Comments on the Paper by Robert D. Brown

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This is at least the third occasion on which I have followed Bob Brown on a tax panel. I also followed him as chair of the Canadian Tax Foundation. Long ago, I learned that in whatever capacity Bob is acting, his is a hard act to follow.

Bob's articulate attack against our high overall and high marginal rates of personal income tax is not a new idea to us or to him. At a Canadian Tax Foundation conference held more than 11 years ago, he said:

> I believe that high tax rates, which are inevitably accompanied by incentives and special treatments, result in a very high cost to the economy through distortions in investment decisions. I have . . . a firm belief in the positive economic effects of lower tax rates . . . [This view] is the product of 30 years of observation of a vast wasteland of misguided tax incentives, special treatments, and general boondoggles that have littered our fiscal history and wasted untold billions in public and private resources.[1]

We can see from his remarks today that Bob has not lost his ability to make quotable comments, as he has been doing for 40 years. Anyway, I agree with Bob on this point.

That quotation from the 1987 conference does not specifically mention international competitiveness as a pressing reason for reducing the rates of personal income taxes in Canada. But Bob's paper today does emphasize that point. Too often the international aspects of proposed tax reforms are considered as an afterthought, if at all. This point was made at the same tax conference by Richard Bird, when he said:

> [T]he international dimension of taxation should be the starting point for serious tax policy analysis in an open economy such as Canada, not something to be optionally added on at the end.[2]

The much-talked-about "brain drain" is an important part of this issue, but only a part.

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[1] Robert D. Brown, "Overview," in Jack Mintz and John Whalley, eds., *The Economic Impacts of Tax Reform*, Canadian Tax Paper no. 84 (Toronto: Canadian Tax Foundation, 1989), 443-50, at 450.

[2] Richard M. Bird, "Tax Reform in Canada: Some Continuing Issues and an International Perspective," in Canadian Tax Paper no. 84, supra footnote 1, 433-42, at 435.

I agree with what I take to be Bob's thesis that a significant reduction of overall and marginal rates of personal income tax is not a separate issue from, but rather an integral part of, tax reform. Not only is it politically difficult to sell a combined package of "tax reform" now and the promise of tax reductions somewhat later (witness the public reaction to the introduction of the goods and services tax), but genuine reform is not likely without addressing a major defect in our present tax system, which is the high tax rates. This is not to deny the point made by Jon Kesselman[3] that a restructuring of the tax base is also called for.

Our governments continue to profess that their objective is a substantial reduction in personal tax rates. But as far back as most of us can remember—and some, such as Bob and I, can remember back quite far—governments have asked us to wait until their revenues have improved to the point where meaningful tax reduction becomes possible. We are still waiting—but not as patiently as before. Far be it from me to recommend that we now abandon the balanced budgets that have finally been achieved with great effort by the federal government and, if we talk about realistic budgeting, a few of the provincial governments. But too often we take a static, cut-up-the-present-pie approach to public finance. The level of taxes does have a profound influence on economic activity, even though that influence is hard to isolate, in empirical studies, from a host of other variables.

One of the reasons why the US economy is so much more productive than ours, as Bob pointed out, is the difference in prevailing tax rates. And the productivity gap is likely to continue to widen so long as a significant tax-rate gap remains. Our objective should be to generate the needed government revenues with lower tax rates. If we implement significantly lower taxes—particularly marginal taxes—now rather than later, we will kickstart the economy to higher growth rates, which will enable our governments to maintain their programs. Granted, there will inevitably be a time gap between the reduction in rates and the effect on the economy, which we will have to deal with. While I agree with Bob that debt reduction needs attention, I believe we should give priority to tax reductions until such time as a consequent growth in government revenues permits significant reductions to be made in the public debt. There is no better time to implement such a reform than now, when inflation, unemployment, and interest rates are lower than they have been for years and when the economy is achieving steady (if unspectacular) growth. In the meantime, as well, governments must avoid the temptation to embark on new and costly expenditure programs.

The Canadian public seems to have become more sophisticated than it has been in the past when it comes to the arithmetic of public finance. It is no longer a short way to political gain for a government in power, particularly with an election approaching, to promise voters a variety of

[3] The paper by Jonathan Kesselman follows these comments.

new expenditures without regard to their effect on the public debt or consequential high tax rates. While, in theory, tax reductions should be politically popular, they still need to be implemented with sensitivity. My delight in seeing my taxes reduced can easily be more than counterbalanced by the impression that other taxpayers are benefiting from tax reform far more than I.

There will always be different views on the appropriate level of progressivity of personal income tax rates. In my opinion, progressivity in those rates is an important principle reflecting values that are widely shared in this country. But it should be possible to lower tax rates generally without sacrificing progressivity. The appropriate degree of progressivity, of course, remains open to debate. It does not follow that highly progressive top rates, distorted by so-called temporary surtaxes, are the ideal or the norm and that their reduction or elimination is part of a conspiracy by the elite. We should keep in mind, of course, that the most important question here concerns the degree of progressivity of the tax system as a whole rather than of any of its individual components.

The "flat tax," which Bob referred to, that is to be introduced at the provincial level in Alberta is an interesting experiment and will no doubt be closely watched by other provinces, if not by the federal government. Unless the claimed simplicity of a flat tax system is to be abandoned, however, it will almost inevitably lessen the progressivity of the personal income tax. As well, as Bob points out, significant relief of the present high marginal tax rates can go a long way toward achieving the incentive advantages claimed for the flat tax while avoiding many of its serious drawbacks.

Relief for low-income taxpayers, while trumpeted almost every year at budget time, is still inadequate. And high effective marginal rates create a very bumpy road that must be followed in escaping from the poverty trap. The objective should not be getting more low-income taxpayers off the tax rolls, as government budgets frequently boast, but getting them onto the tax rolls by encouraging them to take steps to increase their incomes and by imposing only modest rates of tax on incremental incomes above a basic sustenance level.

Bob's call for a longer-term fiscal plan is one that our governments should heed, though admittedly there has been some progress in government budgets of recent years by projecting fiscal figures beyond the coming year. Individuals and businesses, in planning to make investments and in choosing careers and places of residence, must make commitments that involve a consideration of middle- and long-term prospects. The assurance that we will maintain a stable tax system and the prospect of gradually decreasing tax rates would be enormous incentives, just as our past history of tax turmoil has been a serious and underrated disincentive. I agree as well that it is artificial and unwise to attempt to separate personal and business tax reform; but, unfortunately, meaningful reform of the business tax is likely to reduce government revenues and may need a relatively long phase-in period.

One pressing need is to provide a greater degree of tax incentive for saving. Not only has the federal government been lagging in increasing the maximum contribution to tax-deferred plans, but relief is also required for the taxation of the return on savings that themselves have been fully taxed. And Jon Kesselman's proposals on this question seem to me to have a great deal of merit. The aging population referred to in Bob's paper underlines the need to address this issue.