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	simplicity
Income redistribution	fairness
Effect on competitiveness	
Impact on behaviour	efficiency
Location of tax bases	

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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?

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MFQ General Equilibrium Model

- Structure and operation of the model
- Strengths and limitations of the model
- Interpretation of results

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Estimation of the impact of taxation on economic efficiency using the GE model of the MFQ

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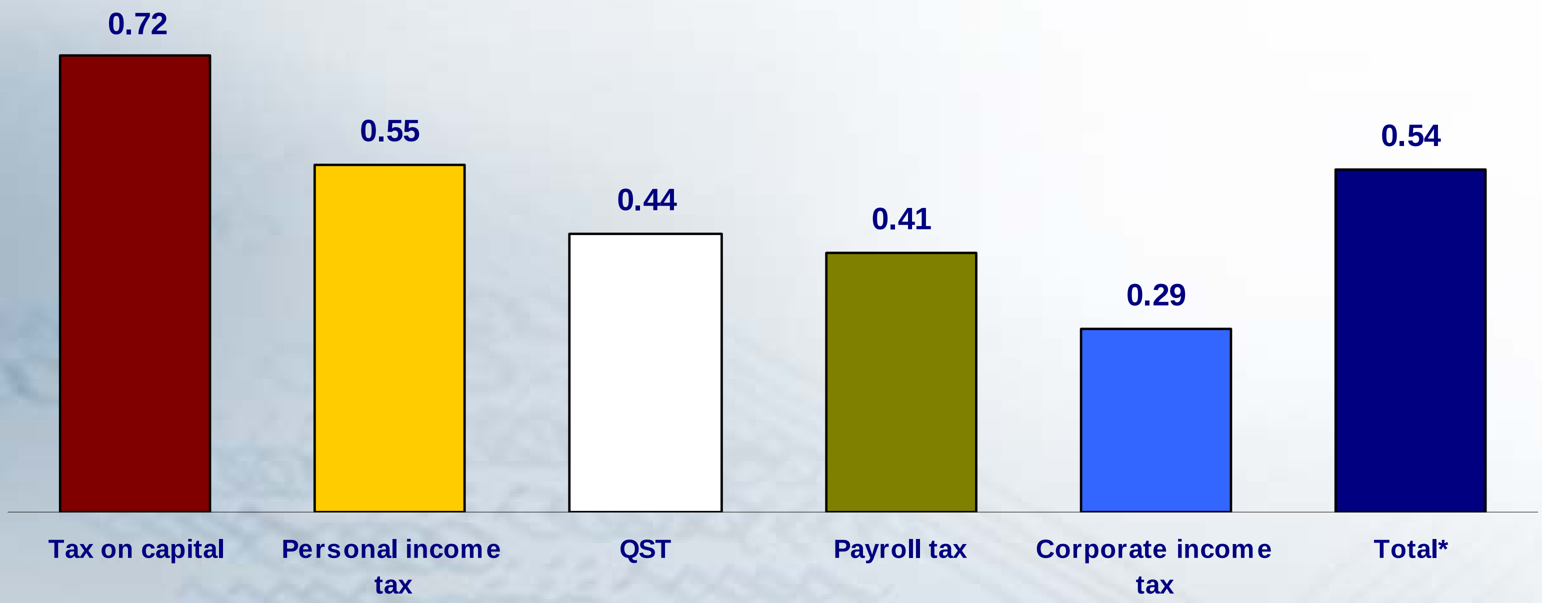
Short-term impact on real GDP

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 proportional reduction in all taxes.

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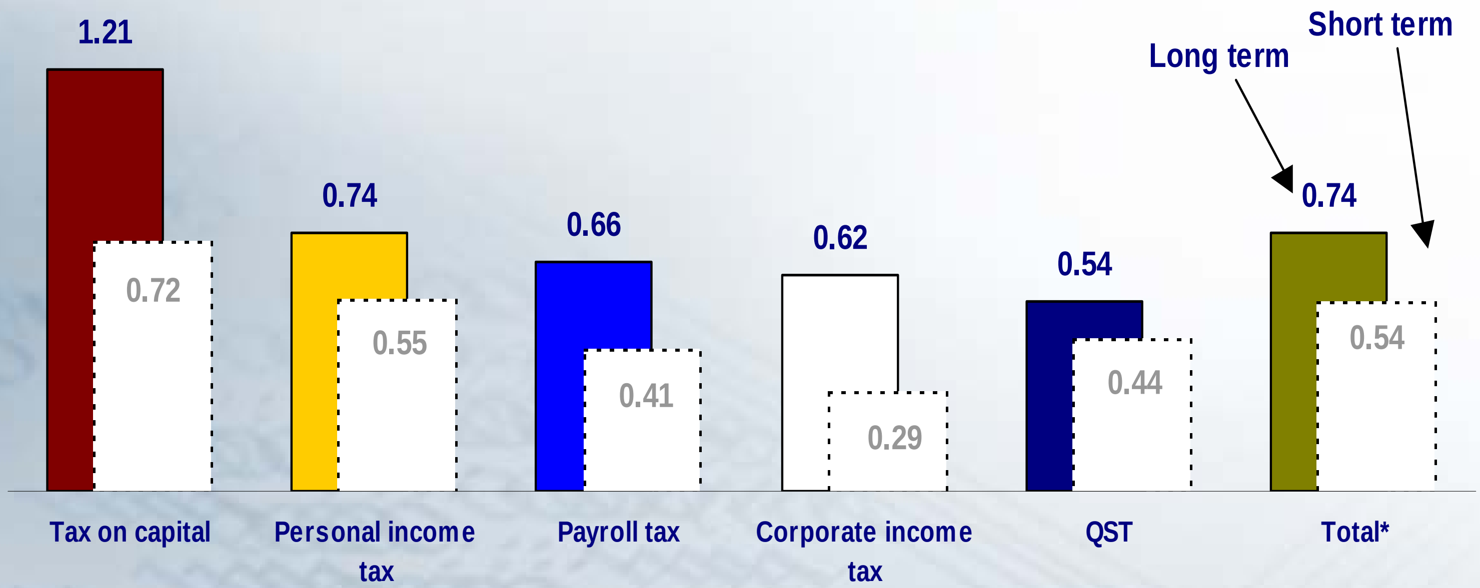
Long-term impact on real GDP

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.

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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

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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

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Economic efficiency and tax mix: Concluding remarks

- 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