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Dear Readers:

Happy New Year!

I hope you had a wonderful holiday season and that you are energized to start another semester!

This issue features two of our student contributors. William Dunstan presents a fascinating piece on wealth taxes and Brennan Sorge discusses Canada’s Consumer Price Index. In addition to these two articles, this issue also highlights a recent infographic on the new Fraser Institute study on forest fire activity in Canada and a video from the Fraser Institute’s Essential Robert Nozick series, “A Framework for a Free Society.”

We’re also including a thought-provoking quote from the late Walter E. Williams, two exciting blog articles, and two more recordings from the Explore Public Policy Issues webinar series for your enjoyment.

If you or someone you know wishes to contribute content to the Canadian Student Review, please have them contact me directly at Ryan.Hill@fraserinstitute.org.

Regards,

Ryan
In light of the COVID-19 recession and the related deep fiscal deficits, as well as growing concerns about economic inequality within the developed world, wealth taxes have received renewed attention as a policy option. A wealth tax is a tax on an entity’s net worth – i.e., the value of any assets that they own, minus their liabilities. Wealth taxes are usually designed to target wealthy individuals and households. Middle-income earners are often shielded from such taxes through exemptions on certain amounts or forms of wealth. For example, the tax might not apply to fortunes below $2 million, or to the value of an individual’s principal residence. Is implementing such a tax a good option for governments? No. Economic theory and the experience that various countries have had in taxing wealth suggest that wealth taxes fail to deliver on the promise of a fiscal windfall courtesy of the rich.

The first difficulty with taxing wealth is identifying it. It can be challenging for authorities to determine how much an art collection is worth, for example, or the value of shares in a company that is not publicly traded. Taxes are easiest to collect when they are levied on transactions for which one party has an incentive to accurately report details; for example, taxes on labour function smoothly because employers have a financial incentive to report the wages that they pay (Kopczuk, 2019). This is not the case for wealth taxes, which people have an incentive to avoid paying by under-reporting wealth. Consequently, wealth taxes can be costly to administer and can miss large sources of potential revenue.

More concerning is the negative impact of wealth taxes on economic decision-making. As with any tax, those it targets have an incentive to avoid the tax by relocating themselves and their assets to countries that do not impose such a tax. The particular trouble with wealth taxes is that they target people and activities that are easily able to cross borders; capital is very mobile and high-income professionals and investors are the economic actors best placed to relocate or to separate their residence from their place of work (Cross, 2020). The French wealth tax, which was scrapped in 2017, illustrates the costs of tax avoidance. It drove so much economic activity out of the country that the tax revenue it lost exceeded the revenues it generated; in other words, the tax reduced overall government revenue (Pichet, 2007).

Wealth taxes also distort a country’s remaining economic activity. If governments place an additional tax on the purchases of company shares – which a wealth tax does – this reduces returns on investment. Lower returns, in turn, may push people who would otherwise contribute to the nation’s future productivity through investing in growth-enhancing economic activities to instead spend their money on immediate consumption; for example, through purchasing clothing or jewelry. Pichet (2007) estimates that the French wealth tax reduced GDP growth by 0.2 percent per year. A study of 20 OECD countries in the 1980s and 1990s revealed similar, albeit smaller, negative effects on growth (Hansson, 2010).
These realities force governments that do introduce wealth taxes to keep the rates low. Governments that tax wealth must carefully avoid chasing away other tax revenue-generating economic activity. It is for this reason that wealth tax regimes rarely impose rates above 1 percent per year, and tend to include generous exemptions (Hansson, 2010). The aforementioned French wealth tax reduced government revenue while imposing a top marginal rate of 1.8 percent, along with exemptions and a system of progressive rates that set the tax levied on most wealth far below the top rate. As a result of these constraints, few countries collect more than 1 percent of their total tax revenues through wealth taxes (Hansson, 2010).

In summary, wealth taxes have limited capacity to remedy our economic and fiscal ills. Even a relatively substantial wealth tax is unlikely to generate significant revenue and may, as was seen in France, ultimately reduce government revenue. When we further consider the negative impacts of wealth taxes on economic growth, these policies appear quite damaging. It is little wonder, then, that the majority of OECD countries that had a wealth tax in the 1990s have since abandoned it.

Proponents of wealth taxes often imagine a role for these policies that extends beyond raising government revenue; namely, they intend for wealth taxes to reduce economic inequality. Without commenting on what constitutes an acceptable level of economic inequality, there is a strong case against using wealth taxes to combat disparity. First, economic inequality in Canada is less severe than headline figures on wealth distribution often lead people to believe. While it is true that two-thirds of wealth in Canada is held by the top 20 percent of households and that the bottom quintile own less than 1 percent, these figures reflect age-based patterns in wealth accumulation more than true economic inequality (Sarlo, 2017). Most people maintain relatively stable levels of consumption throughout their lifetime even as the amount of income that they save varies. Young people and retirees generally consume more than they save, financing this consumption by saving – i.e., accumulating wealth – throughout their working
lives. Plenty of Canadians who own no wealth at 25 will be among the wealthiest 20 percent by the time they retire, and will enjoy a consistent quality of life throughout.

Second, even if reducing economic inequality remains a policy objective, the administrative challenges posed by wealth taxes, their limited or even negative impacts on government revenue, and their growth-retarding tendencies make them a poor mechanism for achieving these aims. The goal of reducing economic inequality is presumably to improve living conditions for the lower and middle classes. However, given that wealth taxes fail to generate significant revenue, they can, at most, enable only minor increases in wealth transfers and social spending. Wealth taxes might bring in more money if they allow for fewer exemptions, but this would increase the burden on less well-off individuals and would therefore be counterproductive to the goal of economic redistribution. Lastly, a sustained reduction in economic growth brought on by a wealth tax would depress future living standards and future governments’ ability to spend – hardly bettering anyone’s living conditions.

Ultimately, wealth taxes generate little government revenue and impose significant fiscal and economic costs. They are a poor way to fund government or to alleviate the (often overblown) problem of economic inequality. Wealth taxes simply aren’t worth it.

William Dunstan is a Public Affairs and Policy Management student at Carleton University. He has a passion for the power of markets to improve people’s lives and for developing policy that allows this to occur.
A FRAMEWORK FOR A FREE SOCIETY

THIS VIDEO EXPLORES ROBERT NOZICK’S FRAMEWORK THAT WOULD ALLOW FOR COUNTLESS PERFECT SOCIETIES WITHIN WHICH PEOPLE COULD WILLINGLY CHOOSE TO LIVE—AND LEAVE—AS THEY WANTED.

WATCH VIDEO HERE

EPISODE 6
A Framework For Society
In recent years, a common public perception has emerged in Canada, especially among those who are younger or lower income. These Canadians are often facing major life expenses, such as paying for university or buying their first home, while also having almost no assets to fund their purchases. With prices for homes increasing at a historically rapid pace and university tuition costs increasing faster than inflation, many Canadians often see major purchases like homeownership as out of reach (Statista, 2020; Better Dwelling, 2020). So, when the Bank of Canada reports that Canada’s inflation rate is near or below two percent, many Canadians are dubious; the figure doesn’t correlate with their own experience as they observe prices rising faster than their earning or savings potential.

In August, the Bank of Canada (BoC) recognized that many Canadians perceive inflation to be higher than the figures the bank releases (Carmichael, 2020, August 26). To solve this perception gap, the bank made some adjustments to the basket of goods used to calculate inflation, such as reducing the importance of gasoline and air travel given changes in consumer behaviour during the pandemic. This strategy may be missing the root cause behind Canadians’ loss of faith in the inflation index. During the pandemic shutdown, when our economy experienced one of the worst contractions in living memory, housing prices reached all-time highs, rising rapidly despite the substantial challenges posed by the pandemic and even as the BoC expressed concerns about low inflation rates. At the same time, there was no deflation in university tuition fees. These major purchases, among others, are usually debt financed, and are inflating. Canadians can feel the effect, even though it doesn’t seem to appear in the official inflation figures (Trading Economics, 2020a; Rate Inflation, 2020).

Two questions follow from the gap between Canadians’ perception of inflation and the actual figures. First, why does this gap exist, and second, what, if anything, should be done about it? The first question is easier to answer. Canada tracks inflation based on the Consumer Price Index, or CPI, a “basket” of goods that the average Canadian would regularly buy on a monthly basis, including costs like rent and insurance. Rising amounts of consumer debt don’t show up as inflation even though they do have an impact on the financial wellbeing of Canadians.

In other words, the substantial increase in housing costs experienced before and during the pandemic will not be seen in the inflation figures because of the substantial drops in interest rates we have experienced. However, that increase in home prices means that Canadians are carrying more debt, and likely for a longer period (Trading Economics, 2020b). They are financially less well off as a result of the debt they hold, even though their monthly expenses may not have changed.
What should be done about the gap between perception and the actual figures is a harder question to answer. Public confidence in the CPI can be restored and the perception gap closed. Shifting the CPI’s basket of goods to better reflect consumer spending would be an improvement, but more can be done. The largest area for the number-crunchers to address is the rising cost of housing. Canadians experience the effects of inflation in the housing market through rising home prices, as well as consequentially rising minimum down payments and larger debt loads. Such key consumer costs should be reflected in Canada’s inflation statistics.

Adding these new components to the CPI would be a large step towards addressing the perception gap between Canadians’ experience of inflation and the numbers that are presently reported. Placing greater weight on goods that are financed by consumer debt may be an important avenue by which to help close the CPI perception gap and restore faith in its reporting.

The concerns Canadians have over inflation are real. Statistics should help to identify the source of those concerns, and accurately reflect the financial challenges that Canadians face. When Canadians take on larger debts to make the same purchases they did in the past, they are experiencing inflation, even if lower interest rates keep the monthly costs of servicing that debt down. If the Bank of Canada is genuinely concerned about the growing number of Canadians who are losing faith in the CPI, it should address this deficiency and take better account of the growing costs of major debt-driven purchases like housing.

Brennan Sorge is currently an economics and business student at Thompson Rivers University. His interests centre on the effects of law and policy on the economy, and he hopes to act on these interests in further study of both economics and law.

REFERENCES
FOCUS ON ECONOMIC GROWTH AND THE MILLENNIALS WILL BE ALL RIGHT

NIELS VELDHUIS AND JASON CLEMENS

Much ink has been spilled on the narrative that millennials and other future generations of Canadians may experience lower living standards than preceding generations. A recent study on wealth inequality, however, challenges this narrative.

In reality, from 2010 to 2019, millennials have enjoyed greater increases in wealth than other generations of Canadians. That fact raises the question—why do the Trudeau Liberals (and their governing partner, the NDP) want a wealth tax?

In Does Canada Need a Wealth Tax?, Philip Cross, former chief analyst at Statistics Canada, finds that “wealth inequality” in Canada has diminished over the past decade. That is, the share of wealth (assets minus liabilities) held by lower-income groups has increased while the share held by upper-income groups has decreased.

Specifically, from 2010 to 2019, among the five Canadian household income groups, wealth increased by 77 percent for the lowest income group, 89 percent for the second-lowest, 91 percent for the third-lowest, 68 percent for the second-highest and 66 percent for the highest income group. As a result, the share of wealth held by the lower three income groups has increased from 27 percent in 2010 to 29.5 percent in 2019.

Now, some may argue that because lower-income groups have less wealth a higher percentage gain is not as meaningful. And yes, most of us would rather have more wealth (and a smaller percentage of wealth growth) than low wealth and a high percentage of growth.

But the wealth story doesn’t end here.

Age of course has a large impact on income and wealth. People in the earlier stages of life and in their careers (e.g., millennials) typically have lower incomes and have not yet accumulated significant wealth. Over time, with a robust economy, good job prospects, and upward income mobility, that changes.

Consider these facts based on Statistics Canada data. Between 2010 and 2019, the total wealth of the baby boomers increased by 65 percent (to $5.8 trillion) compared to 189 percent (to $3.2 trillion) for generation Xers and 464 percent (to $1.0 trillion) for millennials.

In other words, millennials already have a trillion dollars in wealth, equal to roughly 17 percent of the wealth of boomers.

Of course, most millennials would rather have wealth equal to the boomers, but with a strong economy, they will get there. If anything, the data reveal great prospects for millennials. They’re not doomed, like so many falsely claim.

What they need, and what our government should focus on, is the right economic environment—one that leads to higher rates of economic growth. Indeed, more growth with more opportunities and higher wages for young Canadians is the surest way to a
more prosperous future. It's not by penalizing wealth through increased taxes.

As the Cross study spotlights, wealth taxes have many adverse effects including discouraging savings, investment and entrepreneurship, and therefore stunting long-term economic growth.

Historically, wealth taxes also provide little government revenue—they tend to exclude most taxpayers and the rate can't be too high otherwise wealthy households simply shift their wealth to other jurisdictions. And wealth taxes are also expensive for governments to collect (they require lots of bureaucrats and tax collectors).

Finally, many countries have experimented with taxing wealth with disappointing results. “France recently eliminated its wealth tax,” writes Cross, “after concluding its three-decade experiment had mostly resulted in an exodus of wealthy people from the country.”

In Canada, housing and pension assets comprise the largest sources of household wealth. That's why it's so concerning that the Canada Mortgage and Housing Corporation (CMHC), a Crown corporation, gave the University of British Columbia $250,000 to “research solutions to housing, wealth, and inequality,” including research on a federal home equity tax.

Rather than promoting economic growth, the Trudeau government seems distracted by a false notion of wealth inequality in Canada. Unfortunately, the government’s mix of higher taxes, more government involvement in the economy, and indebtedness has not produced a robust economy (pre-COVID) as promised. GDP and income growth have slowed, business investment has collapsed, and there are worrying signs for entrepreneurship. Changing course will help create the conditions for a more robust economy that will provide young Canadians with opportunities and higher wages. Do so and they will continue to save and indeed become wealthier. ✅

Read the blog post here.

Jason Clemens is the Executive Vice President of the Fraser Institute. He has an Honors Bachelors Degree of Commerce and a Master’s Degree in Business Administration from the University of Windsor as well as a Post Baccalaureate Degree in Economics from Simon Fraser University. He has published over 70 major studies on a wide range of topics, including taxation, government spending, labour market regulation, banking, welfare reform, health care, productivity, and entrepreneurship.

Niels Veldhuis is President of the Fraser Institute. He has written six books and more than 50 peer-reviewed studies on a wide range of economic topics. He has written more than 200 articles that have appeared in over 50 newspapers He holds a Bachelor's Degree in Business Administration, with joint majors in business and economics, and a Master’s Degree in Economics from Simon Fraser University.
Forest Fire Activity in Canada from 1959 to 2019
PRIOR TO CAPITALISM, THE WAY PEOPLE AMASSED GREAT WEALTH WAS BY LOOTING, PLUNDERING AND ENSLAVING THEIR FELLOW MAN. CAPITALISM MADE IT POSSIBLE TO BECOME WEALTHY BY SERVING YOUR FELLOW MAN

— WALTER E. WILLIAMS
PROVINCES SHOULD REMOVE TRADE BARRIERS TO ACCELERATE ECONOMIC RECOVERY

JAKE FUSS

When developing an economic recovery plan, Canadian policymakers must advance policies that will increase productivity, living standards, and prosperity. Removing interprovincial trade barriers is one of best ways we can accelerate this recovery.

Over a period of several decades, government policies have created substantial barriers to investment, trade, and migration among the provinces and territories. These barriers restrict the flow of products, services, and workers. Often, these barriers serve no valid purpose yet they hinder growth across the country.

Barriers to trade include differences in regulations, certification requirements for professions, credential recognition, and provincial monopolies over the distribution of alcohol. Each province or territory has unique policies in these areas, which hinder trade, lower productivity, reduce worker mobility, and raise prices for goods and services.

Indeed, research estimates that interprovincial trade barriers add between 7.8 percent and 14.5 percent to the prices of goods and services Canadians purchase. Put differently, these barriers add more to your shopping bill than the GST.

Clearly, the Canadian economy would benefit from reduced trade barriers that allow businesses to shift resources more easily to areas where goods and
services can be produced more cheaply. Moreover, eliminating such barriers would increase trade flows, expand productive firms, decrease prices, and raise household incomes.

Recent findings from the International Monetary Fund show that Canada could increase its overall economic productivity by 3.8 percent nationally through the elimination of internal trade barriers. This represents an aggregate increase in Canada’s economy of almost $90 billion annually—more than $2,300 per person. Specific provinces may experience even greater gains with an estimated productivity boost of 12.8 percent in Newfoundland & Labrador and 16.2 percent in Prince Edward Island.

So how can we reduce trade barriers?

Provinces can move toward freer trade by engaging in more bilateral or multilateral partnership agreements, which seek to harmonize regulations and improve labour mobility. The New West Partnership Trade Agreement (NWPTA) between British Columbia, Alberta, Saskatchewan, and Manitoba already represents a positive step in this direction. Other provinces could join to expand this agreement or pursue their own multilateral or bilateral deals.

Another option is for provinces to unilaterally reduce trade barriers. The Alberta government, for instance, removed several self-imposed barriers last year. If other provincial governments followed suit, they would also see economic gains from making imports cheaper.

Post-COVID, Canada must pursue a growth agenda that enhances both our productivity and living standards. As such, provinces across Canada must recognize that internal trade barriers hinder our economy and that their removal will help fast-track and strengthen our recovery.

Jake Fuss is an Economist at the Fraser Institute. He holds a Bachelor of Commerce and a Master’s Degree in Public Policy from the University of Calgary. His research covers a wide range of policy issues including government spending, debt, taxation, labour policy, and charitable giving.
Creative Destruction, Entrepreneurship, & Discovery
Russell Sobel

What exactly does it mean to be an “entrepreneur” and how do disruptive innovations affect the economy? Based on the work of noted economist Joseph Schumpeter, Dr. Sobel’s presentation explores the different definitions of entrepreneurship, the contrast between invention and innovation, and how creative destruction has reshaped the world in which we live. 

Link to Russell Sobel’s Recording

The Mystery of Capital
Hernando de Soto

“The hour of capitalism’s greatest triumph,” writes Hernando de Soto, “is, in the eyes of four-fifths of humanity, its hour of crisis.” In The Mystery of Capital, the world-famous Peruvian economist takes up one of the most pressing questions the world faces today: Why do some countries succeed at capitalism while others fail? In strong opposition to the popular view that success is determined by cultural differences, de Soto finds that it actually has everything to do with the legal structure of property and property rights. In this presentation, de Soto will discusses his persuasive book that revolutionized our understanding of capital. 

Link to Hernando de Soto’s Recording
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