

FROM THE EDITOR'S DESKTOP/ LE MOT DU RÉDACTEUR

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A tax cut too far?

You can understand how the Canadian Alliance came to propose a flat tax—or, as they prefer to call it, a “single-rate” income tax—as the linchpin of their fiscal plan. Last winter, when the Alliance was still the United Alternative, the federal Liberal caucus was getting religion on tax cuts. Back-bench Ontario MPs reportedly were lobbying hard for Finance Minister Paul Martin to announce significant tax cuts in last spring’s budget. For seven years, the Liberals had ridden high in the polls by stealing many of Reform’s policy ideas. Now it looked as if they were going to walk off with what had always been the central plank in the Reform/United Alternative platform: big tax cuts. Would Reform/UA, whatever new name it might choose for itself, simply be a party of “us, too”? That political strategy sometimes works, especially when disaffection with a government is high and the challenger party can offer some other attractive feature, such as a new leader. But, with Preston Manning the odds-on favourite to lead the new party, it looked as if some flashy new attention-getting policy would be required.

Enter the flat tax, a fiscal innovation Reform had toyed with in the mid-1990s but never adopted. (See Herb Grubel’s recently-published autobiography for the evolution of Reform thinking on flat taxes.) As the Canadian Alliance insists, the single-rate structure is only part of its overall fiscal plan. The other important parts of the personal income tax package include raising personal exemptions to \$10,000 and granting a \$3,000 deduction per child. As a result, all Canadians get tax cuts. Those currently paying 17 per cent at the margin get the benefit of higher exemptions and deductions, while taxpayers in the 26 and 29 per cent brackets—most of whom are not “high-income” Canadians—also benefit from the rate reductions.

Economists, as is our wont, have shown no reluctance to evaluate all aspects of the Alliance plan, but what we’re actually qualified to comment on are its “efficiency” aspects, that is, its ability to squeeze more output out of society’s “factors of production” (which include you, me, the rest of our fellow workers, and all the capital and knowledge available to us). In simple efficiency terms, the tax has got to be a big winner. As a share of GDP, taxes are at an all-

time high in Canada. At least one study has shown that the “excess burden” of high income taxes can run as high as \$70 per dollar of revenue raised (in those provinces with especially high surtaxes), while on average, as James Davies argued in a 1998 paper for the C. D. Howe Institute, the effective marginal rate of tax in Canada is 36.5 per cent.

(In the article beginning on p. 32 of this issue of *Policy Options*, Nicholas Rowe says he would prefer to call this the *net* marginal rate of taxation, and stresses that it must take into account the effects of income-conditioned social benefits, as well, which Davies’ calculations in fact do. Rowe also argues that the need to look at the entire impact of the public sector means share-of-GDP numbers like the one just quoted aren’t very helpful, which is also true, except that in recent years, as income tax rates have risen, most Canadians have *not* experienced offsetting increases in benefits.)

The flat tax also encourages efficiency by cutting the number of income tax rates to two, thereby reducing the temptation to try to lower tax liabilities by moving income between years or among family members, all of which consumes resources that could be used to better purpose. Bad news for tax lawyers is, as always, good news for the real economy.

How big an efficiency gain might the flat tax bring? The proponents of the best-known US flat-tax initiative claim a six per cent increase in GDP, but they would also engage in a radical base-broadening exercise that the Alliance has shied away from. (Because it did, it argues it’s not proposing a “flat tax.” But, of course, the “flat” part of the term “flat tax” comes from the single rate, which it does propose, not the base broadening, which it doesn’t.)

On efficiency grounds, the flat tax clearly has a lot going for it. But in terms of fairness—which economists in fact aren’t especially qualified to comment on—it raises obvious questions. The overall public sector is quite “progressive” in Canada: Before all taxes and transfers the top 20 per cent of the income distribution makes 21 times more than the bottom 20 per cent. After taxes and transfers it makes only five times more. That’s quite a drastic difference. Most of the effect comes from public expenditures, howev-

er, which go disproportionately to people at the bottom end. The overall tax system is essentially proportional, though that proportionality comes from a combination of reasonably progressive income taxes and mildly regressive other taxes. Reduce the progressivity of the income tax and you very likely tilt the tax system toward regressivity, and reduce the progressivity of the overall tax-transfer system.

Maybe we *could* do with less progressivity in our tax-transfer system. Many economists certainly believe so, though, in fairness, it must be said that most would benefit personally from the reductions they recommend. That's why it's interesting that none of the three well-known economists I interviewed on the Alliance's flat tax was willing to endorse the proposed rate cuts enthusiastically, while two of the three seemed, ahem, flat opposed to them. (Read the edited transcript of our conversation beginning on p. 24.)

Whether this is typical of opinion in the country at large remains to be seen. Judging politics by conventional Canadian standards, it should be easy for the Alliance's opponents to point out that while its fiscal plan gives small tax cuts to people making less than the average income, and puts very tight constraints on public spending, it gives tax breaks measured in the tens of thousands of dollars, and in

some cases in the hundreds of thousands of dollars, to the richest Canadians. The Alliance will argue, with some justification, that envy and class warfare shouldn't matter so much; that the important thing is that everyone gets a cut; that one-rate-for-all is intuitively fair; that upper-income Canadians pay the lion's share of income taxes and deserve a substantial break; that even after the cuts they will still pay the largest share of income taxes; and, finally, that low-income Canadians will benefit from the higher employment and greater economic output that sharply lower tax rates will bring.

And yet ... even now Liberal Party researchers are probably hard at work trying to calculate just how big a tax break Conrad Black will receive should the Alliance plan be enacted. It's hard to believe old politics of that sort won't work: There just aren't enough voters in the 29 per cent bracket.

Now that the Alliance has a new leader to distinguish itself from its opponents, the need for dramatically distinctive policies is reduced. So far as I can see, the difficult choice the party now faces is between backing off now or being hammered—albeit perhaps not fatally—in the general election. My only hope is that they not decide until this issue of *Policy Options* is safely in the hands of readers.

Trop c'est comme pas assez

On comprend que l'Alliance canadienne ait fait de sa proposition d'un impôt à taux uniforme (ou « impôt à taux unique », selon l'expression que l'on préfère dans ce parti) le pivot de son programme fiscal. L'hiver dernier, alors que l'Alliance s'appelait encore l'Alternative unie, les députés libéraux fédéraux érigeaient en dogme la réduction des impôts. Les députés ontariens d'arrière banc, disait-on, pressaient très fort le ministre des Finances Paul Martin, d'annoncer à ce chapitre de substantielles réductions dans son budget printanier. Depuis sept ans, les libéraux jouissaient d'une cote élevée dans les sondages, grâce à des politiques inspirées en grande partie des idées des réformistes. Et voici qu'ils semblaient vouloir s'approprier l'idée cardinale du programme réformiste : de bonnes, grosses réductions d'impôts. Les réformistes (ou « alliancistes » ou quelque autre nouveau nom qu'ils décidassent d'adopter) se verraient-ils condamnés à n'être que des « béni-oui-oui »? Il arrive que semblable stratégie politique fonctionne, particulièrement quand l'électorat est mécontent du parti au pouvoir et que le parti concurrent peut faire valoir un trait séduisant comme, par exemple, un nouveau chef. Mais, puisque Preston Manning partait grand favori pour la direction du nouveau parti, il semblait nécessaire d'attirer l'attention grâce à quelque nouvelle politique accrocheuse.

Ainsi refit surface l'idée d'un taux d'impôt uniforme avec laquelle le Parti réformiste avait flirté au milieu des années 1990 mais qui n'avait jamais été adoptée. (Sur l'évo-

lution de la pensée réformiste en cette matière, voir la récente autobiographie de Herb Grubel.) Quoi qu'il en soit, insiste l'Alliance canadienne, la structure à taux unique n'est qu'un élément de son programme fiscal global. Le volet impôts sur le revenu des particuliers comprend, entre autres, deux articles importants : hausser à 10 000 \$ le montant pour crédit de base (la fraction du revenu qui n'est pas assujettie à l'impôt) et accorder une déduction de 3000 \$ par enfant. De la sorte, tous les Canadiens bénéficieraient d'une réduction d'impôt : les contribuables actuellement soumis au taux marginal de 17 p. 100 bénéficieraient d'exemptions et déductions plus généreuses qu'aujourd'hui alors que ceux se situant dans la fourchette des 26-29 p. 100 (et dont la plupart ne sont pas des travailleurs à revenu élevé) bénéficieraient en plus de la réduction des taux.

Fidèles à leurs habitudes, les économistes n'ont pas hésité à commenter tous les aspects de cette proposition. Mais, dans les faits, ce que leurs qualifications les autorisent à analyser, c'est son « efficacité » : c'est-à-dire son aptitude à tirer un meilleur rendement des « facteurs de production » (vous et moi, nos collègues de travail, ainsi que tout le capital et le savoir dont nous disposons). À ce chapitre, l'impôt devrait en sortir grand gagnant. En proportion du PIB, l'impôt est plus élevé que jamais au Canada. Au moins une étude a montré que le « fardeau fiscal excédentaire » qui frappe les revenus élevés atteint 70 \$ par dollar de revenu perçu (dans les provinces où la surtaxe est très élevée) alors qu'en moyenne, ainsi que le soutient James Davies dans un