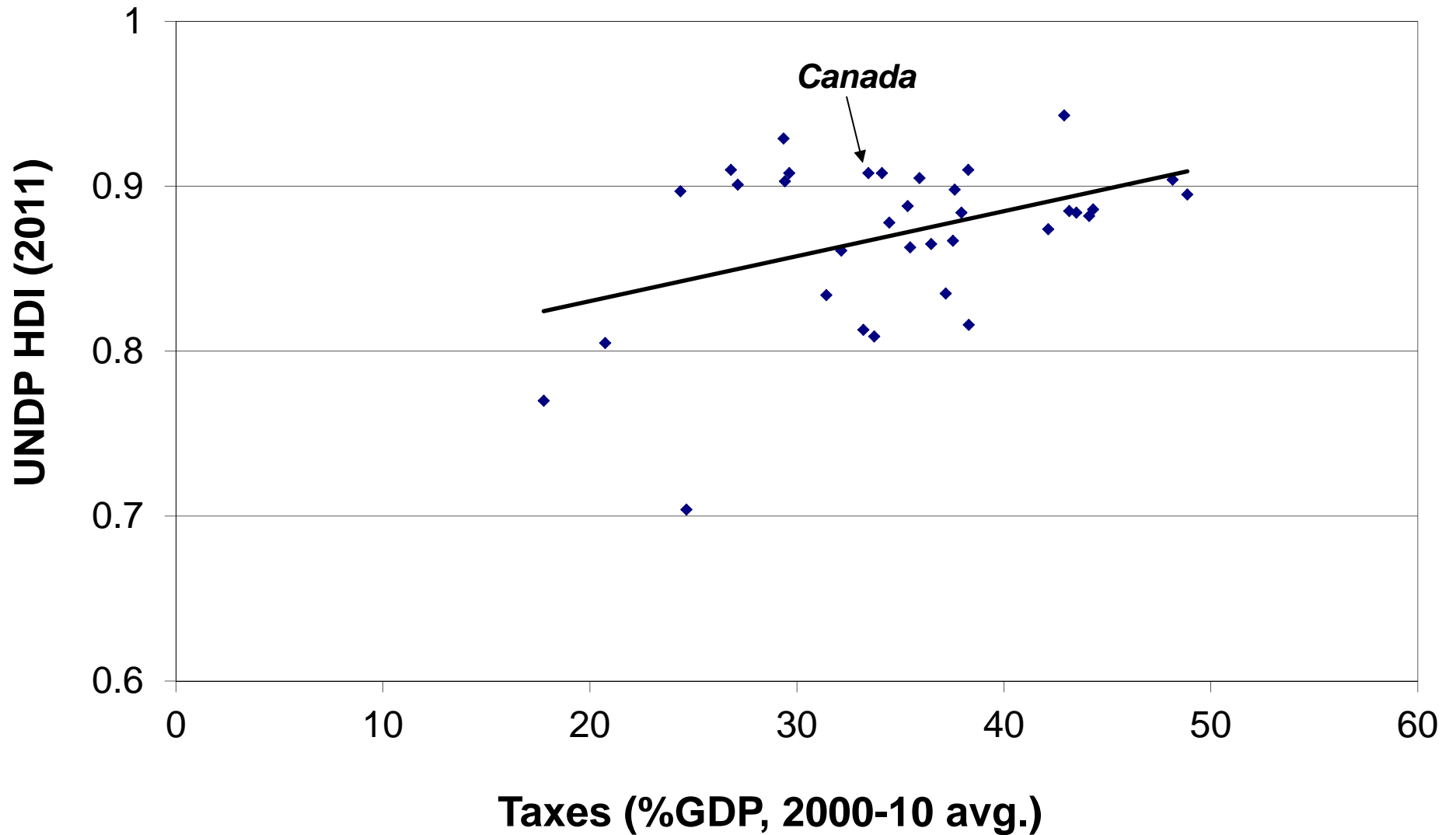
Source: Author's calculations from OECD and UNDP data.

Taxes and Unemployment



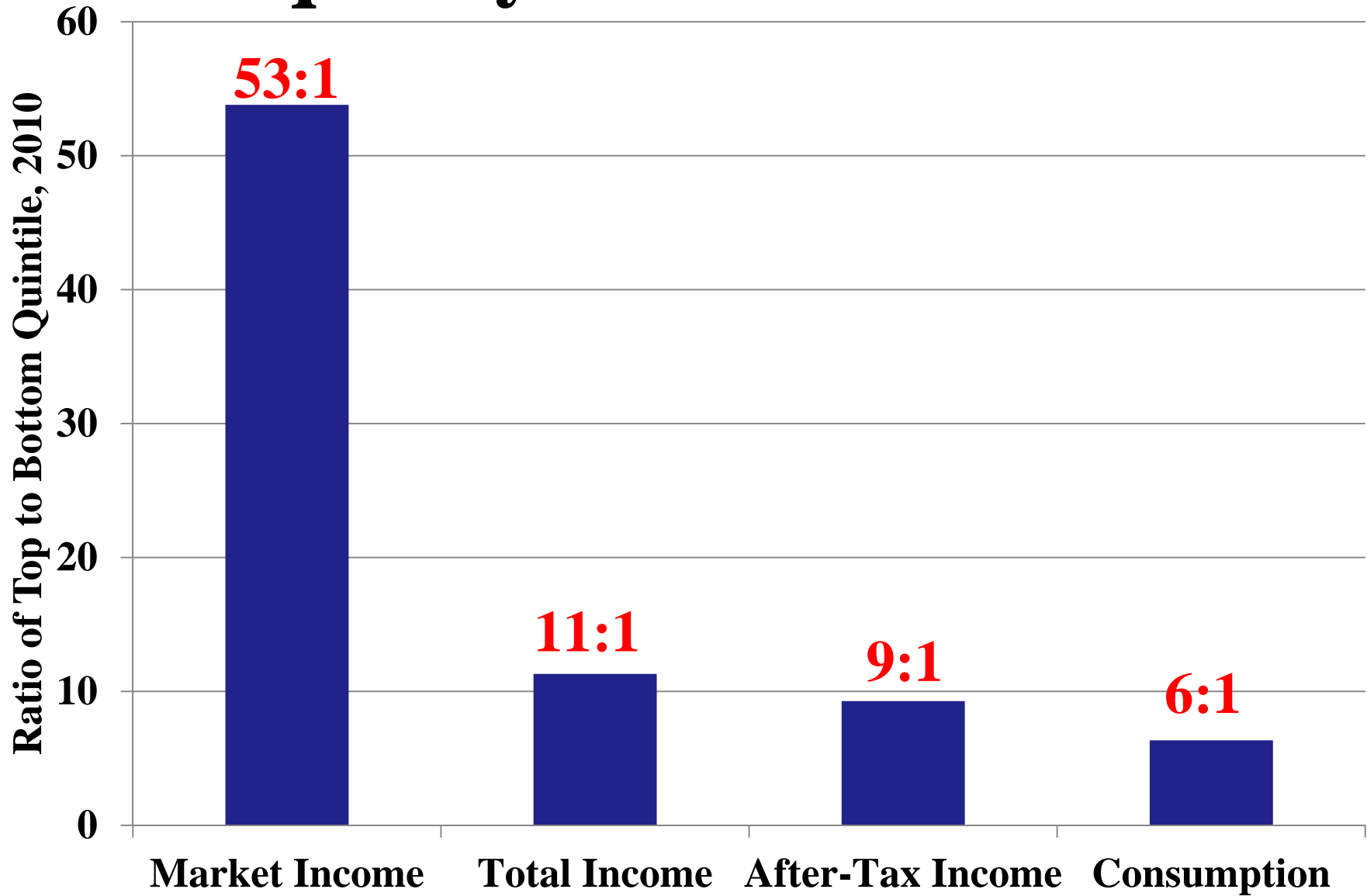
Source: Author's calculations from OECD and UNDP data.

Taxes and Human Development



Source: Author's calculations from OECD and UNDP data.

Inequality and Government



"Fair Taxes": Be Careful

- Can't analyze impact of taxes without analyzing impact of programs they fund.
- Some progressive forget this lesson, too.
- Concern with the distribution of taxes cannot overwhelm commitment to the value of public programs.
- An important program funded with a (slightly) regressive tax is still progressive:
 - CPP, EI.
 - Role of sales taxes in modern fiscal base.

Deficits and Debt: The Bogeyman of Fiscal Policy

- Deficits caused by insufficient revenue
 - Structural: not taxing enough to pay for services
 - Cyclical: automatic impact of recession on revenues, spending
- Debt is the culmination of consecutive deficits
- Debt is OK if:
 - Debt incurred to pay for public investment
 - Debt is stable as share of GDP
 - Interest rates are not too high

The Politics of Debt & Taxes



The Politics of Debt & Taxes

- Phobia about debt aimed at justifying downsizing
- True constraints on public finance:
 - Debt can't grow forever as a share of GDP
 - After-tax profits must be sufficient to motivate desired business investment
- But that's a lot of room:
 - Moderate annual deficits OK
 - Taxes on individuals OK
 - Some additional taxes on business OK

An "Animal Farm" Theory of Debt



"Private debt good, public debt bad."

- But like any other borrower, public debt makes sense to finance productive long-lived assets.

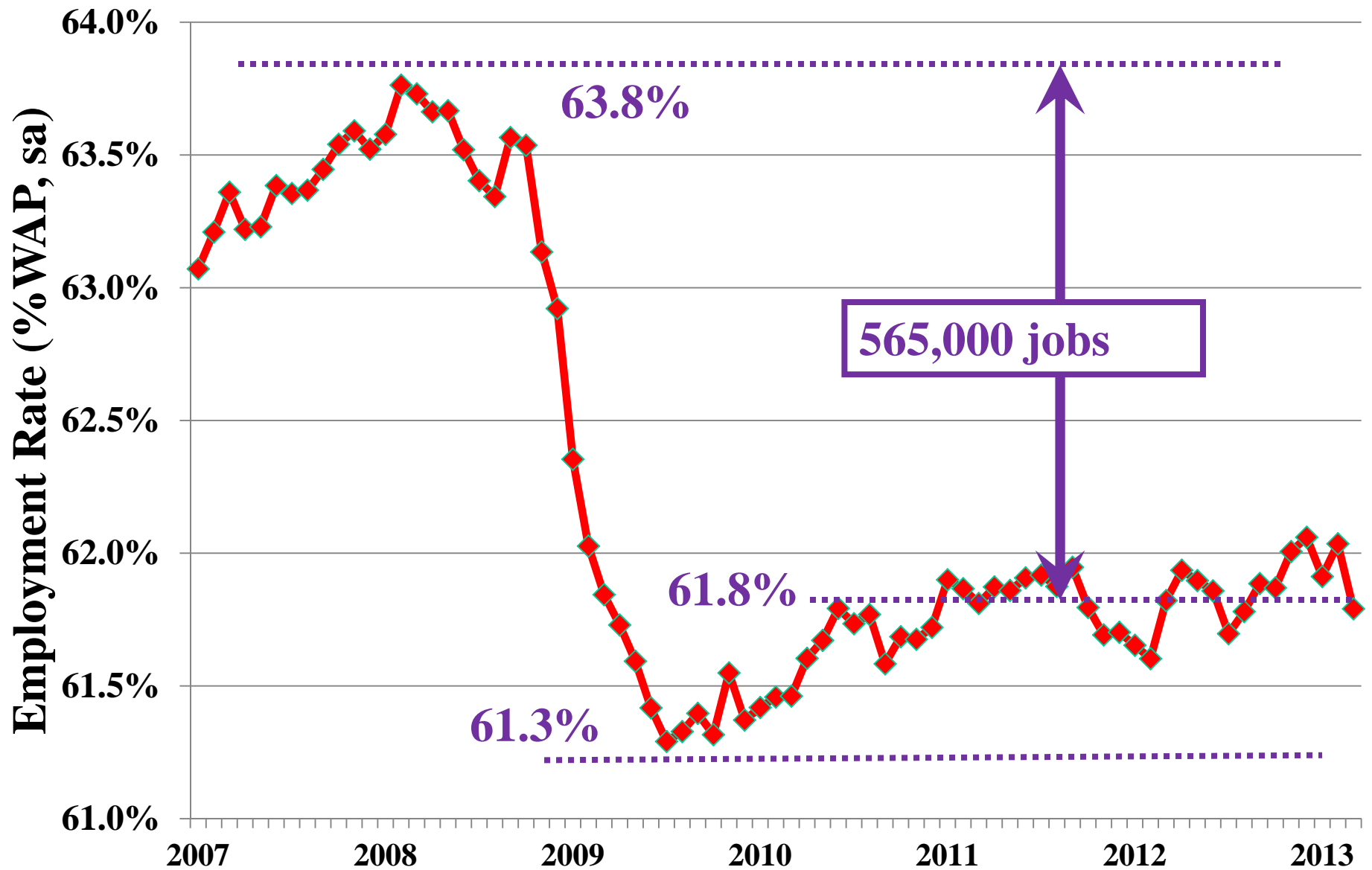
Deficits Today

- N.S.'s deficit was small, cyclical.
 - Never more than 1% of GDP.
- Canada's deficit was small, cyclical.
- Both cured by job-creation.
- "Balanced budget" obsession is wrong:
 - True constraint is to stabilize debt as a share of GDP.
- Even in good years, public borrowing makes sense to pay for productive assets.

The "Scarcity" of Labour...



Employment Rate (Canada)



Do the Math

"Official" & Actual Unemployment *March 2013*

Official Unemployment	1.4 million
Lost Participation	350,000
Involuntary Part-Time	450,000
Waiting for Job to Start	150,000
Total Actual Unemployment	2.35 million
As Percent (Adj) Labour Force	12%+

Fiscal Benefits of Putting Canadians Back to Work

New Employment	2 million
Average Productivity / worker	\$100,000
New GDP	\$200 billion
Automatic Government Share	35%
New Government Revenue	\$70 billion
Total Fed & Prov Deficits (2012)	\$45 billion

The Self-Defeating Logic of Austerity

- Recession caused the deficit (not "overspending").
- Austerity "solves" the deficit by cutting spending, employment.
- But that worsens the recession.
- At best, austerity swims against the tide.
 - Fiscal gains of cutbacks offset in part by contractionary macro effects (33%?).
- At worst, austerity reinforces recession and worsens the deficit.

Recognizing their Errors

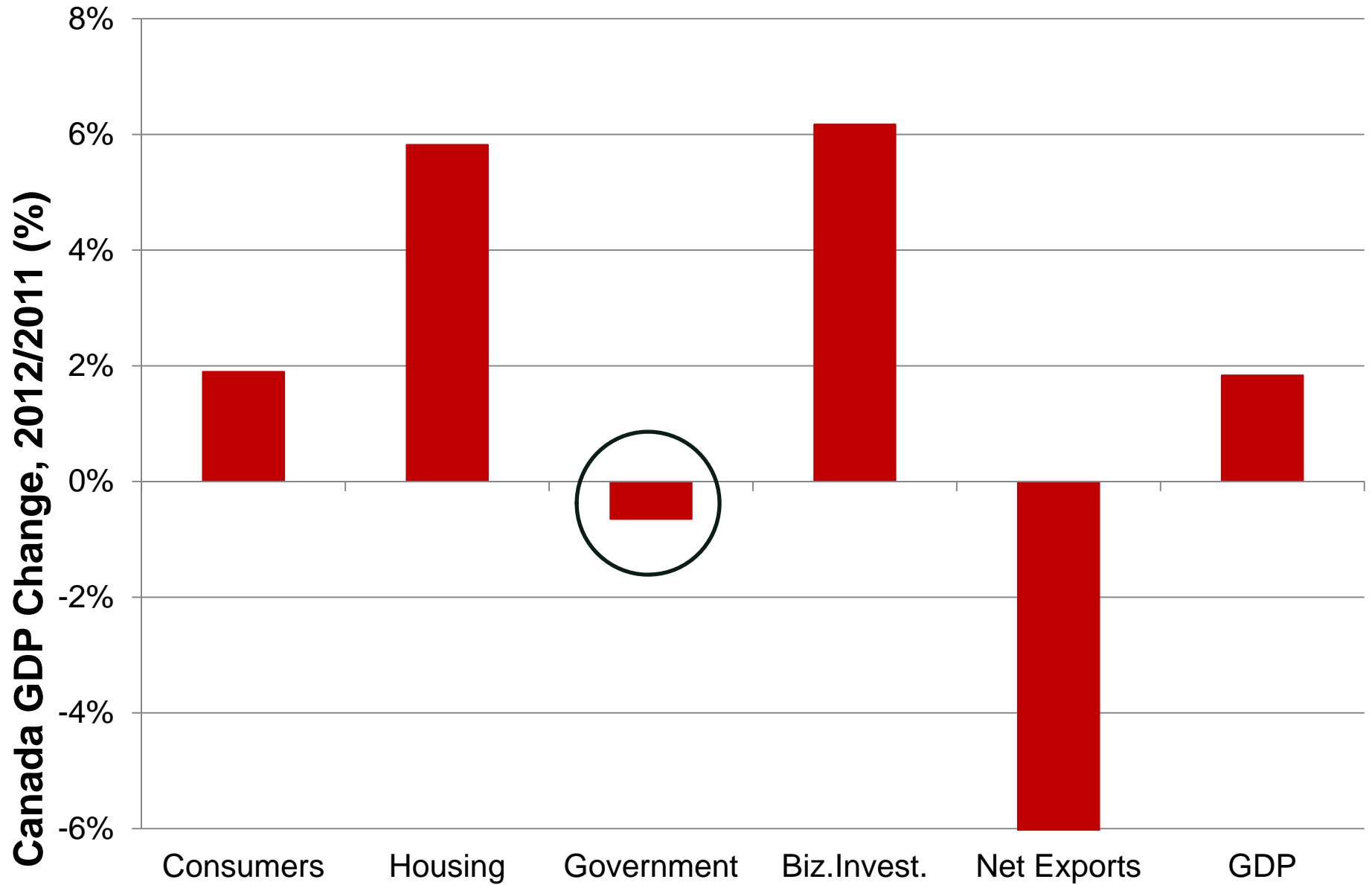
- European austerity creating a lost decade:
 - Euro zone in another recession.
 - Catastrophe in southern Europe.
- IMF paper (Blanchard) recognized they underestimated fiscal drag.
 - Multiplier estimated at 1.5.
- Rogoff-Reinhart analysis was wrong.
- Ideology, not facts, is driving austerity.
 - Austerity is making things worse, not better.

Austerity From Coast to Coast

(% GDP)

	Deficit (2011)	Cuts (2009-12)		Deficit (2011)	Cuts (2009-12)
BC	-0.8	1.0	Que	-0.8	1.4
Alta	0.0	1.6	NB	-0.8	1.9
Sask	+0.5	2.1	NS	-0.7	1.0
Man	-1.8	0.4	PEI	-1.5	3.6
Ont	-2.0	0.8	N&L	+2.3	6.1
FED	-1.5	1.8			

Fiscal Drag in Canada



Fiscal Drag in N.S.

- Provincial program spending falling by 1% next year.
 - And by almost 1% as share of GDP.
- Federal & municipal program spending falling, too.
- Add a multiplier: total lost output could equal 3% of GDP (over some yrs).
- Unless other economic engines are strongly in gear, this pulls the economy back toward recession.
 - No wonder GDP here is only growing 1%/yr.

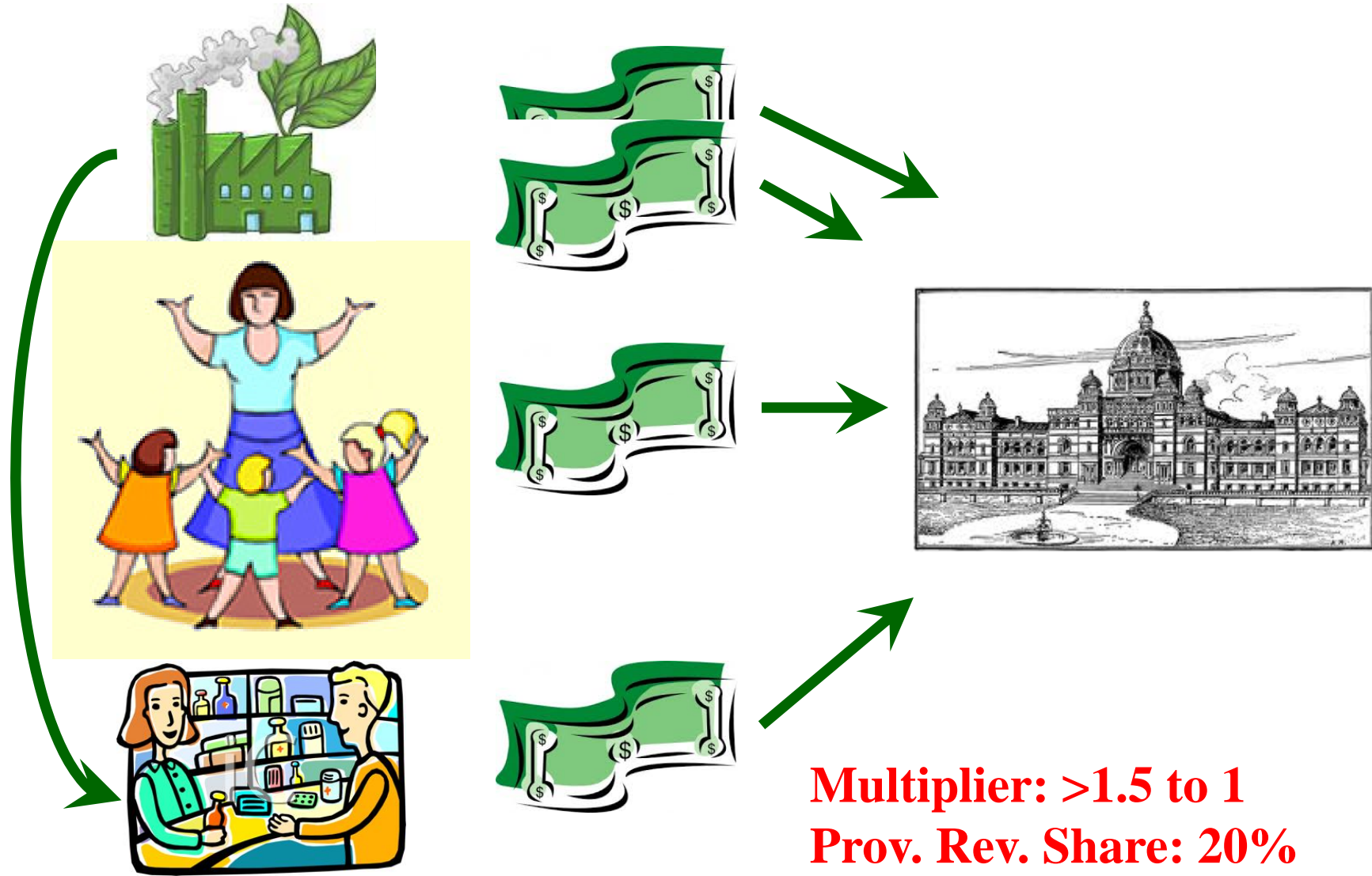
Canada's Tax Record

	Total Gov't Revenue (%GDP)	5-yr Change (%GDP)
US	31.3	-2.3
Japan	32.1	+0.2
Canada	37.4	-2.6
UK	40.0	-0.9
Germany	44.2	+0.9
Italy	45.4	+0.7
France	50.6	+0.5
OECD	41.5	-0.9
Norway	58.1	-0.1

Thinking Twice About Tax Cuts

- N.S. increased the HST 2 points in 2010.
 - Filled in space vacated by federal GST.
- Also created new bracket \$150,000+.
- Now they plan to unwind HST changes:
 - \$400m/yr in lost revenue.
- This is driving the spending cuts.
- Question: what will stimulate N.S. production & employment more?
 - New consumer spending (much on imports).
 - Valuable services produced right here.

Multiplied Benefits



Conclusion:

Paying for a Better Society

- Working people have fought hard to get the state to serve their needs, too.
- That requires paying taxes.
 - Substituting public consumption for private consumption.
- Can't pretend that only the "rich" will pay.
- Challenge: Educate Canadians about how they are better off with a government that "taxes fairly, and spends wisely."