Busting the myths that create and justify inequality

Today's economic system greatly benefits the richest at the expense of the middle and working classes. The system is sometimes justified by theories that have been proven false. A review of the evidence shows how these myths are not simply wrong, but also harmful.

Myth No. 1 The market works best with no government intervention

The first myth, and maybe the most common one, is the theory that the best way to ensure prosperity for everyone is by limiting government intervention and allowing the market to operate unhindered.

This philosophy is sometimes called laissez-faire economics, a French term that translates as 'let it be.' The foundation of this view is that markets are the most efficient way to allocate all resources, and any interference with markets and their operation will result in economic losses for society. Governments, then, should do as little as possible – in taxation, regulation, or service provision.

As most of us know from our own experience, however, it's not that simple. Competition in free markets only works as advertised if no one has enough power to set prices. The power to influence prices can come through market share, or through unequal information between buyers and sellers. The closer a market is to a monopoly (only one seller), or a monopsony (only one buyer), the more unfair outcomes will be, and the greater the opportunity for profit — usually through a combination of underpaying workers and overcharging consumers, or through exploiting others lacking power.

During the so-called free-market era starting in the early 1980s, governments reduced regulations, slashed corporate taxes and taxes on wealth, weakened labour protections, reduced social transfers, and generally shaped markets to benefit the few. The results of this global experiment are clear. A "free market" will always distribute more wealth to the top, because people at the top always end up with more power and influence. We need a neutral actor to intervene and put a stop to extreme inequalities and redistribute wealth fairly across society.

Myth No. 2 Increase the size of the pie, and everyone will benefit

The second myth is if the economy grows – measured by gross domestic product (GDP) – everybody will benefit because they'll get a bigger slice of the pie. This myth claims that government should focus on growth and not on wealth redistribution, because redistribution is simply taking some of the existing pie from the better off to give to others.

But big corporations may grow their "productivity" by finding ways to pay workers less for the same output, or by turning to automation. Either way, their gains come out of workers' pockets. A corporation's growth does

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not necessarily mean more jobs or higher wages for workers. Usually, rich CEOs and shareholders reap most of the benefits of that growth. In 2019, the average CEO in Canada earned more than 200 times the average worker's pay – a dramatic increase from 1998 when that ratio was 104:1.

A pie is also a bad metaphor for how the economy actually works. Economist Kate Raworth has used an analogy of a doughnut – with the outside of the doughnut representing finite natural resources and the inside representing our social foundation. Any model that removes people, unpaid care work, public infrastructure and our natural environment from an understanding of the economy is bound to come out with the wrong answers.

Myth No. 3 The "trickle down" of wealth from the top benefits everyone

The third myth we often encounter is that if we cut taxes for the richest or for big corporations and make them better off, the benefits will "trickle down" to the rest of us. Investors and corporations will reinvest their tax savings, create jobs and grow our economy.

A study by London School of Economics economists David Hope and Julian Limberg, published in December 2020, analyzed more than 50 years of tax cuts for the richest in 18 of the major European and North American OECD countries and found very conclusively that the trickle-down theory is false. Tax cuts don't stimulate growth or create jobs, they just increase inequality.

If we want to improve the quality of life of everyone in Canada, including the richest among us, we need to ensure that the wealthiest individuals and big corporations pay their fair share, instead of giving them more money.

Myth No. 4 Taxing the wealthy constitutes theft

The myth that raising taxes on the wealthy is a kind of theft rests on the premise that these people deserve to keep their money because they worked for it, earned it, and should not be taxed more just because they have been successful. The super-rich themselves often argue we should not ask them to pay more, because they created our jobs and wealth (see Myth 3, above); they often threaten – implicitly or explicitly – to leave the country if they have to pay more.

Governments have shaped markets to allow this extreme accumulation of wealth, at the expense of the rest of us, and they have a responsibility to rewrite the rules to make the system more fair. Businesses benefit from important public infrastructure such as roads, railways, ports and airports, but they also benefit from government-sponsored social programs. In other words, the government does not steal money from the richest when it collects higher taxes; it collects a return based on the contribution of public infrastructure to private profits.

Changing the system

These myths are persistently cited despite clear evidence that they are false. They are used to deny inequality or justify inaction, which in today's world rivals climate denial as an effort to deflect action on issues that demand urgent attention. Those holding great wealth and power have no interest in changing the system; indeed, they will fight such efforts. If we want to change things, there is a lot of work to be done.

This is an excerpt from Angella's new book Share the wealth! How we can tax Canada's super-rich and create a better country for everyone*, co-authored with federal New Democratic Party Director of Policy Jonathan Gauvin. Want to read more? Ask your public library to order a copy or consider ordering one through a local independent bookstore.*

Taxing capital gains would raise billions for public services

The way the Canadian tax system is structured helps the rich get richer. It also robs us of billions of dollars in revenue we need to pay for strong public services and infrastructure. The most extreme example of this is how capital gains are taxed.

Capital gains are taxed at a much lower rate than employment income, and even at a lower rate than dividends. Comparing how these forms of income are treated shows us how extreme the capital gains benefit is for the wealthy.

Capital gains and dividends are both forms of income that come from wealth rather than employment. Capital gains come from the increase in the value of property, usually real estate or stocks, at the time of sale. Dividends are a portion of a company's profit that is passed on to shareholders. Most countries tax capital gains at rates higher than or equal to dividends, but Canada is a notable exception.

The amount of tax paid on dividends is calculated using the recipient's marginal tax rate. However, the tax paid is reduced by a dividend tax credit. The credit is meant to account for corporate income tax that is assumed to have been paid. This means dividends are almost always taxed at a lower rate than employment income, because the dividend tax credit assumes the company paid the statutory corporate income tax rate, rather than using the actual, and lower, effective tax rate. The size of this tax loophole depends on the ability of the firm to reduce its tax owing, either through legitimate deductions, aggressive tax avoidance strategies, or in some cases, outright tax evasion.

Originally, capital gains were not subject to personal income tax at all. The 1966 report of the Royal Commission on Taxation recommended that income be taxed at the same rate no matter its source, with the chair, Kenneth Carter saying, "a buck is a buck is a buck." By the time tax reform was implemented in 1972, many of the commission's recommendations had been watered down, with only half of income from capital gains made taxable. The proportion of capital gains considered taxable increased to 75 per cent by 1990, but the federal Liberal government cut it back to 50 per cent in 2000.

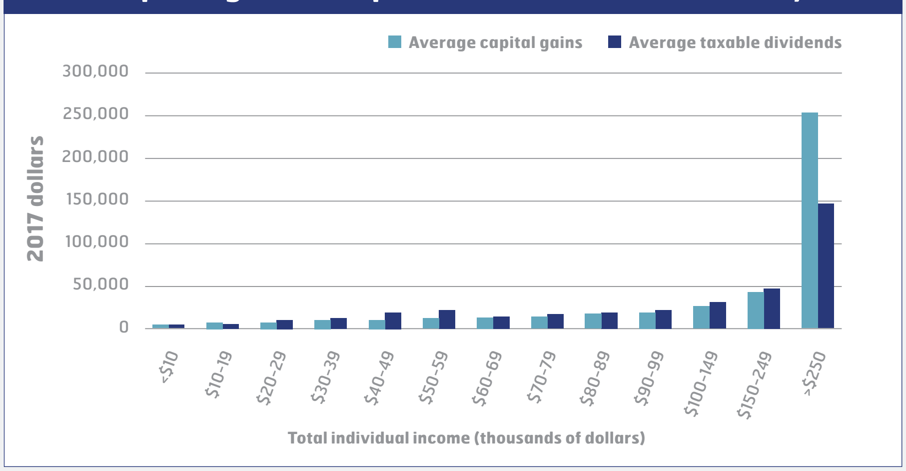
This chart shows the average capital gains and taxable dividends for individual income groups. It only includes people who had income from these sources. As this data reveals, income from capital gains is even more unequally distributed by income level than income from dividends, which might be expected given the more favourable tax treatment.

Even though they are very different forms of income, creative accountants can set up structures that turn corporate income into capital gains – called 'surplus stripping.' Being able to cut your tax rate in half and earn income tax-free provides a very strong incentive for rich people to establish this kind of avoidance structure. Academic research estimates that 88 per cent of the benefit of this loophole goes to the top one per cent of income earners.

There is no evidence that justifies this favourable tax treatment for capital gains. Since capital gains are based on the value of the property, there is no corporate income tax that has already been paid in the same way that there is for dividends. Those in favour of the status quo will argue that investors should be rewarded for the risk they take in making investments, but research shows that taxing a higher proportion of capital gains does not discourage investment.

By returning the capital gains inclusion rate to 75 per cent, the federal government could raise $10 billion in additional revenue every year that we could use to make smart investments in much needed public services. It would also make the tax system more fair for us all.

Capital gains loophole benefits the wealthy



Source: Canada Revenue Agency T1 Final Statistics, Table 3, 2019

A closer look at measuring inflation

The Bank of Canada tracks three alternative measures of the Consumer Price Index (CPI) to better understand what is happening with prices in our economy. These alternative measures try to look beyond changes that are temporary or that only affect one item in the CPI basket but that likely won't spread to other goods and services.

It is useful to understand the Bank's forecasts when bargaining. The Bank's understanding of how prices will vary influences their decision on setting the interest rate. That, in turn, affects workers in several ways. A higher interest rate tends to slow economic growth, moderate wage growth, and make governments more hesitant to spend.

The Bank's three inflation measures are:

CPI-trim – excludes CPI items whose rates of change in a month are much bigger or smaller than the average changes. This helps filter out extreme price changes affecting specific CPI basket items.

CPI-median – measures the price change at the midpoint, or 50th percentile, of the range of price changes. This filters out extreme price changes at the top and bottom of the range.

CPI-common – tracks price changes that are common to different CPI basket categories, using a statistical model to filter out price movements that have a specific cause and are not influencing broad changes. For example, if the price of computers increased temporarily because of a breakdown in a chip manufacturing facility, that would not affect other prices, and so would be excluded from this measure.

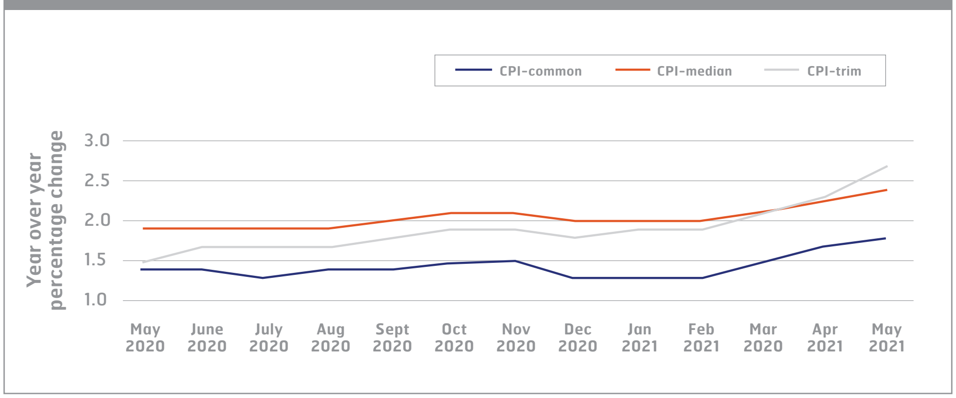
All three measures have increased over the first half of 2021, which is expected as the economy rebounds from public health restrictions in place for most of the past year and a half. All three measures are also well within the Bank's target inflation range of one to three per cent, but CPI-trim is nearing the upper limit. This should level off soon – what we are seeing here is partly base year effects (when inflation numbers are deceptively large, because they're being compared to a temporarily low price level). Since the indicator is a year-over-year change, and last year was unusual and extreme, we will have to interpret CPI-trim with caution for the rest of 2021.

Economists are predicting that Canada will have an overall average CPI increase of 2.6 per cent for 2021, with prices rising faster in Atlantic Canada.

Base wage increases in 2021 have been slightly lower than 2020 in most provinces. Alberta is a notable exception since their average base wage increase in 2020 was only 0.1 per cent, and in 2021 it has been a much healthier 2.4 per cent.

This means that for most workers, wages aren't keeping up with inflation. CUPE provides members with a tool to measure inflation and to check if their wages are keeping up with changing prices in their region. Find it at **cupe.ca/cpi-calculator**.

Bank of Canada measures of core inflation



Source: Bank of Canada, www.bankofcanada.ca/rates/indicators/key-variables/inflation-indicators/

Wage and price increases

	Canadian average	Federal	NL	PEI	NS	NB	QC	ON	MB	SK	AB	BC
Average base wage increase in major settlements, 2020	1.6	2.2	--	--	1.7	--	2.3	1.1	1.2	1.4	0.1	2.0
Average base wage increase in major settlements, 2021	1.5	2.0	2.0	--	--	--	2.0	1.0	1.2	1.1	2.4	2.1
Inflation average 2020*	0.7	--	0.2	--	0.3	0.2	0.8	0.7	0.5	0.6	1.1	0.8
Inflation average forecast 2021**	2.6	--	3.2	3.4	3.5	2.8	2.9	2.5	2.2	2.6	2.3	2.4

Wage settlements from Labour Canada. 2021 wage settlements include data from January to June

*Statistics Canada. Table 18-10-0005-01 Consumer Price Index, annual average

**Based on the latest forecasts by RBC to June 9th, 2021

ECONOMIC BRIEFS

National Housing Strategy Falls Short on Affordability

The Parliamentary Budget Office (PBO) published an evaluation of the federal government's National Housing Strategy in August and found that the strategy is falling short of its goals on a number of fronts. For example, once inflation is taken into account, the planned spending for helping out low-income households has actually fallen by 15 per cent, and funding for new social housing units has fallen 42 per cent. As part of the National Housing Strategy, the Canada Mortgage and Housing Corporation (CMHC) has shifted to contributing capital to developers for new builds, rather than to provide ongoing affordability supports. This strategy has resulted in a much lower bang for our buck in terms of affordability, with every $1 in government spending only resulting in 38 cents of benefits for low-income renters. It also contributes to the financialization of rental housing, making investments in real estate even more profitable for investors, and housing less affordable for renters. Finally, there have been significant delays in getting money invested in projects, with only half of planned spending being allocated over the past three years. Clearly, relying on incentives to the private sector is a failed approach to building affordable housing, and the federal government should change course as soon as possible to avoid making the problem even worse.

Canadians agree – It's time to share the wealth

A survey commissioned by the Broadbent Institute finds that an overwhelming majority of Canadians think that the pandemic made income and wealth inequality worse. A lucky few are profiting during the pandemic, and some big corporations are taking advantage of programs intended to help those who are struggling. The good news is that Canadians also support a variety of tax measures to help address the growing divide, and 89 per cent even say that it could influence their vote in an election. CUPE and allies are working on making sure that tax fairness is an election issue, check out the campaign at **www.broadbentinstitute.ca/tax_the_rich**.

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ECONOMIC DIRECTIONS

Base year effects — The dramatic economic impact of the COVID-19 pandemic will make it more challenging to track economic indicators and interpret their meaning this year. Many indicators are expressed in year-over-year growth, and there were sudden and sharp changes in these indicators last year. The timing and direction of last year's changes will have to be taken into consideration when interpreting this year's indicators.

Economic growth — The Bank of Canada has forecast that economic growth in Canada will be 6.0 per cent this year, and 4.5 per cent in 2022, assuming no further lockdown measures are required through the fall of 2021. Canada's economy will be a beneficiary of stimulus spending in the US especially.

Jobs — Employment for service sector workers rebounded somewhat in June and July, as most provinces eased public health restrictions. The labour market has still not fully recovered, especially for self-employed workers, with the national unemployment rate at 7.5 per cent. Long-term unemployment remains high, as more than four hundred thousand people have been without work for six months or more as of July 2021.

Wages — Both public sector employers and private sector employers are likely to be reluctant to move on wages. As prices for food and shelter are continuing to rise, it will be especially critical for workers to stand firm on the need for real wage increases.

Inflation — Overall inflation has picked up, but it remains to be seen how much of the price pressure is temporary and how much is permanent. The overall Consumer Price Index (CPI) for May 2021 was 3.6 per cent, higher than the Bank of Canada's target, but this is mostly because of base year effects. The Bank of Canada expects that supply bottlenecks will keep inflation around 3 per cent for the rest of 2021, but this pressure should ease in 2022 with inflation falling closer to 2.0 per cent.

Interest rates — The Bank of Canada has indicated that it expects to keep its key lending rate at 0.25 per cent through to the end of 2022. Government borrowing remains affordable, with 30-year federal government bonds selling at 2.0 per cent interest.