Special Report, Part 4: Proceedings of a Conference on Personal Income Tax Reform—Social Transfer and Retirement Issues, the Politics of Personal Income Tax Reform, and Closing Comments

The following papers by Robert D. Brown, Ken Battle (with comments by Thomas A. Wilson and Richard Shillington), Satya Poddar and Morley English (with comments by James B. Davies and Ian C.W. Russell), and Allan Maslove constitute the fourth and final part of the Canadian Tax Foundation's publication of the proceedings of a conference on personal income tax reform, which was held in Ottawa on April 9-10, 1999.

The conference launched the Foundation's first intensive look at comprehensive personal income tax reform—an issue that has important implications for how governments finance public services as well as for individual Canadians concerned about their tax burden. Aimed at academics, public policy analysts, and federal and provincial government officials, the conference looked first at the need for reform, the process of reform, and the relationship between personal income taxes and other federal, provincial, and local taxes. Then the focus moved to the specifics of reform: the base, the rates, indexation, and interactions with the social transfer system. The appropriate treatment of retirement savings and the broader issue of the tax treatment of savings rounded out the formal papers.

The papers presented at the conference have been published over several issues of the *Canadian Tax Journal*, starting with the volume 47, number 2, 1999 issue. In this issue, the final part of the special report on the proceedings presents various discussions on social transfer and retirement issues, an examination of the politics of personal income tax reform, and closing comments.

Personal Income Tax Reform and Politics

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As we are all aware, taxation and political processes go together like apple pie and cheese. Taxation is something that affects everyone in the community, both directly—in the pocketbook—and indirectly, through the government programs financed by that taxation. With the final two papers on personal income tax (PIT) reform, the intriguing issue of the politics of PIT changes becomes even more evident.

Taxation policies are, in some sense, only a derivative in the political process. A country, or a political subdivision, first makes important policy choices in other areas—social programs, defence, governance, and so forth—and then determines its tax policies so as to raise the revenues necessary to fund those programs and support them. But from its very beginnings, taxation has been used not only to raise revenue, but also to reinforce policies in other areas. Therefore taxation and changes in taxation, especially the traumatic upheavals that come from those changes, are inextricably linked with the whole of the policy choices and political processes of a modern state.

I would like first to comment briefly and personally on the interrelation of political processes with taxation and tax reform. My comments are generic, in the sense that they relate to no particular government or level of government; they could apply to federal, provincial, or municipal tax policy.

Now, some academics and tax practitioners hold the view that politics interferes with good policy. Some have argued that political concerns and involvement lead to a less-than-optimum outcome in arranging our tax system. According to this view, the tax system adjustments made to reflect popular perceptions of equity and other goals, the heavy weight of popular myths about taxation, and the inevitable compromises associated with balancing the needs and desires of diverse groups in our society make the tax system less rational and more complex than it otherwise would be, and the task of reforming it substantially more difficult.

Nonetheless, as in so many other areas the ultimate truth is that the only thing worse than a tax system heavily influenced by politics would be a system that was not influenced by politics at all. The political processes

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provide a way, a rather imperfect and difficult way, to translate the thinking of policy theorists into a system that reflects how people feel and believe with respect to such issues as fairness and ultimate goals.

Even if tax policy analysts could agree on the perfect tax system (and these conference papers certainly confirm that there are vast differences of opinion on that subject) their conclusions would not be capable of being implemented if they ran against the public perception of justice and reason. A tax system that is manifestly unpopular—that is perceived not to be fair or reasonable—is a tax system that in any democratic process will not survive. And ultimately the aim of policy theorists must be not only to develop brave new ideas for reform, but also to explain and debate them in a public process so as to develop popular support.

There are, however, some aspects of the political process and its interrelationship with the tax and welfare system that do create special issues, with their own inevitable biases.

First of all, politics and the political process tend to concentrate on direct, immediate, and personal issues, as opposed to broader, longer-term, and structural concerns. The timing, in terms of popular concern, tends to be concentrated on the short view, rather than the long term; and the focus is on direct rather than indirect impacts. It is therefore essential that the tax policy debate bring into public perception—and therefore into our political processes—the longer-term and structural issues related to tax reform rather than just the obvious and immediate concerns, such as the desire for "a tax cut this year."

A related bias is the tendency of individual citizens to focus on the spending in government programs, rather than on the tax cutting. Taxpayers perceive a greater immediate benefit in any spending program that would affect themselves favourably than in an equivalent general cut in tax rates. If there is a choice between building a new bridge or using the equivalent money to finance a tiny but broadly based tax cut, those living near the proposed bridge will tend to support it over the tax reduction, whereas those living far from the bridge will tend to think the bridge less important than the tax cut.

A related feature of the political process is the "one-issue syndrome": that is that many individuals in our society, and therefore the politicians that serve them, tend to focus on one (or a few) issues or concerns. Those that desire urgently some particular "reform"—whether fairer taxation of the family, reduced capital gains rates, special treatment for a particular industry, or an immediate solution to the brain drain—want a fast solution to that particular problem. It is not a matter of immediate concern if that "solution" then creates 25 more problems. Their concern relates to a particular issue, not to the functioning of the tax system as a whole; they do not recognize the vital interrelationship of all the various issues.

How we define the problem tends to define the solution. If we define problems in narrow and immediate terms, we get different answers from those we get when we define problems in terms of more comprehensive concerns, issues of balance, and broad, long-term benefits.

A further issue is the pervasive myths that tend to influence popular perceptions of the tax system and tax reform. For example, people sometimes argue that cutting taxes in particular areas would really cost the government no money at all, since the increased stimulus from the tax cuts would boost economic activity and, therefore, the general revenue base. Unfortunately, that is simply not true as a general rule; only in a very unusual combination of circumstances would a particular tax reduction actually result in the same or higher revenues.

Also, in some quarters, there is the widespread belief that if progressivity in the tax system is good, the more progressive the tax system gets, the better it is. In the extreme, this view would mean that the perfect tax system would impose absolutely no tax on the first $35,000 or so of income, and then 100 percent of everything above that. The myth is that the tax system can get indefinitely more progressive without having adverse effects on incentives and economic processes.

Yet another issue is that government processes are by nature sequential and segmented. By that I mean that governments deal with problems, and problems do not arise all at once. Even if they did, one could not handle them all at once. Problems are lined up according to some sense of priority, and attempts are made to solve them one by one. Because of this, it is difficult to get a longer-term view of priorities and consequences.

Several papers have discussed the issue of the conflict between what might be called static and dynamic considerations. Static considerations relate to the present situation, and how it can be adjusted to be fairer, more efficient, and more productive, always starting where we are. Dynamic considerations look instead at the system as a whole, and deal with how we can manage change over time to get a better system with better results.

For example, if Canadians are concerned about what they perceive to be increasing inequality in income distribution, then the static approach would be to tax the rich more heavily, and give the money to the poor. But that approach inevitably results in higher marginal tax rates, reduced personal incentives, lower economic activity, and so on, with whole chains of consequences for society. Approaching the problem in a dynamic way, we should ask, first, why are some people poor, and then, what can we do to help them in terms of increasing job skills, building incentives, improving labour market flexibility, and targeting programs.

The political processes in a democracy are based on accountability, the accountability of governments to the electorate for the policies that the governments have put in place. But they can exercise this accountability better if they have articulated a broad framework of policies and objectives against which their performance can rationally be judged.

In the taxation areas, we deal inevitably with a broad range of complex issues that simply cannot be solved in a single year or even several years. To implement a lot of the possible changes that these conference papers have discussed will require years of time, judgment, consultation, and transition. One can fully evaluate these programs only if there is a well-defined plan as to what will happen over some period of time, against which both bureaucrats and politicians can be held accountable. No one can precisely see the future, particularly with today's pace of change, and it is therefore important to articulate some general idea of direction and priorities in the framework of working toward a better tax system for Canadians.

In the end, governments and politicians reflect the problems, difficulties, prejudices, and myths of the people of Canada. When we quarrel with particular aspects of tax policy development, we need to consider the causes of the programs and conclusions that we disagree with. Those who deal with the development of new issues and ideas in the tax reform process must accept the responsibility of bringing the debate to the public, exposing issues and concerns, developing a better understanding of issues, and debating the alternatives more broadly and more responsibly. Indeed, that has been the primary goal of both the conference and the papers published in these journal issues.