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Payroll Taxes

The issue of payroll taxes has come to the forefront recently, particularly with regard to the fate of the Canada Pension Plan. A recent study by Statistics Canada looked at the evolution of payroll taxes in Canada and compared levels and rates of taxation across provinces and between countries.1 The study found that payroll taxes have increased substantially over the last 30 years, but that they are still lower than in other countries.

Payroll taxes in Canada are basically composed of four components: Unemployment Insurance (UI) premiums, Canada/Quebec Pension Plan (C/QPP) contributions, Workers Compensation (WC) premiums, and the provincial health/post-secondary education (H/E) tax that is imposed by Quebec, Manitoba, Ontario and Newfoundland. The UI and C/QPP components are taxes on both the employers and the employees, whereas the other two components are taxes on the employers only. The UI and C/QPP are both federal taxes, while the WC and H/E taxes are administered provincially. British Columbia does not impose a payroll tax on health or post-secondary education, but it is one of only two provinces in Canada (Alberta being the other) that charge health insurance premiums. These premiums are not considered a payroll tax since employers are not legislated to pay them, but rather do so on a voluntary basis (or through collective bargaining agreements).

Figure 1 displays a comparison of the average payroll taxes per employee for 1966 and 1993 by province in constant 1993 dollars. Clearly, the payroll taxes per employee have increased dramatically in each province. It is also obvious that there are wide variations between provinces. Not surprisingly, the four provinces with the H/E component have the highest per employee average. British Columbia has the next highest figure, but it is still below the Canadian average.

Average Payroll Taxes per Employee by Province, 1966 and 1993
(1993 Constant Dollars)

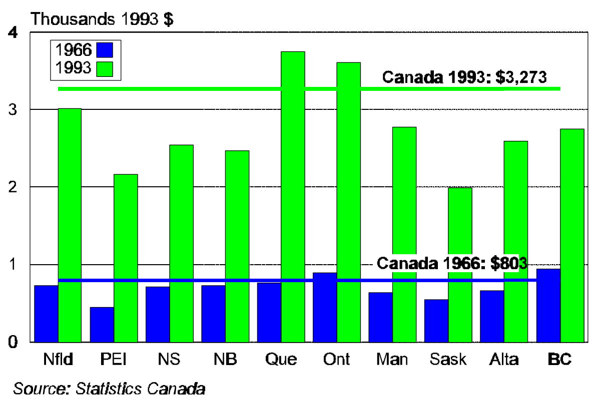
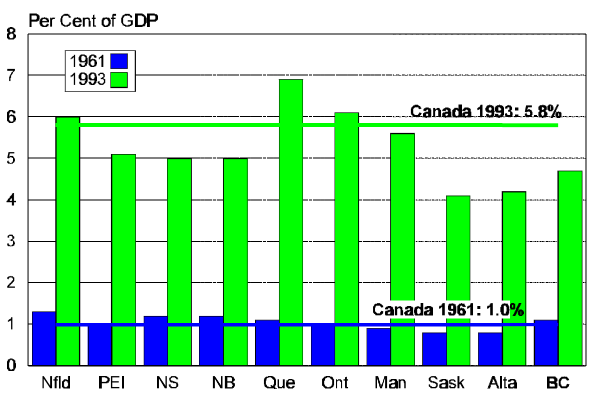


Figure 1

1 Lin, Z., Picot, G. and Beach, C. (1996), *The Evolution of Payroll Taxes in Canada: 1961–1993*, Research Paper Series, No. 90, Analytical Studies Branch, Statistics Canada.

Not only have payroll taxes increased per employee, but also as a share of government revenues and as a percentage of the Gross Domestic Product (GDP). In British Columbia, payroll taxes as a per cent of government revenue increased from 4.6 per cent to 11.5 per cent from 1961 to 1993. The national figures changed even more, from 4.1 per cent in 1961 to 14.4 per cent in 1993. Figure 2 displays a comparison of payroll taxes as a per cent of GDP in 1961 and 1993, by province. Once again, it is clear that payroll taxes have increased substantially for all provinces. The three Western provinces had the lowest ratio of payroll taxes to GDP in 1993, and British Columbia was the third lowest in Canada, in contrast to 1961 when it was among the highest in Canada.

Payroll Taxes as a Per Cent of GDP by Province, 1961 and 1993



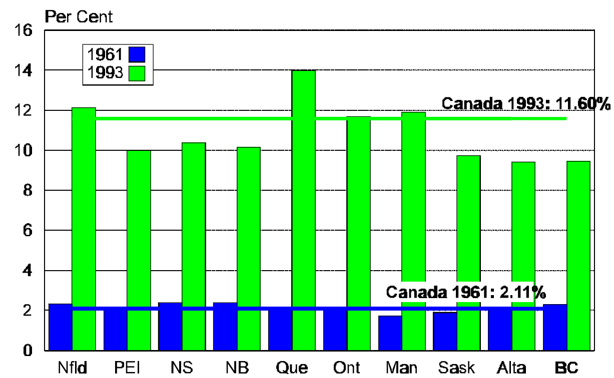
Source: Statistics Canada

Figure 2

In order to compare payroll tax rates across provinces, an effective payroll tax rate was calculated by taking the total of all payroll tax revenues raised in each province as a percentage of the total wages and salaries for that province. Figure 3 displays the effective payroll tax rates by province for 1961 and 1993. British Columbia had the second lowest effective rate in Canada at 9.46 per cent, marginally higher than Alberta at 9.42 per cent. By comparison, the national rate was 11.60 per cent, with Quebec leading the way with the highest effective payroll tax rate, at 14 per cent. Figure 4 shows that, although British Columbia's effective payroll tax rate has been climbing steadily since 1961, it has grown at a much slower rate than Canada as a whole since the early eighties.

In British Columbia, the component that contributed the most to growth in payroll taxes over the 1961 to 1993 period is UI, with CPP not too far behind. This was true for Canada as a whole as well. UI took over from CPP as the largest component of payroll taxes in the mid-seventies. From 1961 to 1970, CPP was responsible for all growth in payroll taxes, but in the next decade, UI and workers compensation took over. During the eighties, UI was once again the big driver for growth in payroll taxes, and this has continued to be the case up to 1993.

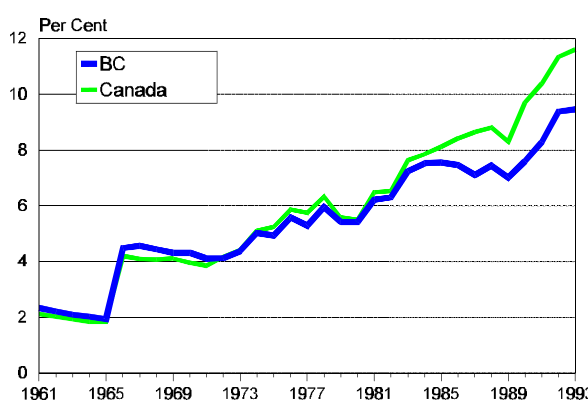
Effective Payroll Tax Rates by Province, 1961 and 1993



Source: Statistics Canada

Figure 3

Effective Payroll Taxes, British Columbia and Canada, 1961-1993



Source: Statistics Canada

Figure 4

The Canada Pension Plan may once again become the driver for expansion of payroll taxes as concern develops over the fund being drained dry under the inevitable sudden rush of retiring baby-boomers. With the considerable increase in people collecting CPP, combined with a relative decline in people contributing to the Plan, there is a possibility that it could break down if remedial actions are not taken. There are a few possible options, including raising the premiums, cutting benefits and delaying the age at which benefits can be collected. However, all these options have possible serious consequences.

Reducing benefits and raising the retirement age could have the effect of placing the elderly in a precarious position financially and many could face poverty. On the other hand, a substantial increase in CPP contributions could result in significant job loss. Since the CPP is comprised of equal contributions from both the employer and the employee, an increase in contributions translates to an increase in the cost of doing business. This leaves the employer with two choices: either reduce the cost of business by reducing labour costs, or increase revenue to counteract the increased cost. The employer could reduce labour costs by either reducing the size of the work force, or decreasing wages. To bring in more revenue, the employer could increase prices of the end products. The end result is that the employees would end up paying the brunt of the cost, either through job loss, or reduction in real wages.

In addition, there is a danger that as payroll taxes increase, there will be an increasing polarization of weekly hours of work. This is because C/QPP contributions and UI premiums[2] are not fully proportional to wages and salaries. Rather, they start at a set minimum and stop at a set maximum. This gives employers an incentive to reduce costs by increasing work hours for some and reducing work hours for others so that those core employees that are absolutely necessary to operations will be well over the maximum wage level and will only contribute to that point, while other employees will remain under the minimum and will not have to contribute at all. In this way, even though salary costs may be the same, the amount of payroll taxes paid will be far less.

Figure 5 shows that this polarization has already been occurring to some extent.[3] The proportion of workers in the 30 to 49 hours per week range has been shrinking (from about 64

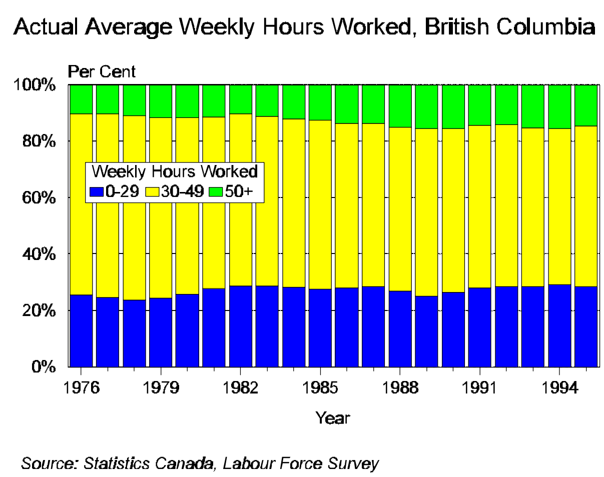


Figure 5

2 Recent changes to the legislation have removed the floor for UI premiums. That is, there used to be a minimum of 15 hours per week worked before UI premiums kicked in, but now there is no minimum, so wages for even one hour of work a week will be subjected to the premium. It is difficult to say if this will have any effect on the trend toward polarization since the maximum limit remains with UI, and the C/QPP still has a minimum and a maximum limit.

3 The data on this chart is by person, rather than by job, and may understate the number of part-time jobs since there are many cases where people take on two or more part-time jobs in an effort to create full-time employment for themselves. For this reason, the lower end of the scale may be understated, which means the actual degree of polarization may be greater than indicated in the chart.

per cent in 1976 to around 57 per cent in 1995) and those working hours outside that range have been increasing as a proportion of the total labour force. Those working greater than 50 hours per week have increased their proportion the most, from about 10 per cent to around 15 per cent. There are other possible reasons for the polarization, such as the increase in the number of self-employed, for example, but anecdotal evidence suggests that payroll manipulation is a significant factor.

Although certainly there are costs to increasing payroll taxes in the form of job loss and polarization of the labour force, the costs of underfunding the Canada Pension Plan could be more serious. There may be other measures that can be taken such as fixing flaws in the Plan, but it is likely that some increase in the compulsory contribution rate will be necessary. Some argue that payroll taxes are already too high, but as Figure 6 shows, Canada has the lowest payroll taxes as a per cent of GDP of all G-7 nations, and one of the lowest among OECD (Organization for Economic Co-Operation and Development) nations.

The effects of payroll taxes are certainly worth further study, particularly since they seem to be growing as a form of program funding. The introduction in recent years of payroll taxes to protect funding for education and health care is an indication of this growth. If governments continue to use payroll taxes as a source of revenue, it is important to determine the effects on jobs, wages and prices, and whether an alternative form of taxation might better do the job.

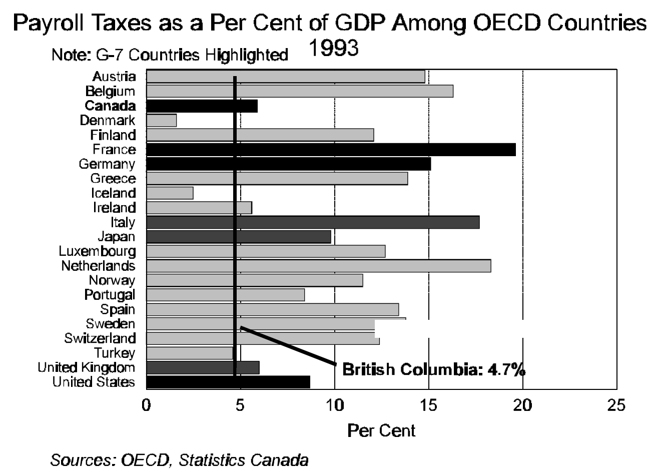


Figure 6