Redressing inequality with taxes
Creating a higher tax bracket for the top one per cent will help as long as the percentage is not too high

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This series on inequality in Canada has discussed the facts on the rise in inequality over the last 30 years. Suppose we want to do something about it. How do we do that? One option is to consider tax and transfer policies to make our system more progressive. There are two fronts to this option- increasing taxes at the top and distributing those resources to those who are struggling.

What might an increase in taxes for the highest earners look like? Brian Topp, one of the front-running federal NDP leadership hopefuls, has recently proposed a new 35-per-cent federal tax bracket for those with incomes over $250,000. A new tax bracket like this wouldn't actually hit very many of us. Fewer than one per cent of us earn more than $250,000, and the tax on dollars earned under that threshold would not change. So, more than 99 per cent would see no change under this proposal. The combined federalprovincial top rate in B.C. would be 49.7 per cent instead of 43.7 per cent. This isn't out of line with other jurisdictions: the top rate in the U.K. is 50 per cent and the proposed top rate for 2012 in California is 46.3 per cent. For those with longer memories, the top rate in Canada 40 years ago in 1971 was 80 per cent.

However, there is an unavoidable caution for advocates of higher taxes. Some of the potential new revenue will disappear, as people subjected to higher rates make different choices for how much to work and how to report their income. Top earners might choose to work a bit less. It seems likely, though, that the 'alpha person' professionals and executives in the top one per cent are more motivated by staying at the top of their field than by a couple of tax points. Economists have a lot of evidence that bears out this conjecture - we shouldn't expect much reduction in work in response to this change.

More likely, we might expect top earners to put more effort into finding legal ways to avoid the higher tax burden by shifting their incomes around and using other tricks devised by their tax advisers. These attempts at avoidance decrease taxable income and push down on the total new revenue raised by a higher rate.

Brian Topp assumes his proposed 35-per-cent federal rate would yield $3 billion in new revenues. Economists have fairly good estimates of how much revenue
"slippage" we might expect for top earners, and these estimates suggest the additional revenue might slip down closer to $1.5 billion. These same estimates suggest that if we pushed the combined top tax rate too close to 60 per cent, higher taxes would stop yielding much new revenue at all.

How could this new money be used to help those who are struggling at the bottom? Cutting income tax rates in the bottom bracket doesn't do much, since the basic exemption and other tax preferences mean that few low-income earners actually pay income tax. Instead, the right target is to enhance our system of refundable tax credits. As examples, think of the HST/GST credit, the Canada Child Tax Benefit, or the B.C. Family Bonus. These payments can be targeted by family income and delivered efficiently through direct deposits into recipients' bank accounts.

A large volume of research tells us that well-designed tax credits can enhance employment prospects and improve the well-being of lower-income families. A downside of our current system is the confusing mess of overlapping federal and provincial programs. However, that does not change the strong case for using well-designed, targeted income transfers to improve the progressivity of our system.

By combining a higher tax rate on top earners with some enhancements to low-income transfers, we could make the tax and transfer system more progressive. A more progressive tax and transfer system could go some way in redressing the increase in inequality we've seen in Canada over the last 30 years.

One question remains. Should we care about inequality? This is a personal decision that derives from personal values. Often those who are very successful have worked extremely hard or made great sacrifices to get there. Is it fair to ask them to contribute more? At the same time, some of us struggle because of an unlucky start in life or risks taken that didn't pay off. Is it too much of a stretch for each of us to ponder, "could that have been me?"

Economies and societies do best when incomes and opportunities continue to grow. Some economic policies are more conducive to growth than others. If we want public support for pro-growth policies that provide the most opportunity for future generations, we need to ensure that economic growth benefits everyone in our society today.

On that point, perhaps all 100 per cent of us can agree.

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