Economic Impacts of Taxation

Estimated using the General Equilibrium Model of the MFQ

Ministère des Finances
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Primary objectives of the tax system and estimation

- Primary objective of the tax system:
  - Fund public spending and maintain state functions

- Effect of the tax system and assessment criteria
  - Costs to taxpayers
  - Income redistribution
  - Effect on competitiveness
  - Impact on behaviour
  - Location of tax bases

- simplicity
- fairness
- efficiency
Efficiency and tax mix: two approaches

- For a given level of total revenue, what is the tax mix that minimizes the economic costs of a tax system?

- For a given level of total revenue, can taxes be rearranged in a way that benefits economic activity?
MFQ General Equilibrium Model

- Structure and operation of the model
- Strengths and limitations of the model
- Interpretation of results
Estimation of the impact of taxation on economic efficiency using the GE model of the MFQ
Short-term impact on real GDP

Impact per dollar of tax reduction with no effect on revenues

- Tax on capital: 0.72
- Personal income tax: 0.55
- QST: 0.44
- Payroll tax: 0.41
- Corporate income tax: 0.29
- Total*: 0.54

Assumption: The government's revenue loss is offset by a lump-sum tax.
Source: General equilibrium model of the ministère des Finances du Québec (MEGFQ).
* Corresponds to the combined impact of a proportional reduction in all taxes.
Impact per dollar of tax reduction with no effect on revenues

Assumption: The government’s revenue loss is offset by a lump-sum tax.
Source: General equilibrium model of the ministère des Finances du Québec (MEGFQ).
* Corresponds to the combined impact of a pro-rata reduction in all taxes.
Tax efficiency

◆ The tax on capital is the most damaging for economic activity:
  – Short term: increases the cost of capital and the risk of investments
  – Long term: reduces investment and the attraction of capital

◆ Corporate income tax:
  – Short term: increases the cost of capital and the value of benefits allowed by CCA
  – Long term: reduces investment and the attraction of capital
Tax efficiency

- **Personal income tax:**
  - Short term: reduces the incentive to work and disposable income
  - Long term: reduces the incentive to save and invest

- **Payroll tax:**
  - Short term: increases the cost of labour and reduces employment
  - Long term: reduces return and investment

- **Québec sales tax (QST):**
  - Short term: reduces real disposable income of households
  - Long term: little effect on saving and investment
The impact of the tax system on economic activity differs from one category of tax to another.

Rearrangements of the tax structure could improve economic performance.

However, it should be noted that this analysis covers only part of the overall issue of taxation

- Efficiency is not the only criterion for assessing the tax system