

Who Pays for Higher Corporate Taxes? We All Do

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As the federal political parties gear up for the 2015 election, platforms are developed that appeal to the political bases and distinguish the parties from each other. The NDP leadership is once again arguing the benefits of raising corporate income tax rates. Based on public comments, the current federal rate of 15 per cent would be raised to something like 20 per cent (or even higher?) if the New Democrats became the next government.

This is a perfect example of a promise that makes for good politics – at least among an NDP audience – but bad economic policy.

The political appeal is simple. As NDP Leader Thomas Mulcair recently said: “Companies are not paying their fair share and individuals are.” The promise to reverse the cuts in corporate tax rates that the Liberals and Conservatives enacted over the past decade will surely resonate with the NDP base.

But this proposal ignores two essential facts. First, all firms are ultimately owned by individuals. When profits get remitted to shareholders as dividends, they are fully taxable as personal income, and thus the “fair share” is being paid by the shareholder. Why would it be fairer to make the company pay more in taxes, thereby reducing dividends, especially when we don’t let companies vote? Wouldn’t it be better to have the profits flow through to individuals who then pay their appropriate taxes?

The second and more important fact relates to the genuine burden of corporate taxes. Since corporate taxes apply to profits, they reduce any firm’s incentive to become more profitable, which leads to less investment in productivity-enhancing capital equipment. In the absence of these increases in productivity, fewer new products get developed, fewer new markets are penetrated and fewer new workers are hired. It is no surprise that the research by academic economists, as well as by central banks, national treasuries, the International Monetary Fund and the Organization for Economic Co-operation and Development, routinely shows that corporate income taxes are among the very worst taxes for long-run economic growth – the same growth that increases our average living standards.

I admit that these arguments are unlikely to resonate strongly with the NDP’s political base. So here is a third reason that could even lead the NDP to seriously consider reducing, rather than raising, corporate income taxes: Climate change.

The NDP wants to introduce policies to reduce Canada's greenhouse gas emissions. The party's favoured policy is a cap-and-trade system in which the government sets an overall cap on the amount of emissions and then issues permits to individual (corporate) emitters that can then trade the permits in a free market. As most economists will tell you, this is a pretty sensible policy approach.

But there is a catch. Implementing such a cap-and-trade system will obviously increase the costs of using coal, oil and natural gas. Indeed, this is the policy's central objective – by increasing the costs of “dirty” fuels, the policy provides an incentive to switch toward “cleaner” fuels. But in a modern, energy-intensive economy like ours, increasing the cost of energy will almost certainly reduce the rate of economic growth, which means slowing the ascent of Canadians' living standards.

If the New Democrats genuinely care about reducing greenhouse gas emissions but equally care about protecting Canadians' living standards, they should advocate a two-part policy package. The first part is their favoured cap-and-trade system, but one that raises revenue by selling the permits to the highest bidders. The second part would give back this revenue by reducing the most growth-retarding tax in Ottawa's cupboard – the corporate income tax. The combination would offer Canadians a way to protect the environment and their living standards at the same time.

Such a policy package would require a sea change in the NDP mindset, and is thus unlikely to be adopted. The New Democrats are more likely to retain their anti-corporate view and refuse to recognize the genuine burden of corporate taxes. They might advocate a cap-and-trade system, but with no offsetting reduction in any other taxes. In this case, however, their sales pitch would be pretty challenging. How many of us are really prepared to take a hit to our living standards in return for reducing greenhouse gas emissions – especially when taking such a hit may be unnecessary?

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