

# *Closing Comments: The Politics of Personal Income Tax Reform*

---

—Allan Maslove\*

When David Perry asked me to be the rapporteur for the conference on personal income tax reform, he asked me as well to fit my comments into the politics theme of this session. The idea of being the rapporteur—coherently extracting some themes out of the two days of discussion and out of the excellent papers presented—was intimidating. But balanced against that was the licence I was given to comment on some of the policy and political debates.

In this paper, I try to combine those two tasks, to highlight some of the themes that arose during the conference, and in the process to provide something of both a policy twist and a political twist. A political twist that is further twisted by an economist should be of interest in itself.

It has been interesting to see what issues appeared on the agenda and to note their origins. These issues included productivity; the brain drain; the individual versus the family as a unit of taxation; the compression of the income tax scale, with the top bracket being reached at about \$60,000; and the idea of a flat tax. To a lesser extent, there is the tax mix question, at least as framed by the media, focusing on the high rates of personal income tax. All these issues, which may well constitute the next tax reform agenda, have come out of the popular media and popular discussion.

I think there is an interesting distinction between that agenda and my reading of the history of previous reform exercises. In those previous exercises, the issues, as they were defined, were more likely to be generated internally within the tax community. It might be an overreach to call this change the democratization of tax policy, so I will not use that term, but it is an interesting distinction, and I look forward to seeing how it plays out in the coming months and, indeed, years.

The relationship between tax reform and tax reduction also merits comment. Robert Brown links the two in his paper,<sup>1</sup> and it is certainly correct in political terms to do so. Jonathan Kesselman notes in his paper<sup>2</sup> that

---

\* Dean, Public Affairs and Management, Carleton University, Ottawa.

<sup>1</sup> Robert D. Brown, "Tax Reform and Tax Reduction: Let's Do the Job Right" (1999), vol. 47, no. 2 *Canadian Tax Journal* 182-205.

<sup>2</sup> Jonathan R. Kesselman, "Base Reforms and Rate Cuts for a Revitalized Personal Tax" (1999), vol. 47, no. 2 *Canadian Tax Journal* 210-41.

one can achieve tax reduction through changing the base or restructuring, and that is certainly true as well. For the purposes of at least part of my comments, however, I would like to keep them conceptually separate, and think of “tax reform” as a change in the structure that is more or less revenue neutral, and distinguish that from tax reduction.

Thinking about some of the themes mentioned above, first of all the issue of productivity arose several times in the course of the conference. Productivity has mostly to do with tax reduction and a little bit with tax reform. We must ask first, do we have a problem with productivity in Canada? And second, if there is a problem, how is that related to taxation? I do not intend to answer those questions, but I start my comments on them by recalling Robin Boadway who cited Richard Bird’s admonition that the starting point for discussions of tax in a small open economy should be the fact that it *is* a small open economy. That this should be the starting point rather than an afterthought seems particularly relevant when we are discussing questions about productivity. Productivity, of course, is most directly related to real capital investment. In an economy characterized by very open international capital flows, the link between taxation and domestic saving and domestic investment is not at all clear. And on the other side, I would point out that a tax reduction to promote productivity must inevitably also make it more difficult for governments to invest in the physical infrastructure, human capital, and institutional capital that contribute to our productivity.

As for the brain drain issue, again I think it has mostly to do with tax reduction, not tax reform. After Neil Brooks’s paper,<sup>3</sup> what can one say about the brain drain? I am much less a zealot than Brooks is on this issue, but I think he is probably about right. The drain may not, in fact, exist, but beyond that, it is not clear that it is something we want to worry about, at least for tax purposes. Tiebout demonstrated more than 40 years ago that communities could have different service and tax bundles and need not be driven down to some lowest common denominator in doing so.<sup>4</sup> Much of that carries forward when we talk about countries in a globalized international economy. This is particularly the case when the mobility of people internationally is still much less than the full mobility that Tiebout assumed in his original article. So, as Brooks says, if some people prefer the American bundle of tax and services and others prefer the Irish bundle, that does not necessarily indicate a fatal tax problem. The question that arises and that may become more serious is the inverse: What happens if the brains stay at home, but they transfer much of their tax base beyond the reach of the jurisdictional authorities. This is becoming more feasible all the time. At this conference, several people have referred to this concern in one way or another. The increasing move we have noted here toward user

---

<sup>3</sup> Neil Brooks, “Comments” (1999), vol. 47, no. 3 *Canadian Tax Journal* 608-23.

<sup>4</sup> Charles M. Tiebout, “A Pure Theory of Local Expenditures” (1956), 64 *Journal of Political Economy* 416-24.

fees can be seen, at least in part—in large part perhaps—as a response to tax base mobility. User fees may be a means to keep the tax base at home.

Another issue on the agenda that really is a reform issue is that of the compression of the rate schedule, with the top marginal rate hitting at about \$60,000. It is not clear to me why this is an issue now, since it was perfectly predictable in the 1986-87 reform. It was clear then where the top marginal rate was going to be. But here we are nonetheless.

There is a bit of an interesting disconnect in public discussion of this point, though I am glad to say not at this conference. People bemoan the fact that the top marginal rate comes at \$60,000, yet in the next breath endorse the idea of a flat tax, in particular now the proposed Alberta flat tax, in which the top marginal rate comes at \$11,000. I find it curious how people express both sentiments.

The issue of tax progressivity is an important one and, for the political debate, a critically important one. If it were not essential for tax justice, as Neil Brooks would describe it, or if the issue of tax justice did not resonate for you, I think you would still have to accept it as essential for the political integrity and continuance of a system that relies heavily on voluntary compliance.

Finally on this point, the argument has been made here and elsewhere that the flat tax is progressive. Here I take the opportunity to exercise the licence I have been given. I think it is inaccurate to call a tax such as the proposed Alberta flat tax “progressive.” It is true that, given a basic exemption and a single tax rate, as an arithmetical artifact you get a progressive “average tax rate.” But in the literature, “progressivity” traditionally means progressivity at the margin. I do not think the flat tax proposals meet that criterion. Indeed, we call it a flat tax because it is not progressive.

Nevertheless, I think it speaks to the political importance of the ideal of progressivity that the proponents of flat taxes find themselves forced to put their case in those terms.

Another important issue has received a lot of attention here—the question of an income base versus a consumption base. This issue is not part of the popular discussion, probably because it is much more complicated technically. As Kesselman notes, we are probably already there for the bottom two-thirds to three-quarters of the income distribution (via the sheltering of savings), and indeed many of those taxpayers do not exhaust all the room they already have for sheltering savings. The issue is, should we shelter all the savings for the people at the very top, the highest income earners? Again, referring to this session’s theme of political feasibility, I would argue that a move in that direction, to meet some tests of equity and to be politically feasible, would have to be accompanied by meaningful wealth transfer taxes. We hear little about that part of the discussion, but I think that moving in that direction without some form of wealth taxation, in political terms at least, would certainly be a non-starter. And if we did move toward a consumption base with a wealth transfer tax, much of the putative benefit of sheltering savings would be, if not gone, certainly much diminished.

More basic is the issue that Satya Poddar and Morley English raise in their paper.<sup>5</sup> I learned years ago, at the time of the Fair Tax Commission, that when Satya Poddar speaks on an issue, he has a way of constructing a context that provides an unusual depth of content. We see that again here. This paper raises some basic questions about moving to one of the poles, in other words to a purer system of one type or another. If we are not going to do that, let's be clear about what it is that we want from our hybrid system—or our impure system, if you prefer. These really important questions may, I suggest, provide fodder for the next conference. But such a big and basic issue is not one easily opened up in a short comment.

Looking at less dramatic modifications of the existing personal income tax (PIT), I agree with the basic position taken by Robin Boadway and Harry Kitchen.<sup>6</sup> As a system that is an impure one, somewhere between one pole and the other, the PIT is fundamentally in pretty good shape. Some obvious technical issues need addressing, some of which have been raised here, such as averaging, the return to full indexation, and several others that Boadway and Kitchen identify in their paper. Returning therefore to my distinction between tax reform and tax reduction in that context, it is not yet clear to me whether the government will choose to embark on an explicit tax reform exercise—explicit in the sense that we had a tax reform exercise in 1986-87—or whether it will just tinker at the margins and do technical fixes in a series of budgets. It is much more clear, I think, that we are going to get personal income tax reduction, as distinct from reform, in upcoming budgets. Public pressure is increasing, and the government is likely to respond to that as it responded in the February 1999 budget to the demands for putting more money into the health system. (For better or worse I would add, but that is another topic.)

The question of reducing the personal income tax leads, of course, to the issue of the tax mix. It has been correctly pointed out that there is no theoretical statement that one can make about the optimal tax mix. But it is also true to say that Canada is somewhat of an outlier on this because it relies so heavily on the PIT. So we are likely, if only by reducing the PIT, to shift toward relying less on the PIT and relatively if not absolutely more on other taxes. It may be strange for someone with a personal preference for progressive income tax to say such a thing, but I would not be overly troubled if this were so. Nearly 50 years of incidence studies in this country have clearly shown that we do not get a whole lot of redistribution via the tax system. No matter what the tax mix has been over that 50-year period, the incidence of the tax system looks little different from one regime to another. As Boadway and Kitchen and others have pointed out, most of the redistribution to the poor and to the lower-income groups

---

<sup>5</sup> Satya Poddar and Morley D. English, "Canadian Taxation of Personal Investment Income" (1999), vol. 47, no. 5 *Canadian Tax Journal* 1270-1304.

<sup>6</sup> Robin W. Boadway and Harry M. Kitchen, "Personal Income Tax Reform in a Broader Context" (1999), vol. 47, no. 3 *Canadian Tax Journal* 566-602.

comes from the program side of government. (I use the term program side to include both expenditures as traditionally defined and refundable credits.) If we have to change the mix to maintain the fiscal capacity of governments to supply those programs, I think I would willingly accept that tradeoff.

Another session at this conference dealt with the federal and provincial joint occupancy of the PIT and the tax collection agreements. The papers in that session clearly reinforce the impression that I had before hearing their presentations: that the Canadian system of tax collection agreements works well. It is a model for other systems to emulate. The new shift to tax on base as opposed to tax on tax is an important improvement to that system—recommended, I might add, by the Fair Tax Commission and others both before and since. It follows from that, as Mintz and Poschmann<sup>7</sup> point out, that there will be a need for technical adjustments elsewhere in the tax system, and indeed elsewhere outside the tax system, such as in the equalization system. But those are relatively straightforward and not terribly contentious. The system of tax collection agreements itself works well, and the interesting questions that remain have to do with such issues as the extent to which we will see emerging a joint determination of the tax base in the future. Certainly more radical changes appear to be off the table. I think, Quebec always excepted, that separate provincial systems are now unlikely to emerge. Certainly, more radical ideas that one could have proposed, such as trading tax bases between the federal and the provincial governments, are just non-issues. Let's therefore not be shy about saying (un-Canadian though it be) that we have done something good here, and that other federations elsewhere have come to study how we have done it.

Finally, I want to refer briefly to the session on social policy delivered via the personal income tax, Ken Battle's<sup>8</sup> and Richard Shillington's<sup>9</sup> papers in particular. The issue that they grapple with, boiled down to basics, has been around since the late 1950s, when Milton Friedman and others were writing the first articles on negative income taxes: that is, the difficult tradeoff between, on the one hand, providing adequate support for poor and low-income people, and, on the other, keeping clawbacks reasonable so that we avoid punishing disincentive effects—and all that without breaking the bank. It is a very difficult problem, a very difficult set of tradeoffs. And the designers of the child tax benefit and other similar programs are essentially grappling with that problem. It is difficult, I think, because it is a problem for which there is no objectively correct solution. As society's preferences change, I think we are always going to be grappling with that

---

<sup>7</sup> Jack M. Mintz and Finn Poschmann, "Economic Aspects of Personal Income Tax Coordination" (1999), vol. 47, no. 4 *Canadian Tax Journal* 902-26.

<sup>8</sup> Ken Battle, "Child Benefit Reform: A Case Study in Tax-Transfer Integration" (1999), vol. 47, no. 5 *Canadian Tax Journal* 1219-57.

<sup>9</sup> Richard Shillington, "Assessing Tax-Transfer Programs" (1999), vol. 47, no. 5 *Canadian Tax Journal* 1263-69.

kind of an issue. Ken Battle comes down somewhat more in favour of providing adequate support and worrying less about the clawback rates. At other times, we might change the balance of that worry and, indeed, I am sure that today other people would not share Battle's view on the balance. But it is interesting that this problem, in one form or another, has been with us now for about four decades.

The papers presented at the May 1999 conference on personal income tax reform and published in this and the preceding three numbers of the 1999 *Canadian Tax Journal* have dealt with many important and interesting aspects of tax reform. These comments are some of my reflections on those discussions as well as on some of the political issues inherent in them.