Intelligence MEMOS

From: Bev Dahlby

To: Albertans Concerned about the Budget

Date: November 19, 2019

Re: **The Evidence That Corporate Tax Cuts Work**

While most of the commentary on last month's Alberta budget remains focused on the expenditure restraints intended to return the province to a balanced budget in 2022, a central piece of the government's economic program is the reduction in Alberta's corporate tax rate.

That cut, phased in by one percentage point per year from a current 12 per cent to 8 percent in 2022, has been subject to ill-informed criticisms from some labour leaders, including the assertion that a corporate tax cut "has never worked anywhere, ever." Such assertions are inconsistent with recent reputable economic studies, summarized here, which indicate that corporate income tax cuts have a major impact on growth, employment, and workers' well-being.

While many of the most relevant studies for Alberta are based on the state-level experiences with tax cuts in the US, Ergete Ferede and I have also found in our studies that higher corporate taxes reduce the growth rates of the Canadian provinces. In our recently published School of Public Policy paper, we developed an econometric model of the factors that affect the Canadian provinces' growth rates, based on data from 1981 to 2016. We found that four years after a one-percentage point reduction in a provincial corporate income tax rate the economic growth rate increases by 0.12 percentage points and real per capita GDP increases by 1.2 percent over time.

Applied to the Alberta tax cut, our econometric model indicates that the growth rate of real per capita GDP in Alberta would increase by 0.92 percentage points in 2022 and by 0.28 percentage points in 2029. This would translate into a 2.5 percent increase in real per capita GDP of in 2022 and 6.5 percent in 2029 with employment increases of approximately 58,000 in 2022 and 172,000 by 2029. These results are very similar to those we found using an econometric model of provincial economic growth that we published in 2012 in the *National Tax Journal*, the leading US academic journal on tax policy. This means that our current simulation results are robust because the 2012 study was based on a data set from an earlier time period and used a different econometric model.

Concerns have been expressed about the wisdom of cutting the corporate income tax rate in light of Alberta's large fiscal deficits. However, critics have exaggerated the revenue reduction by failing to acknowledge that the tax cut will spur an increase in economic activity, generating revenues that will substantially offset the loss from the initial tax rate cuts.

Based on our previous study of the tax sensitivity of provincial tax bases, we estimate that the four-percentage-point reduction will reduce total tax revenues by about $350 million per year in the long run. While a $350 million reduction in revenues is significant, it is small in the context of the Alberta's current and projected deficits.

Any discussion of the role of the corporate income tax needs to acknowledge that it is a "high cost" source of revenue because high corporate tax rates diminish the income-generating opportunities for Albertans.

Cutting the corporate income tax will increase investment in machinery and equipment and other forms of capital, raising workers' productivity and ultimately their wage rates. My colleagues, Ken McKenzie and Ferede, have found that for every one-dollar reduction in corporate income tax revenues, aggregate wages in Alberta will increase by 95 cents per hour in the long run. Therefore, cutting the corporate tax rate, even though there is an urgent need to reduce the provincial fiscal deficit, is justified because of its positive impact on economic growth and employment opportunities for Albertans.

Bev Dahlby is Research Director and Distinguished Fellow, Tax and Economic Growth, the School of Public Policy University of Calgary. He is a Research Fellow of the C.D. Howe Institute and was a member of the Blue Ribbon Panel, which published its report on the province's fiscal situation in September.

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