Budget Surplus, Democratic Deficit

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The stated aim of this book is to provide "a political and economic context for a broad understanding of the principles, organization, and politics of Canada's tax system."[1] To assess how well it succeeds, it is necessary to understand that this book is not, and does not attempt to be, a discussion of technical tax issues. It uses the language of budget speeches, not the language of notices of ways and means motions or the language of tax lawyers and accountants.[2] Neither does it employ or discuss in a technical way the language or analysis of economics. Although the literature produced by tax policy economists has been surveyed and is referred to, it is not directly engaged. The book is rather a work of political science,[3] written from the perspective of what might loosely be called the "systems theory" approach to political studies, and it exhibits both the strengths and the weaknesses of that approach.

Systems theory essentially views a political community as a "system" that receives or processes inputs from the various players in the system, including interest and pressure groups, politicians, political parties and bureaucrats, and brokers,[4] or adjusts the conflicts between them, producing a series of "outputs" in the form of policies that both respond to external factors (such as international economic circumstances) and accommodate the various demands of the players. Systems theory emerged as an antidote to the overly rigid and formalistic approach to political science of studying constitutions, rules, parliamentary procedure, and the like. The strength of systems or brokerage theory is that it recognizes the importance of interest groups and pressure groups and the role they play in politics; to that extent, it produces a fuller and more useful description of the political process. The weakness of systems or brokerage theory is that it does not look beyond the system. The ideal system is stable and self-perpetuating, effectively accommodating or brokering the various input demands placed on it so as to maintain a consensus about

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the continuing existence and operation of the system and to avoid any disruption of the system. Systems theory also purports to be value-free:[5] it is not concerned with normative or purposive considerations—whether the outputs produced by the system are good or bad. Indeed, any output that tends to preserve the stability of the system tends to be viewed as, by definition, good. The result is that systems theory is profoundly conservative (in the sense of resistant to change) in not questioning the value of the outputs produced by a particular system.

The strengths of this book, and there are many, reflect the great virtue of systems theory, the realization that the study of politics is not merely equal parts law and history, but rather the dynamics produced by the participation of a large number of players both within and outside the formal machinery of government. In that spirit, the author sets out to describe, for the period from the late 1960s to the present, the various forces that have shaped the main elements of our system of taxation at the federal level, personal and corporate income taxes, and the goods and services tax. He provides a comprehensive and carefully written summary of the main changes and developments in Canadian tax policy in those areas during the period, with separate chapters describing developments during the terms of the Trudeau, Mulroney, and Chrétien governments (and a chapter dealing with the Mulroney government's foray into sales tax reform). The book then considers contemporary tax policy issues in separate chapters dealing with personal taxation, business taxation, federal-provincial financial relations, and policies relating to "civil society."

This is prefaced by an introductory section that describes the mechanisms through which the Canadian political system processes inputs relating to tax matters, principally the federal Department of Finance and the process of consultation through which federal politicians and the bureaucracy communicate with various groups in the budget-making process. The description in this section is heavily skewed to the Department of Finance, which the author virtually equates with the "tax policy community." This may reflect the results of the author's research program,[6] or the fact that political parties and interest groups are of decreasing importance to the formation of tax policy—a depoliticization, if you will, of the tax policy process, which is discussed further below.[7] The reader is also given a clear, non-technical summary of the general direction of tax policy in the period, well illustrated with statistical material that is generally easy to follow and presented at an appropriate level of generality.

Hale's description of the political process that affects tax policy thus contains remarkably little discussion of the role or function of political parties. The description (in chapter 5) of the public part of the policy-making process focuses largely on the Department (and the minister) of Finance's efforts to manage public opinion—to carefully limit the role of interest groups and to forge consensus. The parliamentary parties, apparently, have little real power, and the extra parliamentary parties have virtually none. This reflects the reality of what Hale describes as the "unprecedented centralization" of power in the executive at the federal and provincial levels. It also reflects the increasing separation of tax policy making from domestic politics flowing from the need to accommodate demands of globalization.

The author's general thesis is that the deficits and the ballooning national debt of the 1980s were produced by a malfunction in the system—namely, its failure to achieve a consensus that balanced spending decisions with the revenue measures that were possible in the newly globalized environment:

> The politics of taxation between the 1970s and the mid-1990s reflected this breakdown of social or political trust and the search for a workable consensus on the role and limits of government—and the kind of tax system that would finance its operations while allowing for the growth and adaptation of its economy to a changing world.[8]

The restoration of fiscal balance in the 1990s reflected the forging of a new political consensus about taxing and spending and the rigorous application of that consensus in practice. Michael Wilson is given due credit,[9] but the real hero is Paul Martin, who, with either the active support or the acquiescence of Prime Minister Jean Chrétien, was able to create a new political consensus and to reimpose fiscal discipline on the federal government. A fuller analysis of the role of political parties and the ideas embedded in them might have shed more light on the nature of the consensus on tax policy that Hale sees emerging in the 1990s. Hale is not unaware of ideological diversity in Canada; he identifies at various points a number of different ideological positions reflected in Canadian public opinion that need to be accommodated by the system. He uses an array of terms to discuss these different viewpoints—including business liberal, social liberal, neo-conservative, social democratic, market liberal, small "l" liberal, new liberal, conservative, and conservative populist—but with little attempt at defining what he means by those terms.[10] Hale's analysis in this area is somewhat confused. He recognizes the demand from the Canadian public for equity and fairness in the tax system and characterizes the Martin-Chrétien "consensus" as "neo-liberalism." This is apparently a compromise between the "neo-conservatism" of Thatcher-Reagan and traditional welfare/social liberal policies, but the term is never clearly defined, and it is uncertain how it differs from the ever-shifting balance between welfare and business liberals in the federal Liberal party.[11] Hale's overall conclusion is that future radical change in tax policy is unlikely and that the tax system will continue to "evolve in response to changing social and economic conditions." The apparent vacuity of this statement is misleading; it does not reflect a failure of analysis by the author, but a restatement of the fundamental premise that what a consensual and smoothly running political system produces is ipso facto good.

A more rigorous ideological analysis would, I believe, disclose that a belief in the essential benevolence of government and the necessity of state intervention to one degree or another in economic and social matters has been, and continues to be, the predominant view in Canada, notwithstanding Hale's somewhat surprising comment that the views of American "public choice" economists who portray governments as power-seeking "leviathans" became more influential about the proper role of government than the more benevolent views of Keynesian economists.[12] The predominant view of Canadians in most of the 20th century was that government intervention in social and economic matters was intrinsically benevolent[13] because it enabled the community to protect its members and to pursue a greater degree of equity (and equality).[14] It also reflected the view, in the words of the former Progressive Conservative leader Robert Stanfield, that "a decent civilized life requires a framework of order,"[15] and that government was responsible for maintaining that framework. There is no evidence that this view of government has changed significantly; increasing pressures to restore spending cuts (both federally and in provinces such as Alberta and Ontario) and, more significantly, the concern of politicians such as Premier Ernie Eves of Ontario to accommodate or at least assuage such demands show the contrary. One of the few criticisms that might be made of Hale's statistical materials is the absence of comparison over time of real per capita program expenditures by the federal and provincial governments, which would show how lasting real spending reductions have been.

On Hale's analysis, one has the sense that the new consensus on tax policy is a sort of weighted average of the views of Canadians, and that most Canadians are more or less content with it. A closer analysis might suggest that the tax policy consensus is a compromise forced on Canadians by a mixture of past mismanagement and external forces, such as the resurgence of global free market policies (usually referred to as "globalization"), which, once embraced, are very difficult to escape from. On this view of the world, the Martin-Chrétien consensus on spending and taxation is not a consensus hammered out between different views held by Canadians on the role of government, but a consensus on how Canada dealt with the deficit and debt crisis and how it deals with external factors such as globalization, over which it has little or no control. In other words, the status quo is not what Canadians want but what they are forced to accept.[16] For Hale this does not appear to be a meaningful difference, either because his unstated assumption is that the external environment is as it should be or because the role of the system is to seek not the best but merely the most stable.

One might wish that Hale had recognized more explicitly the role of conflict as well as consensus in Canadian politics. The breakdown of consensus on the tax policy issues that give rise to the deficit/debt problem was the result not only of the social democratic/social liberal/small "l" liberal refusal to compromise on demands for government spending, but also of the conflict of those demands with the pressures of a globalized market system in which were embedded values much less communitarian or egalitarian than prevailing Canadian attitudes. The breakdown arguably was a failure in leadership by the Trudeau and Mulroney governments to articulate choices between maintenance of spending, levels of tax, and levels of debt and to lead the public to a choice and (in the Mulroney government) the failure to perceive, or if perceived to disclose to Canadians, the costs as well as the benefits of free trade and deregulation policies. By 1993, the fiscal situation had deteriorated to the point where it created a consensus of necessity—if not desperation—that deficit financing must be ended despite the cost. It was not, I believe, a consensus about a permanently reduced role for the state, a view that has long been a minority view in the Canadian ideological conversation.

Conflict does appear in the chapter that discusses the relationship of tax policy and "civil society" and, in particular, the degree to which the tax system should support (through deductions or credits) private and non-governmental institutions (families, charities, political parties, unions, churches) and the degree to which such entities should be free to engage in political or quasi-political activity. Hale contrasts direct government support in the form of grants or other direct funding for such bodies (which, in his view, makes them akin to arms of the government and shows improper bias or favouritism by the government between groups that are supported and those that are not) with general tax reductions, which allow individuals to support or not support particular groups. His view is that government should refrain from favouring or directly supporting particular groups; rather, the marketplace should determine which groups do and do not receive funding.

This is an important issue, and Hale is right in asserting a proper balance between government, the individual, the family, and non-governmental organizations. What Hale's consensus-oriented approach ignores is that a significant reason for government expenditure of this kind (and indeed for any redistributive taxation and spending policies) is ultimately to redress inequalities of power in society. Although liberal democratic societies are based on equality of status, the market capitalist system that accompanies them inevitably produces significant inequalities of wealth and therefore of power.[17] A reduction in taxes or an increase in tax expenditures combined with reductions in government spending, while increasing the freedom of those with higher incomes, inevitably reduces the real freedom of others by reducing their power. Government support for specific organizations is often directed (albeit inefficiently in some cases) to assisting the powerless or those who are perceived to be powerless. The poor have little or no power, and reducing government funding of groups or programs that provide support to the poor in order to reduce the taxes of the middle class only worsens their position. To be fair, Hale recognizes the role of taxed-based income support measures, such as the child tax credit, which effectively redistribute income to some of the poor. Discussion of the issue would be improved by an analysis of issues of class and power, which Hale's consensus or brokerage model of political analysis assumes to be non-existent or irrelevant.

Hale's concluding chapter, which deals with the connection between the politics of taxation and the new globalized economy, appears to support one of the chief criticisms of globalization—namely, that it is profoundly anti-democratic. The argument is that participation in the globalized world market and compliance with the rules of that market (whether market forces or explicit rules established, for example, through the World Trade Organization regime) prevents national governments from pursuing policies which the majority of their citizens would otherwise favour and would cause their governments to implement. "Globalization" is a term of imprecise meaning (now used widely for polemical purposes), but, as popularly used, is connected with the re-emergence of the concept of the market as a universal organizing principle for economic and social affairs. The idea of the market was first systematically explored by Adam Smith, who explained how unrestricted trade between persons specializing in a particular economic function maximized the production of wealth and that such a free market was self-regulating so that the desire of each participant for gain or profit (in fact, their greed) worked for the common good ("the invisible hand"). By the mid-19th century, a free market economic system, based on the largely unregulated exercise of individual property rights, had triumphed in Britain, the United States, and Canada and was to transform the economy and society of most western nations during the 19th and early 20th centuries.

The resulting agricultural and industrial revolutions caused tremendous physical deprivation and social and psychic dislocation following the destruction of traditional communities. In response, attempts to restrain or abolish the market ranged from tory paternalism to socialism.[18] "Welfare" or "social" liberals took a middle view: a certain amount of government intervention was necessary to make the market operate properly—to ensure that individuals were able to participate fully in the market by having adequate education, medical care, and the like and to protect the integrity of the market (for example, in the form of antitrust legislation). A somewhat different response to the social dislocation caused by free market economics was the rise of nationalism, a movement that sought to protect the interests of national communities through tariff or investment restrictions on the operation of the market. Running through all these responses was a desire to maintain a degree of stability and social cohesion and a sense that government was the proper means to achieve this goal.

The reaction in Western Europe and North America against the destructive forces of nationalism in the first half of the 20th century produced changes that eventually strengthened the role of the market. Free trade economists (such as Smith and Ricardo) and philosophers (such as Kant) had argued that encouraging trade tended to discourage international conflict by creating a vested interest in peaceful trading. After 1945, protectionist economic policies were seen as an important cause of the Second World War, and western leaders set out to break down national barriers to trade and investment. The post-war international trade system that emerged, based on the International Monetary Fund, the World Bank, and the GATT (and the emergence of the European Common Market), had two important features. It recognized as participants, and gave rights only to, national governments, not individual citizens or economic enterprises; and it did not seek to prevent all anti-market policies, but only those that inhibited international trade, such as tariffs or quotas.[19]

The resurgence of free market economic values and the rejection of socialism and some aspects of welfare liberalism inspired by the leadership of Margaret Thatcher and Ronald Reagan (and the collapse of the fully socialist non-market economies of the Soviet bloc) has led to significant modifications of the international economic regime. These modifications include the extension of free markets to the movement of services, capital, and labour in addition to goods, and the granting of rights to individuals and businesses rather than governments acting on their behalf to directly enforce economic market rights. Such persons are viewed as possessing enforceable property rights in spite of contrary policies and laws adopted by national governments. Thus, for example, under regional free trade agreements such as NAFTA, citizens or enterprises of a contracting state acquired certain rights to enforce their provisions directly in domestic courts or before special dispute resolution bodies. Under the WTO agreement of 1994, which was intended to act as a common institutional framework for dealing with international economic relations, member nations are obliged to accept economic rights recognized under the WTO agreements and to allow the markets to operate freely, notwithstanding domestic law or regulation. The WTO therefore arguably institutionalizes the primacy of market forces, takes power away from elected national and regional governments,[20] and enhances the position of individual or corporate property rights. This is reflected in Hale's conclusion:

> The globalization of the international economy has contributed to the emergence of capital markets and transnational corporations (TNCs) that effectively transcend the efforts of national governments to tax and regulate them as national entities.[21]

It is this perceived transfer of power that has provoked criticism of globalization, and it is in that sense that globalization may be perceived as anti-democratic. Indeed, this criticism should not be surprising, because the early liberal era from which the market emerged was not democratic and was generally hostile to democratic ideas.[22]

It is interesting to place against this background Hale's conclusion that balancing external economic reality and "social" priorities in the tax policy formation process requires "unprecedented centralization" of power in the executive and detachment from the normal forms of democratic representation in the political process. Public opinion, he concludes, will be only a "secondary" factor in shaping tax policy. As noted above, this is also consistent with Hale's description of the dominant role of the Department (and the minister) of Finance in forming tax policy.

Governments, in effect, must constantly manage (and restrain) demands from their voters in order to accommodate the external, globalized economic environment. Hale suggests that public pressure for "equity"[23] is strong enough that such accommodation (for example, in the form of corporate tax rate reductions) has been possible only through simultaneous reductions in tax levels of middle- and lower-income earners. He does not suggest what might happen if and when rising revenues and surpluses are not available to finance this accommodation. Presumably a more rigorous fiscal discipline will be applied to the ruled and Finance will work harder to manage strains to the consensus. The removal of significant areas of tax policy from the ordinary political process is no doubt attractive to the beneficiaries of globalization, but it tends to marginalize the democratic process and to create a "democratic deficit" whereby politics is replaced by administration.[24] This democratic deficit in one of the most important functions of government does not appear to concern Hale. It is arguably connected to the apparent alienation of increasing numbers of people (particularly the young) from the political process (witness the consistently declining voter turnout), or to the tendency for dissent to move outside the system into mass protest movements, accompanied sometimes by civil disobedience or violence. This appears to represent a malfunction of the system that deserves analysis. Perhaps this book might better have been entitled *The Non-Politics of Taxation in Canada*.

NOTES

1 Geoffrey Hale, *The Politics of Taxation in Canada* (Peterborough, ON: Broadview Press, 2002), 31.

2 The absence of technical discussion is unwittingly highlighted by the reference to FAPI as "Foreign *Accrued* Property Income" (ibid., at 307, emphasis added).

3 The author is an assistant professor of political science at the University of Lethbridge, and the book appears to have had its genesis in his doctoral dissertation.

4 Systems theory in some respects is a more sophisticated version of the "brokerage" theory of politics, which views political parties as balancing competing interests and regions (rather than promoting some guiding principle or ideology), giving the stronger enough to satisfy them and the weaker at least a sense of having been listened to, all within a consensus about assumed or unstated common values and assumptions underlying the system.

5 In fact, no political analysis is value-free. The embedded values among systems or brokerage theorists, which surface from time to time, are the liberal capitalist values of the American society from which the theory was itself abstracted. One manifestation of this value-free illusion is the tendency to characterize those who work within the prevailing set of values as "pragmatic" and those who challenge them as "ideological." The former are constructive because their behaviour tends to perpetuate a stable system; the latter are not because they threaten the stability of the system.

6 Which appears to have been focused on the executive branch.

7 It also suggests that the lawyers, accountants, and economists who are interested on a day-to-day basis in policy issues are marginal to the policy-making process. It would be interesting to know Hale's view on this point.

8 Supra note 1, at 129.

9 Hale cites Michael Wilson's management of income tax reform in 1987 as an example of consensus building using a "non-ideological" approach.

10 The term "business liberal" was coined by William Christian and this reviewer (*Political Parties and Ideologies in Canada* (Toronto: McGraw-Hill Ryerson, 1974)) to describe one strain of thinking within Canadian liberalism, in contradiction to "welfare liberalism," which may be similar to what Hale refers to as "social liberalism." While it is flattering to assume that the term "business liberal" has now been so widely accepted as to not need definition, this is probably not the case.

11 See Colin Campbell and William Christian, *Parties, Leaders and Ideologies in Canada* (Toronto: McGraw-Hill Ryerson, 1996), chapter 3.

12 Supra note 1, at 44-45. Perhaps this is the view of bureaucrats who were interviewed—it is difficult to say.

13 This derives from all parts of the political spectrum: "red" tories, welfare liberals, and social democrats.

14 In some cases of opportunity, in others of status.

15 Robert Stanfield, "Some Comments on Conservative Principles and Philosophy" (mimeograph, 1975). The concept of order to which Stanfield referred is not the American concept of "law

and order" but order in the sense of the preservation of social cohesion and the social fabric. This would extend, for example, to reduction of socially divisive income disparities and the protection of public institutions, goods, and services. It is a corollary of this view that the political goal of a properly ordered society would, if necessary, override individual economic objectives and considerations.

16 It is interesting that Hale does recognize the pressure from the Canadian public to maintain equity and fairness—for example, in his suggestion that reductions in business taxation (and perhaps levels of tax for high-income individuals) were politically sustainable only because they were accompanied by tax reductions or other benefits for lower-income groups.

17 The connection between equality of status and inequality of power in classical liberal theory has been explored, for example, in C.B. Macpherson, *The Political Theory of Possessive Individualism: Hobbes to Locke* (Oxford: Clarendon Press, 1962).

18 See, for example, the analysis in Karl Polanyi, *The Great Transformation* (New York: Farrar & Rinehart, 1944).

19 So that a state could have strongly socialist or other anti-market domestic policies without necessarily violating its obligations under these arrangements.

20 Under the arrangements of the European Union, the other major 20th-century experiment in transnational economic integration, power was also taken away from national and regional governments, but much of that power was merely transferred to the EU governing structure. By contrast, under the WTO regime, little power is passed to the WTO and its dispute settlement mechanisms; the intention of the WTO regime is primarily to prevent governments from restricting economic and property rights.

21 Supra note 1, at 313.

22 In classical liberal theory, such external checks on the power of government were inherently desirable to restrict the power of overbearing monarchs. Threats posed by the poor, at the opposite end of the political spectrum, were avoided by treating those without property as political non-persons. International free market economic policies arguably fulfill the same function today by reducing the ability of democratically elected governments to affect rights attaching to property.

23 As noted above, Canadian resistance to globalized free market economic policies is based as much on the desire to preserve a degree of social order and cohesion and to satisfy perceived community needs and goals as it is on the pursuit of equality. Hale misunderstands the resistance to globalized economic policy by assuming that it could be satisfied by balanced tax reductions for all income levels. Tax reductions allow the recipients to acquire private goods; they do not allow (indeed, they inhibit) the production or enhancement of public or communal goods.

24 This is a result not uncommonly sought by the political right—reducing the number of local governments and elected representatives, for example, to promote "efficiency" and reduce the burden of dealing with "politics."