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Focus on economic growth — not distribution through tax hikes on the rich

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Two of the most misleading myths about recent economic trends in Canada are that the distribution of income is becoming more skewed to "the rich" and that these same "rich" largely avoid paying taxes. In fact, as I show in a report released Thursday by the Fraser Institute, the top decile's share of income declined between 2007 and 2017, from 36.1 per cent to 34.2 per cent. This top tenth of earners includes anyone earning $96,000 or more as of 2017, a threshold few would regard as anything other than middle class.

During NDP Leader Jagmeet Singh's concession speech on election night, his supporters chanted "Tax the rich!" — as if somehow "the rich," however defined, are not paying taxes. In fact, the top 10 per cent of income-earners in Canada have long been the only group whose share of taxes paid is greater than its share of income. Over the past two decades it has paid more than half of all income taxes, including fully 54.1 per cent in 2017.

The tax burden on the top decile increased noticeably during the debt crisis of the 1990s. More recently, the top decile has been asked to pay more in part to finance lower- and middle-class tax cuts and credits designed to counter the effect of years with little or no income growth for average Canadians. But marginal tax rates above 50 per cent have not generated substantially higher revenues for governments, which means middle-class tax cuts have been financed largely by rising government debt. It is hardly surprising that people resist tax rates above 50 per cent, a level beyond which even former NDP leader Thomas Mulcair said "you're not talking taxation, you're talking confiscation."

One reason for the shift in tax burden to upper-income families has been the widespread misconception that they are prospering while everyone else stagnates. This is the modern variant of the 19th-century critique of capitalism that "the rich get richer, the poor get poorer." But, as mentioned, the share of income going to the top decile has actually fallen over the past decade.

Average incomes have lagged, not because the top decile is consuming a larger share of incomes, but because GDP growth has slowed. If per capita income growth after 2000 had been sustained at 2.5 per cent a year instead of the 0.9 per cent actually recorded, real incomes in Canada would be one-third higher today, the equivalent of $18,498 more for every person. That is considerably more than recent increases in government transfers to the average Canadian.

The fact that Canada has bucked the trend of rising upper incomes seen in most industrialized countries has largely gone unnoticed, even at home, as anti-inequality rhetoric imported from the U.S. and Europe has driven public discourse. The result has been increasing focus on the distribution of income and taxes. When the economic pie stops growing, different groups in society conclude that lobbying for a larger slice is the only way to raise their disposable income.

The danger is that prioritizing redistribution reinforces the trend to slow growth. Robert Lucas, 1995 Nobel Prize winner in economics and one of the most influential macroeconomists of his generation, declared in 2004 that “of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution.”

Unfortunately, as the Cato Institute’s Alan Reynolds has put it, “the growth and inequality of incomes are topics that seem to inspire many people to form very strong opinions about very weak statistics.” The way the rich-poor divide is usually talked about creates the wrong impression that the same people occupy the same relative points in the income distribution over time — that a distinct group of “rich” people reaps above-average incomes year after year. That’s just wrong. The truth is that people move — a lot — from group to group over time. In this country, for example, 36.1 per cent of people who were in the top decile in 2017 had not been in the top decile five years earlier. Just over half of people in the top five per cent in 2017 had experienced at least one year in the previous five when they were not in that group.

Policy-makers and researchers should focus on higher economic growth, not increasing taxes on small slices of the population. Canada should focus on boosting growth by stimulating investment, improving our trade competitiveness, opening large sectors of our economy that are still sheltered from international competition, lowering the cost of energy, and reducing the tax burden.