

Intelligence MEMOS



From: Glen Hodgson
To: Canadian taxpayers
Date: May 3, 2019
Re: **THE CASE FOR RATIONAL TAX REFORM**

Canada's tax system should be a cornerstone of strong economic performance, encouraging private investment, higher personal savings and high levels of labour force engagement and work effort while also addressing social priorities such as reducing child poverty.

However, populist and opportunistic politics too often drive changes to the tax system, instead of considered analysis about what's best for long-term economic and employment growth and a healthy society. Is it possible to change how tax policy is made and refocus it on the potential benefits to the economy and society?

All too often, proposed changes have been designed first and foremost to win popular support, regardless whether there is any hard evidence that it would be good for the economy and society. Numerous recent examples spring quickly to mind.

The Conservative promise more than a decade ago to cut the GST rate may have been good politics, but precisely opposite to economic policy consensus. Lowering sales tax rates encourages more consumption, which does nothing to boost long-term savings, private investment and potential growth – as many private-sector economists reminded the government. Economic analysis suggests sales tax rates should be raised and personal income taxes cut to improve incentives to work and save.

Politically inspired tax policy has cut across party and ideology. For example, increasing the top income tax rate was justified by the current Liberal federal government as a way to improve tax fairness. However, the increase means taxpayers in every province east of Saskatchewan now take home less than 50 cents of every additional dollar earned above \$210,000 when combined with provincial income taxes. The economic literature suggests a higher top marginal income tax rate may not automatically yield a windfall in related tax revenues or in fairness.

Another result of incessant political intervention is a patchwork of tax incentives and expenditures, many of which have never been adequately assessed to determine if they are actually achieving their objectives. The result is in an unduly complex Canadian tax system that lacks transparency and is expensive to administer, for both government and taxpayers.

The latest example of opportunistic tax politics crowding out good tax policy is carbon pricing. Economists generally support putting a price on carbon because it is the most economically efficient way to reduce greenhouse gas (GHG) emissions. Putting a price on them creates an incentive to innovate and to modify behaviour – consumers can avoid paying the tax by reducing their emissions.

Using the price system to change incentives was once considered a conservative idea. But if you don't like price signals, the remaining policy options to reduce GHGs are to impose burdensome regulations on business that will eventually also affect consumers, to use subsidies to pick winners in some sectors or to hope for technological breakthroughs.

History shows that political leaders are able on occasion to look past the short term and achieve alignment between successful tax politics and good tax policy. The Harper government successfully reduced corporate income tax rates to improve Canadian business competitiveness, with little serious negative public response.

Ontario's Liberal government successfully harmonized its sales tax system with the federal GST and B.C. Liberals (arguably really Conservatives) successfully introduced a carbon-tax system. Both governments were re-elected. The B.C. economy is now outperforming every other province, so it is hard to argue that carbon taxation has impaired its growth.

What should we do to reduce the central place that inferior tax ideas often occupy in political popularity contests? The Canadian Chamber of Commerce recently called for a royal commission on tax reform.

Another approach would be to create a continuous tax review or advisory process separate from the political cycle, where expert and evidence-based analysis could help to develop proposed reforms to the tax system – ideally not just federally, but also provincially and at the municipal level. Serious non-partisan research and public engagement would be critical to its success.

Politicians are not going to give up their power to tax, but at least we could create a more transparent process of shaping tax policy advice based on expertise, not opportunism.

Glen Hodgson is a senior fellow at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

The views expressed here are those of the author. The C.D. Howe Institute does not take corporate positions on policy matters.