LOW TAX LIES

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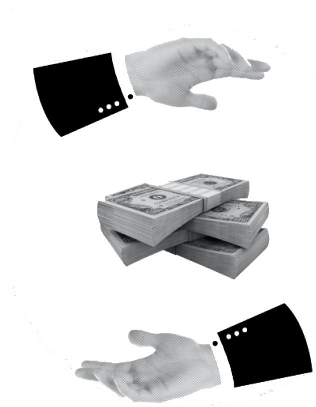
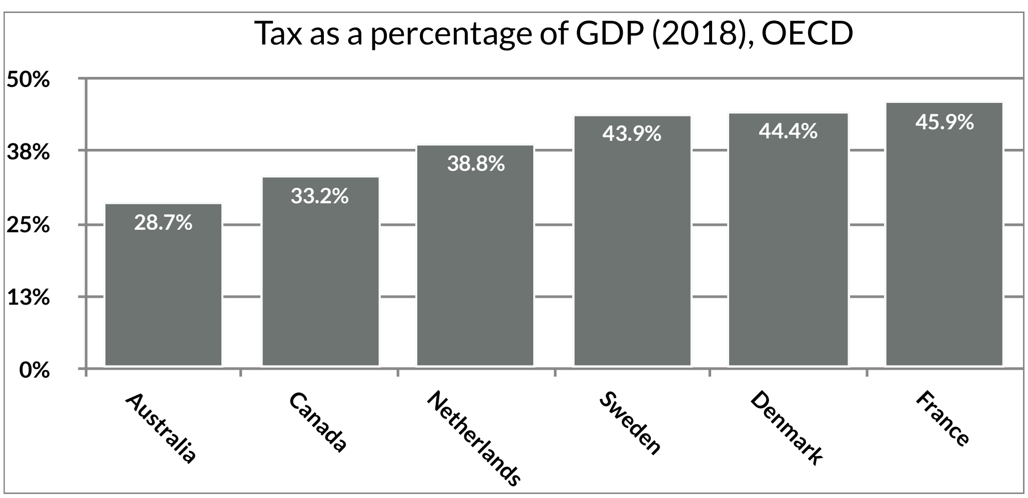
In 2019, the Montreal Economic Institute (MEI), a conservative think tank, published a short research note titled *More Prosperity through Smaller Government*[1]. This research note contains several common conservative lies about economics.

LIE 1:
LOW TAXES = MORE INNOVATION AND MORE BUSINESSES

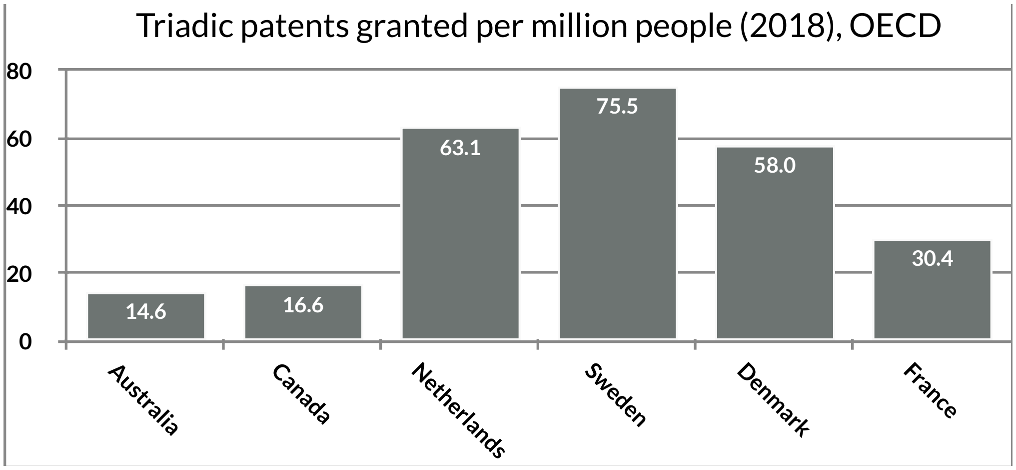
> "THE MAIN FACTORS NECESSARY FOR PRODUCTIVITY GROWTH ARE PRIVATE INVESTMENT AND INNOVATION... THE FIRST SUCH MEASURE TO CONSIDER IS THE REDUCTION OF THE TAX BURDEN, STARTING WITH THOSE THAT AFFECT BUSINESSES. WHEN TAXES ARE HIGH, THERE ARE FEWER ENTREPRENEURS, AND FEWER BUSINESSES ARE CREATED, WHICH IN TURN MEANS THAT LESS WEALTH IS CREATED."

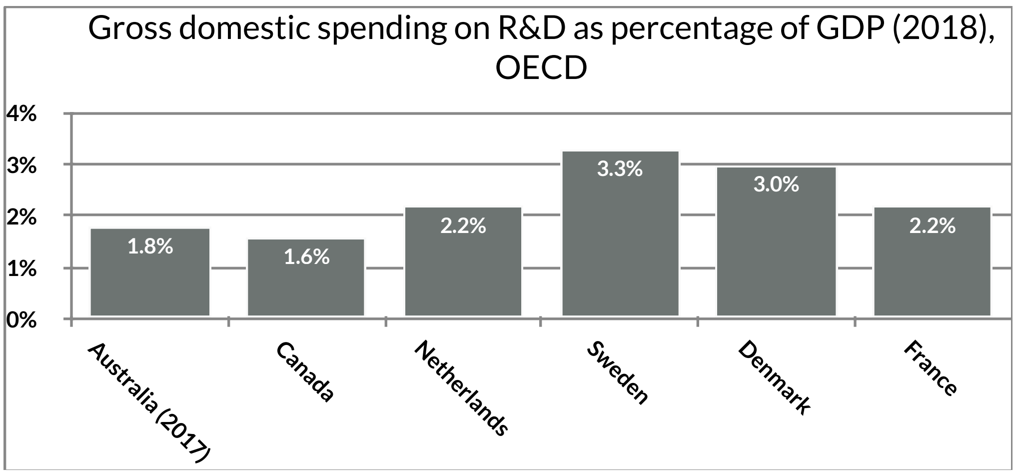


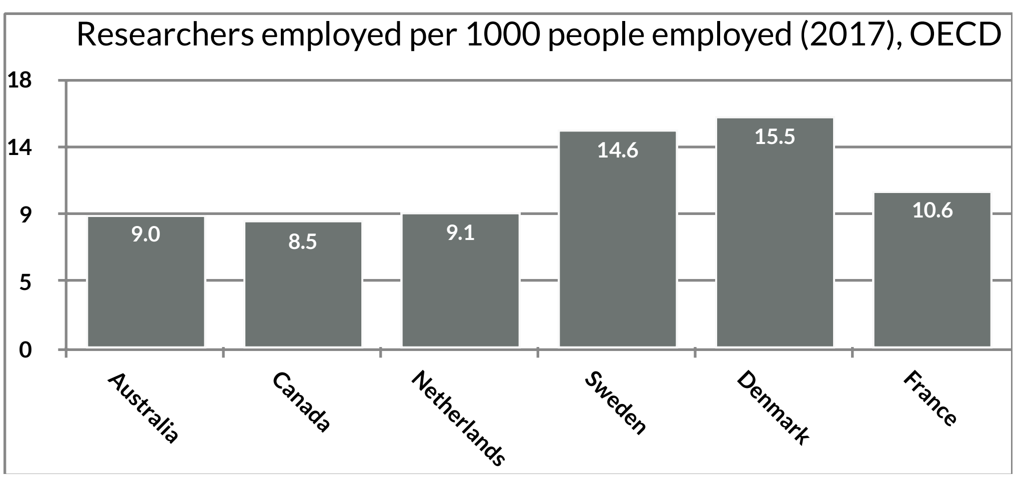
This claim is not true. Some useful measures of innovation are the issuance of patents, domestic spending on research and development, and researchers employed per capita. High tax western countries generally score very well on these metrics.



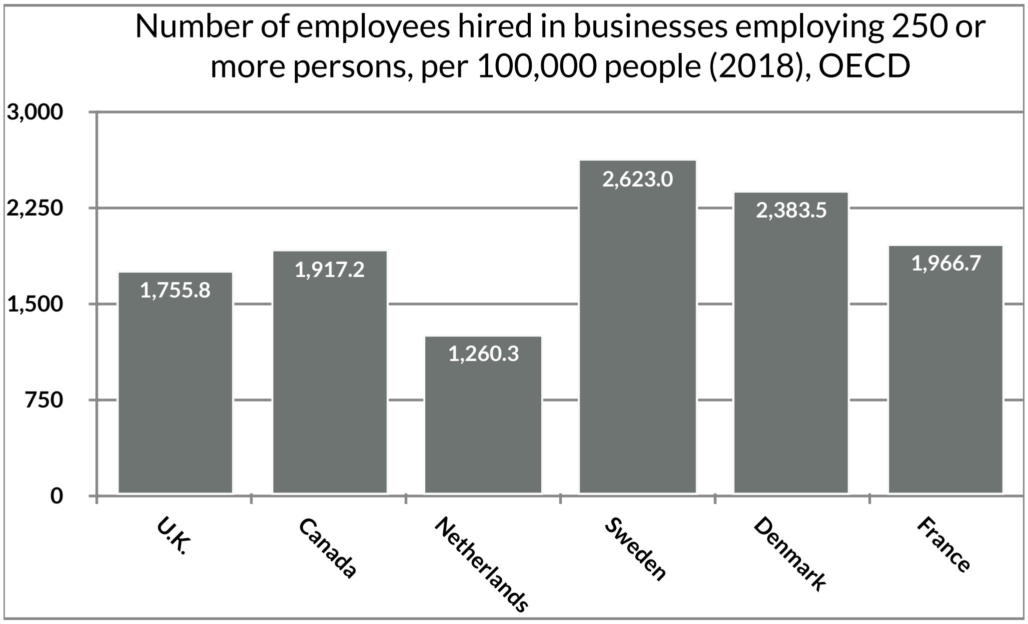
[1] https://www.iedm.org/wp-content/uploads/2019/02/lepoint0219_en.pdf

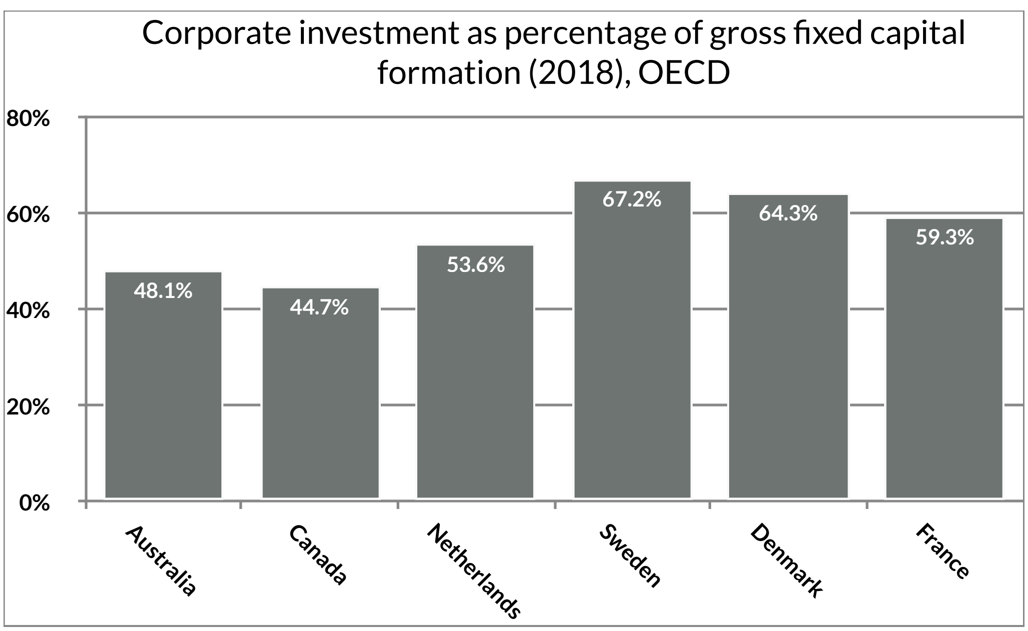

Triadic patents granted per million people (2018), OECD
80
60
40
20
0
14.6
16.6
63.1
75.5
58.0
30.4
Australia
Canada
Netherlands
Sweden
Denmark
France


Gross domestic spending on R&D as percentage of GDP (2018), OECD
4%
3%
2%
1%
0%
1.8%
1.6%
2.2%
3.3%
3.0%
2.2%
Australia (2017)
Canada
Netherlands
Sweden
Denmark
France


Researchers employed per 1000 people employed (2017), OECD
18
14
9
5
0
9.0
8.5
9.1
14.6
15.5
10.6
Australia
Canada
Netherlands
Sweden
Denmark
France

The number of employees hired in businesses employing 250 or more persons and corporate investment as a percentage of overall capital investment are reasonable indicators of business success. High tax western countries generally score well on these metrics.





In practice, higher tax rates do not lead to a worse environment for business or innovation. If anything, the opposite is true. This is easy to understand.

High tax rates lead to higher spending rates on social services and welfare, which allow people with lower incomes to develop their own businesses and work on innovative ideas instead of being forced immediately into low-wage labour or job seeking.

This allows for a large number of people to develop innovative concepts and businesses instead of this activity being limited to a smaller group of people who have the means to afford to go without income. Redistribution through the tax system also creates a larger base of consumers to consume goods, making the development of business more efficient.

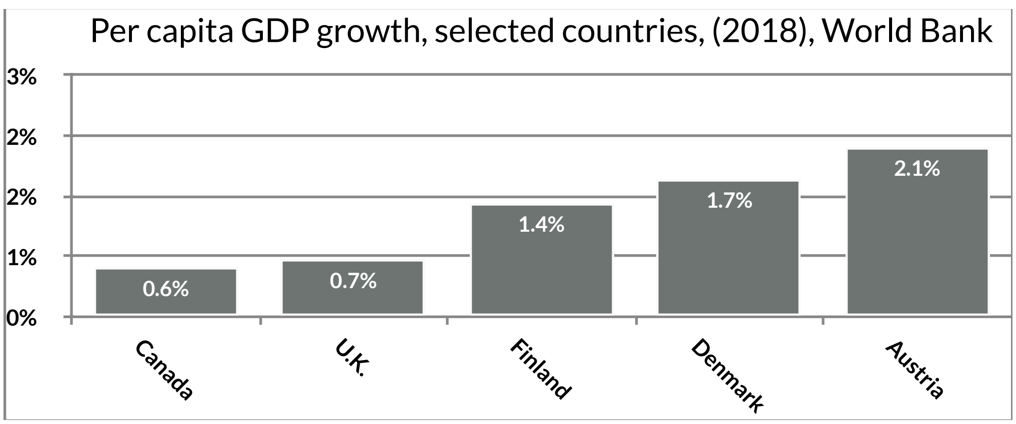
A strong tax system typically actually increases the total number of dollars flowing in the economy, as higher income people tend to turn a large percentage of their income into asset purchases instead of spending it on goods and services. Lower income people tend to spend every dollar they earn and don't typically purchase assets.

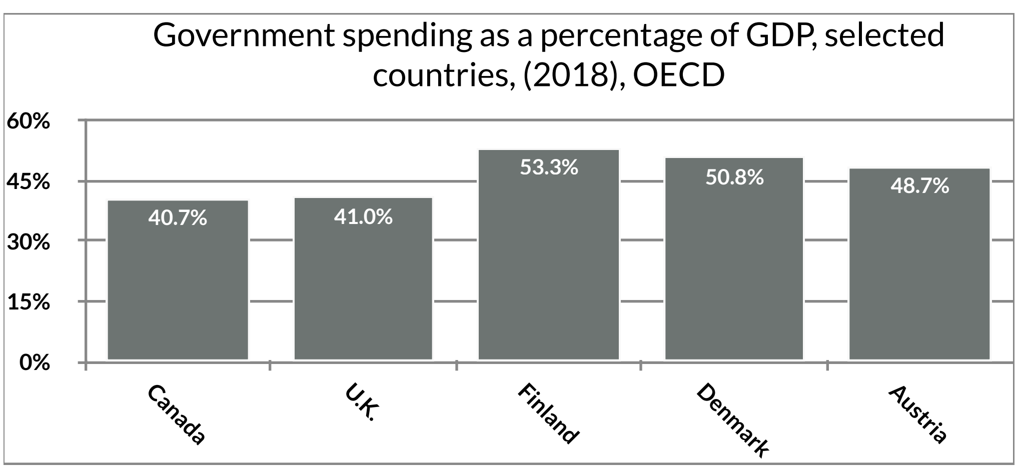
For these reasons, strong tax systems lead to strong business development and innovation as well as general economic growth.

LIE 2:
HIGH SPENDING = LOW GROWTH

"ACCORDING TO ECONOMIC RESEARCH, THE RATE OF GROWTH STARTS TO SLOW WHEN GOVERNMENT SPENDING EXCEEDS 26% OF GDP. IN CANADA AS A WHOLE, GOVERNMENT REPRESENTS AROUND 41% OF GDP... SUCH A LEVEL OF SPENDING AND INTERVENTION IN THE ECONOMY UNDERMINES THE POTENTIAL PRODUCTIVITY GAINS THAT ARE NECESSARY FOR SUSTAINABLE ECONOMIC GROWTH... "

This claim is simply not true. Some of the highest growth western countries have high spending rates:





The reasoning for this is contained in the response to lie #1 above, but to summarize, a strong tax and spending system creates a strong social base for business creation and innovation, and can lead to high rates of growth.

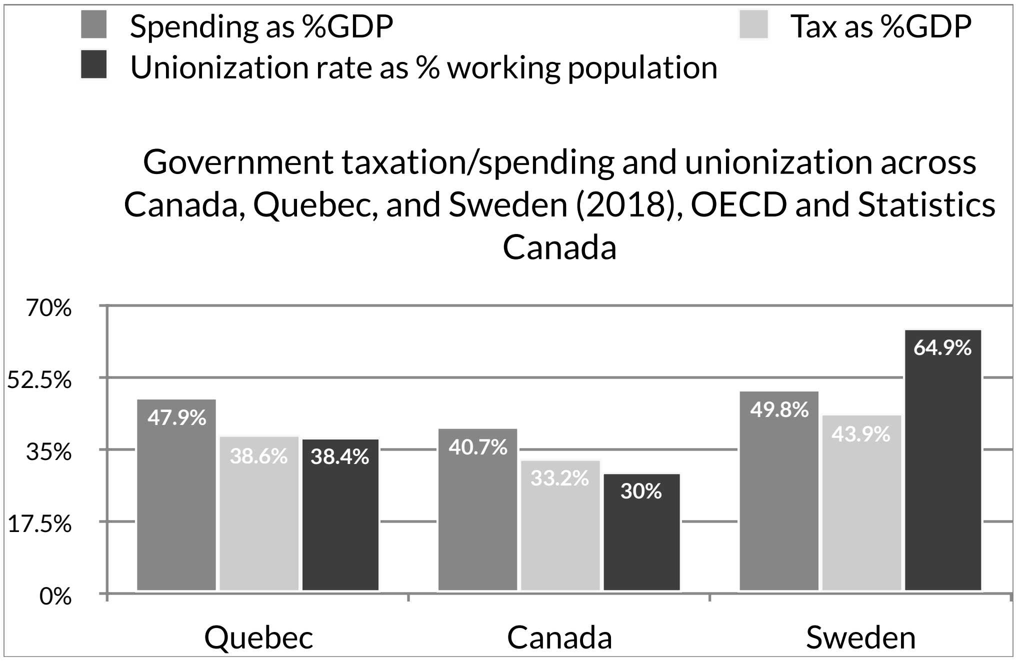
LIE 3:

SWEDEN IS CONSERVATIVE

"OPTING FOR A BIG-SPENDING GOVERNMENT THUS ENDS UP REDUCING THE STANDARD OF LIVING OF QUEBECERS. STATISTICAL DATA COMPILED BY THE CPP FOR THE YEAR 2017 SHOW THAT THE STANDARD OF LIVING OF QUEBECERS COULD HAVE BEEN FAR HIGHER, AND CLOSER TO THAT OF OTHER PROSPEROUS JURISDICTIONS, HAD PRODUCTIVITY GROWTH BEEN COMPARABLE TO THAT OF SWEDEN, FOR EXAMPLE. INDEED, WHILE QUEBEC'S PRODUCTIVITY GREW 1.2% PER YEAR ON AVERAGE BETWEEN 1981 AND 2016, SWEDEN'S GREW 1.7%."

MEI compares Quebec (a low-growth jurisdiction) to Sweden (a high-growth jurisdiction), prefaced by the statement that Quebec should not have a "big-spending government".

Sweden is a high-spending high-tax jurisdiction relative to Quebec and the rest of Canada. It also has heavy labour market regulation, with very high unionization rates.



So why does Sweden have high growth? Certainly it can't be the low tax and spending rates advocated by this research note. This point alone makes the research note look kind of comical.

Arguments along these lines are frequently made by conservatives. They will point to the fact that Scandinavian countries have high growth rates, low business taxes, weak or nonexistent minimum wages, and are often governed by conservatives.

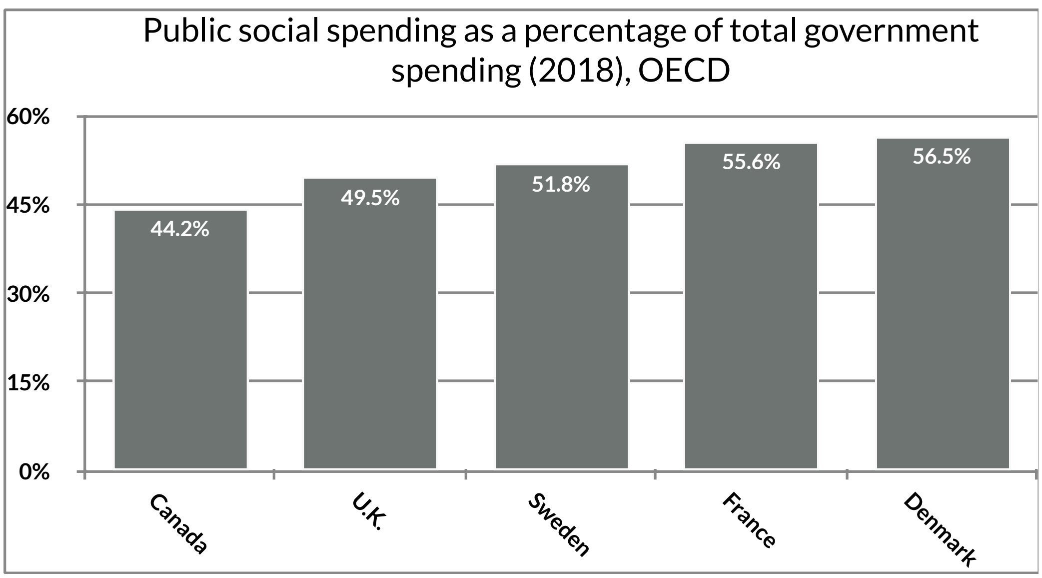
These facts ignore the broader picture of Scandinavian countries, which is that they have high overall tax rates, very strong unions that set high effective minimum wages through sectoral bargaining, and that the conservative parties in these countries tend to maintain this economic framework when they are in government.

If Sweden is a good model for jurisdictions like Quebec to achieve higher growth, Quebec should have high taxes, lots of spending, and heavy unionization, not the opposite.

LIE 4:
PUBLIC SPENDING TAKES UP "SPACE" THAT WOULD OTHERWISE BE PRIVATE SPENDING

"GOVERNMENT THUS TAKES UP NEARLY 27% MORE SPACE IN THE PROVINCE'S ECONOMY, COMPARED TO THE CANADIAN AVERAGE. SUCH A LEVEL OF SPENDING AND INTERVENTION IN THE ECONOMY UNDERMINES THE POTENTIAL PRODUCTIVITY GAINS THAT ARE NECESSARY FOR SUSTAINABLE ECONOMIC GROWTH, WHICH IS ITSELF A NECESSARY CONDITION FOR RAISING THE LIVING STANDARDS OF THE QUEBEC POPULATION.'

The language of "space" is often used when discussing the economic implications of government spending. It is a misleading metaphor.



Around two-fifths to one-half of the spending of a typical western government comes in the form of social services. These mostly consist of cash benefits, which are taxed from workers and wealthy people and given mostly to nonworkers. These benefits do not take up economic “space”, they simply move money around within the existing economy to be spent in the usual way for goods and services.

The remaining one half to one third of government spending is typically mostly spent on infrastructure and general public services, like policing. These are generally understood as essential services and are not generally subject to private competition and therefore do not occupy economic “space” that privately funded private business would otherwise occupy.

Sometimes governments operate state owned enterprises (SOEs). In Canada, Canada Post is our most prominent SOE. These SOEs replace useful but sometimes nonessential private services with government services. Private sector businesses are typically allowed to compete with these SOEs without restriction.

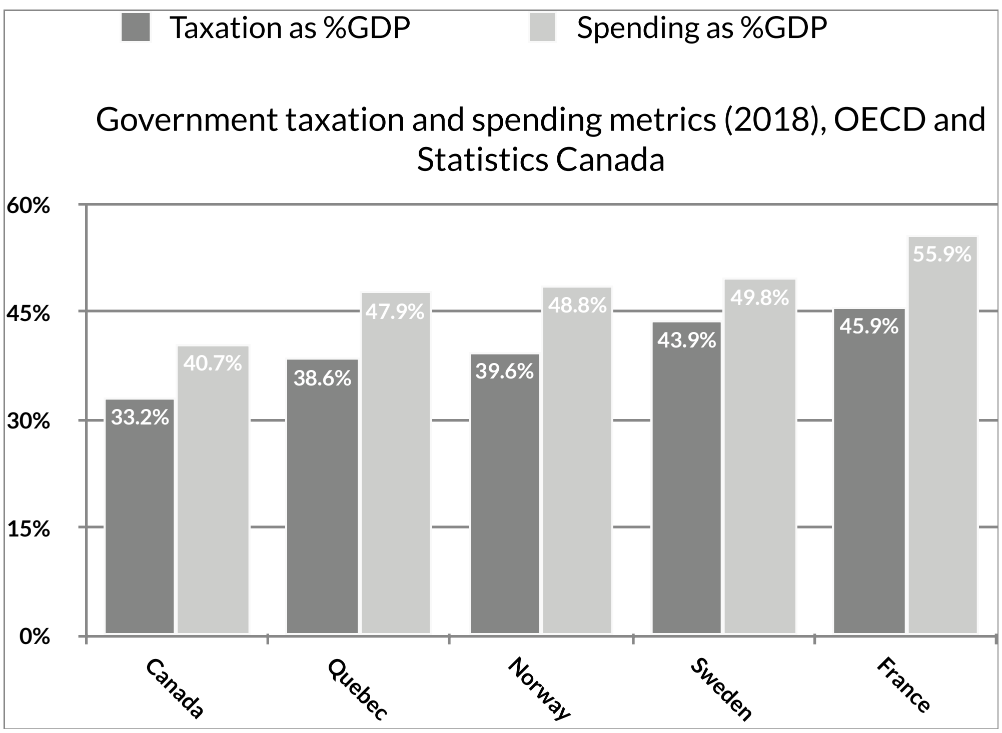
SOEs are the clearest example of potential crowding out of the private sector, but typically compose a small percentage of government expenditures and are exposed to competition with private sector businesses. The remainder of government spending does not meaningfully crowd out the private sector as it is typically understood.

LIE 5:

RELATIVE LEVELS OF TAXING AND SPENDING ARE THE SAME AS ABSOLUTE LEVELS

"QUEBEC IS ALSO A BIG SPENDER... PROPORTIONAL TO THE SIZE OF ITS ECONOMY, QUEBEC SPENDS AROUND 21% MORE THAN THE CANADIAN PROVINCIAL AVERAGE."

This is a bit of a more subtle move but is often deployed by conservatives to avoid discussing absolute tax and spending levels, which often undercut the argument they want to make. It is true that Quebec spends more on its population than other large provinces, largely due to the fact that Quebec has a higher proportion of nonworkers than Ontario or BC, has somewhat more generous provincial welfare programs, and has lower GDP per capita than most provinces.



But this difference is not very significant in light of the fact that Canada and Quebec have low tax and spending rates relative to many European countries.

It may be true that Quebec has higher spending rates than some other provinces. But even if that was a strong disincentive to growth, innovation, or business formation (it isn't), the absolute levels of spending and tax would be not be abnormally high.[2]

CONCLUSION

Conservatives love to tell lies about economics to justify their economic policy, which centres around lowering taxes and cutting social spending so high-income and wealthy people can accumulate financial assets more quickly.

These lies are typically based on projections of the supposed indirect effects (high growth, high innovation, low poverty) of a low tax, low spending government. These indirect effects never seem to materialize in the real world.

In reality, the best way to generate broad economic prosperity is through a big government, big growth approach that mimics the success of countries in northern Europe.

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[2] As a subnational government in a distributed federal system, most of Quebec's revenue comes from the federal tax system. Much of the increase in tax and spending as a percentage of GDP in Quebec is not related to policy inside of Quebec, but rather is the product of demographic factors that increase federal transfers to Quebec and individuals in Quebec relative to other provinces.

For instance, Nova Scotia and Prince Edward Island are major recipients of federal transfers and have government spending at around 60% of their GDP. Alberta and British Columbia spend around 30% of their GDP. This has little to do with interprovincial policy differences and is instead mostly related to the proportion of nonworkers versus workers in a given province.