Do tax policies that contribute to competitiveness also create inequality?

By Armine Yalnizyan
November 28, 2019 – *The Globe and Mail*

As economic forecasts continue to downgrade global growth prospects, policy makers' fixation with boosting growth remains, well, fixed. Meanwhile, concerns about stubbornly high levels of inequality have triggered a growing chorus of calls – including from the Organisation for Economic Co-operation and Development, the International Monetary Fund and the World Bank – for more inclusive growth.

The opening question faced by 900 or so attendees at the Canadian Tax Foundation's annual conference in Montreal on Sunday is a testament to the tension of our times: Do tax policies that contribute to competitiveness also create inequality? As a panelist wrestling with this question, I'm wondering: What is meant by competitiveness? More innovation? Or simply more capital?

Lower taxes may attract more capital, although that's not guaranteed. And three cautionary tales reveal how more cash may not produce advances in productive capacity, through technology or knowledge.

The Legend of Zero: Economists remind us that corporations don't pay taxes, people do. So is the ideal corporate-tax policy rate zero? Putting aside the fact that would mean Canada would need to replace about $50-billion in federal revenues, cut $50-billion in services or some combination thereof, it is instructive to look at the 12 nations that currently offer zero corporate taxes. All are tax shelters and most, such as Bermuda and the Bahamas, are more playgrounds for the rich than hubs of innovation and development. On the flip side, countries with the highest corporate-tax rates both attract and repel capital inflows. The United Arab Emirates tops the list at 55 per cent, but countries as disparate as Brazil, India, France and Japan, not to mention Chad, Venezuela and many others, have corporate-tax rates of more than 30 per cent. Taxes aren't the key reason for huge differences in rates of growth and investment.

Concentrating market power: Canada enjoyed a clear tax advantage over the United States between 2002 and 2017. But U.S. President Donald Trump's sweeping package of tax reforms makes the advantage less clear. Steep permanent corporate-tax cuts; large, if temporary, personal income-tax cuts; and incentives to repatriate capital to the U.S are game-changing considerations. What kind of investments did this newly found competitive edge on taxes buy in the U.S.? A US$1.1-trillion surge in share buybacks, slower growth rates in productivity and job creation, and between US$1-trillion and US$2-trillion in additional public debt by 2025.

Lower taxes, less investment? Canada's corporate-tax rate was cut almost in half from 2000 to 2012, and cuts to personal income-tax rates resulted in hundreds of billions of dollars in forgone revenue. Yet, business investments account for the same share of gross domestic product (GDP) today as in 2000. Machinery, equipment and intellectual property account for less business investment than they did in 2000 (just as in the U.S. since 2017). Have U.S. tax cuts siphoned foreign investment away from Canada? Both inbound and outbound foreign direct investments are up in Canada, but outbound flows have risen faster, possibly more because of trends in globally set oil and commodity prices than taxes.

Tax levels are rarely the first consideration for investors, unless the "investment" is a tax dodge. For any business operation, regulations matter, proximity to markets matter; and so do community features, such as a healthy and well-educated work force, well-maintained infrastructure, reliable energy, transportation and communications systems, and a robust justice system backed by widely trusted social institutions.

When these things are equal between locations, taxes will decide where to invest. But these things are not usually equal. And it's the differences that distinguish places as people and money magnets. Or not.

That insight offers a big clue about why tax policies matter. Tax policies can increase competition by reducing taxes or by funding what makes whole systems work. Tax policies shape the nature of growth, which determines how much is needed for redistribution and how much for expanding innovation.

Unless "competition" is code for "less government" and "tax policies" is code for "tax cuts," the question we should be asking is how to make our tax policies contribute to the drive toward inclusive growth. What tax policies best share the costs and benefits of inevitable growth, decline and transition? What tax levels and tax designs provide the basics for everyone, minimizing the burden while maximizing individual well-being and resilience, built on a foundation of excellent physical and social infrastructure, in all communities?

Competitiveness and equality are not diametrically opposed goals. For decades, policy makers have used tax policy to drive growth, paying less attention to the deeply lopsided ways in which society carved up that bigger pie. Why not bake in the missing ingredient – inclusive growth – so that tax policies yield a better tasting recipe for everyone.

Armine Yalnizyan is an economist and the Atkinson Fellow on the Future of Workers.