

## Taxing in an Uncertain World

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*Now, more than ever, political, business and civic leaders must embrace the fact that ours is an age of rapid transformation, significant risk and sometimes bad outcomes.*

Stephen Harper (*The Globe and Mail*, October 8, 2018, p. O5)

Since no one has a crystal ball, tax policy designers are no more certain about what the future holds than anyone else. As Mr. Harper says, however, dealing with change, expected and unexpected, good and bad, is undoubtedly going to occupy much of their time and effort in the years to come. I have no more idea of what lies ahead than anyone else, but it may perhaps be relevant to offer a few reflections about why we should think about taxation from a somewhat broader and deeper perspective than we usually do.

### Types of Uncertainty

*There are things that we know that we know. They are known unknowns. That is to say there are things that we know we don't know. But there are also unknown unknowns. These are things that we do not know we don't know.*

Donald Rumsfeld, U.S. Secretary of Defense, Press Conference at NATO Headquarters, Brussels, June 6, 2002.

Some ridiculed Mr. Rumsfeld for saying this at the time, but he, like Mr. Harper, was quite right. Among the 'known unknowns' are 'predictable surprises' from demographic shifts (Foot and Stoffman 1998) and the inevitable (though seldom precisely predictable) cyclical swings in volatile resource prices or the housing market. For example:

- People get older, often become ill, and cease working, leading to rising pension and health costs, increased pressure on the tax system, and usually more tension between federal and provincial governments.

- People also move and have tended increasingly to cluster in larger metropolitan areas with the result that the gap between the fiscal needs of local governments and their tax revenues increases, again raising both intergovernmental tensions and the pressure on taxes.
- Oil (and other resource) prices rise, fall, and perhaps rise again, leading to large and diverse fiscal impacts on different regions, once again exacerbating tension in both tax and governance.
- The housing boom slows, or resumes, and in either case the result is popular unrest, tax tension and pressure on intergovernmental relations.

Such ‘known unknowns’ should not come as a surprise, although they often seem to be one. Fortunately, on the whole our fiscal institutions have so far managed to accommodate both cyclical and demographic ‘surprises’ moderately well. For example:

- The relatively strong automatic stabilizers built into the federal fiscal system largely in the first flush of post-war Keynesianism have on the whole served us well (Wilson, Dungan and Murphy 2016), though it remains to be seen if our persistent failure to have sufficient ‘shovel-ready’ public works on the shelf in times of need will be remedied to any extent by the recently launched Canada Infrastructure Bank.<sup>1</sup>
- Canada managed in the 1990s not only to dig itself out of a substantial fiscal hole but almost simultaneously to restructure the CPP more sensibly than most similar plans in other countries<sup>2</sup> - although the 2017 decision to cancel a planned increase in the age of eligibility was clearly a step in the wrong direction.
- Although Canada has not done so well in managing the differential effects of changes in circumstances and policies on different regions, on the whole we have arguably managed to juggle the tax, transfer and spending components of our fiscal constitution sufficiently successfully to hold the country together (Bird 2018).
- So far, however, little has been done to accommodate at the local level the twin problems of metropolitan expansion and the very different reality of less urbanized regions.

One reason we have perhaps not handled ‘national’ policy like the last two just mentioned quite as well as we have the essentially federal issues first mentioned is perhaps because, although we have moved a long way towards a more ‘integrated’ federal-provincial tax system in recent years, our 19<sup>th</sup> century constitution continues to make it hard to deal with 21<sup>st</sup> century

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<sup>1</sup> <https://www.infrastructure.gc.ca/CIB-BIC/index-eng.html>

<sup>2</sup> As noted recently in *The Economist*, January 19, 2019, p. 74.

problems when it comes to resource policy and local governments. Nonetheless, on the whole, when it comes to dealing with ‘known unknowns’, Canada seems to have done at least as well as most countries.

Unfortunately, when it comes to the more difficult problem of the ‘unknown unknowns’ -- the ‘black swans’ as Taleb (2007) calls them – no one has done well. Are our political and fiscal institutions sufficiently robust to cope with major problems calling for an immediate and major policy response – for example, the unexpected erection of a ‘wall’ on our southern border or another international crisis that disrupts the economy in a big way and calls for a big policy response if life as most of us know it is to continue? Another big problem area is climate change: those who believe in evidence-based decision-making should presumably by now be battering down the environmental hatches, moving to higher ground, and laying supplies: what are we doing? The excuse that no one else is doing much either is not very reassuring.

### **Responding to Uncertainty**

‘Muddling through’ -- or gradual incrementalism – as our usual approach to policy problems may not inappropriately be labelled, has served us well for over a century. The normal response of human beings faced with crisis is to delay making changes until we really have to do so. When disaster finally hits, we tend to rely on the ‘fast’ thinking instincts inherited from the days when the main way people stayed alive was to dodge the current predator. But instinct alone seldom does the job when faced with big problems. What we usually need instead is what Kahneman (2011) calls ‘slow’ thinking – the process of deliberation needed to reach a reasoned response that might enable us collectively to escape a large hole that none can escape alone. Instead of thinking through in a reasoned, systematic way how to cope with problems, however, all too many people these days seem to prefer to defer to some authority (a ‘strong leader’), to turn to tribal loyalty as the answer, to blame everything on some specific group of evildoers, or simply to rely on some kind of magical thinking for a solution.<sup>3</sup>

When we do react, it is usually only after the catastrophe is upon us. The First World War led us to introduce the first national income and sales taxes. The Second World War turned the income tax into the most important mass tax, and over the next fifty years of (mostly) increasing prosperity we developed both a relatively integrated federal-provincial tax system and an extensive system of interpersonal and federal-provincial transfers. Few foresaw any of these changes much in advance. To ‘re-imagine’ our future tax system coping with the

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<sup>3</sup> For an articulate assault on all these approaches, see Pinker (2018).

uncertain but almost certainly erratic – and perhaps at times catastrophic – events we may face in the years to come is not a simple task.

Of course, every tax expert probably has some concept of the ideal tax system ready to hand, so a natural response when asked to think about the future tax system is simply to suggest that we adopt this better tax system. As many have learned, however, others are often reluctant to accept even the best ideas, and some may even have learned that when their ideas are accepted they may not always work out as well as forecast. Perhaps the first question one should focus on is thus not so much what we should do as how we should decide what to do, that is, the ‘process’ rather than the ‘product’ of tax policy. How should we decide how to tax, how much to tax, by which level of government and how? Should taxes be more or less centralized? How should taxes in Canada relate to taxes elsewhere? What role should taxation play in redistribution? To what extent and in what ways should taxes be used to regulate and shape economic and political decisions? None of these matters is simple, or easy to decide, but perhaps a few possible starting points may be mentioned:

- On the international side, to which so much attention has been paid in recent years, we should continue – indeed, increase – the attention we pay to what others are doing and why and take an active part in every relevant international forum. Improving our detailed knowledge of what is going on out there, the possible implications for us, and the likely impact of any changes we may make is essential to sound tax policy formulation in this volatile environment. Canada is a relatively small frog in the international pond, and small frogs need to watch closely both the actions of bigger players and changes in the environment if they are to be able to act sufficiently quickly and effectively to survive.<sup>4</sup>
- Equally importantly in the Canadian context, close attention must continue to be paid to developing ways to provide federal and provincial governments sufficient freedom to differ while still maintaining a largely integrated system towards the world at large. Both sides, federal and provincial, need to spend more time thinking and talking to each other both about how to do this. For example, most provinces need to build up their tax policy capacity and the federal government needs to pay more attention to the provincial take on matters. Talking to each other is not a distraction from the real work of tax policy but an essential component of good policy formulation in Canada.
- Similarly, it is important to consider tax policy and tax administration together from both a short -and a long-term perspective. Digitization, for example, has potentially deep implications, for better or ill, with respect to the organization and effectiveness of

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<sup>4</sup> For further discussion, see Bird (2016); the ‘small frog’ analogy comes from Katzenstein (1986).

tax administration, the effectiveness with which different tax bases can be taxed, the extent to which taxes are ‘personalized’ and redistributive, and the relationships between citizens and the state.<sup>5</sup>

## **Tax as a Policy Instrument**

Economics has made significant contributions to tax design.<sup>6</sup> Good economics is an essential ingredient of good tax policy, but economics alone is not enough.<sup>7</sup> Moreover, since taxation is only one of the policy instruments available to governments, changes in tax need to be considered in the context of policies implemented through other instruments such as spending and regulation. Tax economists properly focus on the impact of tax changes on economic decisions both because that is their field of expertise and it is what policy-makers want and expect them to do. But taxes are more important than their economic effects. In part because taxation plays a critical role in enabling and sustaining the very political institutions through which it is implemented, efficiency is by no means the only criterion that must be used in appraising tax policy. Those who want to re-imagine how to structure taxes in an uncertain future must cast their nets more widely.

Aristotle once remarked that one can only know a thing completely when one knows its causes and first principles.<sup>8</sup> Few, if any, seem likely to reach this high standard with respect to anything, but to think usefully about the future of tax we must indeed know at least something of its past – why we have the system we do – as well as what we want taxes to do and why. In recent years, there have been many studies of the critical role taxes have played in developing effective governance around the world.<sup>9</sup> Some authors have emphasized the power of taxation to destroy: Rabuska even goes so far as to assert that “...the origins of recorded history were inextricably linked to oppressive taxation” and that “...civilization tends to self-destruct from excessive taxation.”<sup>10</sup> Others are more positive, suggesting that modern democracies exist and thrive in large part because their citizens have (so far) proven to be largely willing to pay taxes. In a recent book, Steinmo (2018) neatly summarizes this view by noting that “Jean Baptiste Colbert once famously argued: ‘the art of taxation consists in so plucking the goose as to obtain

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<sup>5</sup> See Bird and Zolt (2008) and Bird (2016a) for further discussion.

<sup>6</sup> As Boadway [2012] shows, and Mirrlees [2010] and other sources illustrate at length.

<sup>7</sup> The key role of economists with respect to taxation is, as Harberger (1971) once said, to bear the proud banner of efficiency, an objective that no one else in the tax game is usually pursuing.

<sup>8</sup> As cited by du Preeze and Stiglingh (2018).

<sup>9</sup> On Canada, for example, we have the recent thorough historical studies by Heaman (2017) and Tillotson (2026).

<sup>10</sup> Foreword to Adams (1993). The Adams book is replete with examples from ancient Egypt to the United States in the 1990s of poor tax policies and their undesirable outcomes. In a later (impressively exhaustive) study of taxation in colonial America, Rabushka (p. 808) concludes that the very existence of the U.S. is largely the result of bad taxes: “The American Revolution ...was a tax revolt, first and foremost.”

the maximum amount of feathers with the smallest possible amount of hissing.’ In the most successful societies, the geese pluck themselves.” Why have so many been apparently willing to make the huge ‘leap of faith’ required to give governments control over so much of their income and wealth? Steinmo’s answer is that there are essentially two reasons: they believe that they will get something in return, and that the burden is shared fairly with others. These two tenets are also central to what is often called the ‘fiscal contract’ between citizens and the state that underlies democratic states.<sup>11</sup>

Building a strong and sustainable tax system is not a simple or short process. It requires establishing sufficient capacity to administer taxes in a way most people consider fair as well as delivering public services that they value and consider worth the price.<sup>12</sup> Much effort has been expended in recent decades in studying whether and how developing countries might be able to emulate – and hopefully shorten and make less painful – this key component of state-building.<sup>13</sup> Little success has been attained to date: building state capacity and developing the kinds of social norms underlying Steinmo’s ‘leap of faith’ are not tasks that can be completed in a few years or imposed or imported from outside (Bird 2016). Creating and sustaining an effective and sustainable governance structure in the heterogeneous societies found within most national boundaries is far more difficult than designing an optimal tax system or simply emulating someone’s idea of ‘best practice’, an idea all too often based on experiences in very different places.

Taxes may be ‘what we pay for civilization’<sup>14</sup> but developing and maintaining the underlying fiscal contract between state and citizens is always and everywhere a work in progress. What do people understand by ‘fair’ taxes? How do governments enforce such taxes effectively? What services do people value, and how much are they willing to pay for them especially when they do not themselves directly benefit? The only way we have to deal with complex and difficult questions like these is can through cumbersome political processes, often encrusted with the remnants of past ages and almost always responding only slowly to changing conditions and seldom working to the satisfaction of all citizens.

Viewed from an historical and worldwide perspective, Canada seems to be, like Australia, a ‘lucky country’, one that has had a relatively short and easy passage through these turbulent

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<sup>11</sup> See Timmins (2006) and Bird and Zolt (2015).

<sup>12</sup> For examples, see Brewer (1990) and Ferguson (2001) on the United Kingdom, and for a brief overview of the role of taxation in political and economic development, see Hoffman (2015).

<sup>13</sup> For a good introduction to the subject, see Brautigam, Fjeldstad and Moore (2008) and for two good country studies see Bergman (2009) and Prichard (2015).

<sup>14</sup> Inscription on Internal Revenue Service building in Washington, usually attributed to a remark in a 1927 U.S. Supreme Court decision by Oliver Wendell Holmes.

waters. Viewed from inside, however, though the ship of state continues to sail on into the uncharted waters of the future many citizens seem to rather unhappy, although as yet we have been spared the political upheavals recently seen in some other high-income democracies in which citizens unhappy with their governments (and often, their tax systems) have taken to the streets and polls to express their discontent. A recent study (Bergman and Steinmo 2018) suggests three guidelines for maintaining a sustainable tax system in these turbulent times:

- Taxes must be seen to produce services – infrastructure, education, health, security, that people at all levels perceive to be beneficial, if not to them personally, then to the health of the society in which they live.
- Everyone, including the poorest, but of course especially the rich, must be seen to pay something and the system must be perceived to be acceptably progressive, which for most seems less to be a matter of achieving a particular standard in terms of the Gini coefficient or some other number but instead approximating to what Sheffrin (2013) calls ‘folk justice.’
- Finally, not only who pays how much in tax but how the system is applied matters. As Adam Smith told us centuries ago, taxes should be as simple and certain as possible and as recent experience has underlined, they should also be visibly, fairly and strictly enforced across borders as well as domestically, which implies that only taxes that can be properly enforced should be imposed.

There is nothing new or startling in any of these propositions, although few appear to have sufficiently stressed the critical importance of good spending as the foundation of a good tax system,<sup>15</sup> the importance of perceived fairness in ensuring the acceptability of taxes, or the central role played by good tax administration not only in determining how taxes work but also in shaping how people perceive the tax system. Of course, even those who have chosen, perhaps wisely, not to venture into the murky waters of political economy recognize that taxes do not simply raise revenue. They also redistribute income and wealth and, by altering the incentives facing economic actors, shape the rate and pattern of growth.

As Avi-Yonath (2006) has noted, the “three R’s” of taxation – revenue, redistribution, and regulation – in most countries mesh surprisingly neatly with the three ‘big’ taxes: the value-added tax (GST) for revenue, the personal income tax (PIT)s for redistribution, and the corporate income tax (CIT) for regulation. This categorization could easily be expanded -- adding excises as regulatory taxes, payroll taxes as revenue taxes, and, perhaps more arguably, property taxes as redistributive taxes. Each tax could also be characterized in terms of how it

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<sup>15</sup> Although Musgrave (2010), following Wicksell (1896) did so consistently throughout his long professional life.

relates to such presumably desirable social norms as certainty, simplicity and linkage to benefits.<sup>16</sup>

The instruments chosen to achieve a particular objective may, like the weight attached to any objective, vary with changes in circumstances and in the mix of ideas and interests that shape policy decisions. Regardless of the intentions of decision-makers, however, policies often impact objectives other than those being targeted. For instance, a reduction in corporate tax rates, even if well-designed and likely to have a positive impact on investment and growth, may not be acceptable in the face of the importance taxpayers may attach to the corporate tax rate as a symbol that even the rich and powerful are being taxed (Hale 2002). As Hirschman (1967) long ago emphasized there are no such things as ‘side effects’ (or collateral damage) when it comes to policy outcomes: there are only consequences, all of which need ideally to be taken into account before making a decision. Of course, one can no more think through every possible consequence when deciding tax policy than when deciding to cross the street: to do so would mean never reaching a decision or getting to the other side. The point, however, is simply that because taxation is always political, it is always important to recognize the possible political as well as economic consequences of particular decisions.<sup>17</sup>

## **Taxes and Redistribution**

The first and often most important aspect of tax changes for governments is their impact on revenues. British Columbia’s hasty and ill-planned decisions on the HST a few years ago offers a clear example. The initial decision to move to the HST appears to have been made primarily to fill a revenue gap arising from the 2008-09 recession.<sup>18</sup> The newly re-elected provincial government had run on a platform of restoring fiscal balance as well as expanding spending in some areas. It quickly found it could not fulfill these promises because the money was not there. However, Ontario had just shifted to an HST, and seemed to be doing so with no problems and some revenue gain, so emulating their success appeared to offer an obvious way to resolve the problem. Unlike Ontario, however, which had both analyzed the change in depth and made a considerable effort to prepare the public for it, BC simply announced the change without either doing its homework or preparing the public to expect it. As a result, BC is one of the few jurisdictions in the world to first implement a value-added tax and then reverse its decision --

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<sup>16</sup>As noted earlier, policy objectives may be achieved not only by taxes but by such other instruments as direct expenditures, transfers, and regulation as well as by influencing such macroeconomic means as exchange and interest rates: see the interesting discussions of the relative merits of and connections between different governing instruments in Trebilcock et al. (1982) and Linder and Peters (1989).

<sup>17</sup> The outstanding book by Hettich and Winer (1998) remains perhaps the best introduction to this subject.

<sup>18</sup> This account is based largely on a forthcoming study by Lesch (2018)



and the only one not to soon reverse its reversal (Bird and Gendron 2007). Of course, Ontario has also fallen into 'revenue-driven' policy traps at times. In a similar budget-balancing exercise in 1998, a series of major policy initiatives associated with a major local tax reform resulted in inappropriately shifting some social functions to the local level essentially to balance the accounts when the province took on responsibility for financing a much larger share of educational spending.<sup>19</sup> Getting the budget numbers 'right' is always and everywhere a major factor shaping tax decisions.

Although revenue needs may drive many government tax policy decisions, for most people the main tax question is who pays. Although it is usually technically difficult to be definitive about the distributive effect of any proposed tax change, people are invariably sensitive to what they perceive to be the effects on distribution, and in the absence of persuasive evidence to the contrary, they seldom hesitate to make strong (and often unwarranted) assumptions about who pays. Some think consumption taxes and user charges invariably and unfairly target the poor. Others think that increases in income taxes inevitably make everybody poorer by discouraging savings, investment, and growth. The evidence provides little support for either of these extreme views, but most prominent advocates in public discussion of fiscal matters generally ignore the evidence, rely heavily on prior beliefs and (often atypical) examples to support their cases, and tend to focus on the presumed impact on this or that margin of specific changes. To overcome the clamour of the often self-interested and unfounded claims that tend often to dominate public forums, those proposing tax changes need to provide consistent and comprehensible answers to the questions raised in such discussions. And, of course, they should also try to shift the focus to the more relevant question of the impact of policies as a whole on social policy objectives. Both these tasks are difficult and require considerable and persistent efforts by those advocating change.

The importance of distributional concerns has recently been underlined by the growing evidence of international tax avoidance and evasion, combined with the noticeable growth of inequality in many countries including Canada. Many believe, with some reason, that not only are many large multi-national firms not paying their 'fair share' but that the rich in general are getting off much too lightly. These concerns pose two problems for tax policy: How should cross-border transactions be taxed? How progressive should domestic taxes be? Tax experts everywhere have been working to find better answers to the first of these questions, although as yet it is not clear how successfully. All I shall do here however, is simply to raise a basic question about the role of taxes in redistribution: what do people want from their tax system in this respect?

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<sup>19</sup> The Ontario experience is discussed at length in Bird, Slack and Tassonyi (2012).

Canada, like most countries, effects most redistribution through expenditures, not taxes. It is thus not surprising that some seem to think the best way to deal with distributional issues is simply to increase taxes and spend them on good things like education and health. The substantial increase in such spending in the postwar era, for example, clearly made the life of many – notably the old – much better, so perhaps it is natural that many see more of the same as the way to go. Unfortunately, considerable evidence suggests that simply pouring more money into existing programs seldom results in more and better public services.<sup>20</sup> Some inevitably flows into the elaboration of ever more complex administrative structures and simply increasing the income of service providers. Even in the 1980s, it was difficult to detect that the tax increases being borne by the mythical average taxpayer were matched by any visible gain in the benefits received from public sector activities (Bird 1982). The trend continued: in 1985, for every dollar paid in income tax, Citizen Average could see that about \$1.15 was being spent on health and education; a decade later, the comparable figure was \$1.06 (Bird 2001) and matters have decidedly not improved since then.<sup>21</sup> The first pillar underlying the ‘leap of faith’ required to maintain a sustainable tax system in a democracy discussed earlier has, it seems, become noticeably weaker in recent decades.

The second pillar supposedly underlying that faith is the belief that, even if not every dollar collected is spent in ways that citizens can visibly perceive as benefiting them (either personally or as members of a desirable society), at least the taxes are imposed fairly. Unfortunately, in part because it is the rich – the group that has gained the most from growth in recent decades – who have also benefited most from the increasingly visible failure to capture cross-border transactions adequately within the tax net, this pillar too seems to have been weakened.

One way to overcome this problem and shore up the foundations of fiscal civilization that some have suggested is to increase tax rates on higher-income people. Some progressivity, most visibly through personal income tax rates, is indeed likely an essential ingredient if any tax system to be considered ‘fair’ in a democratic country (Bird and Zolt 2015). Those who have more should clearly contribute more to financing government activities. Many may also agree that a high-income country like Canada should provide at least a minimum level of support to those with incomes below a certain level in addition to a decent opportunity to access such public services as health and education. But none of these objectives require either a highly progressive income tax or more strongly ‘targeting’ public services to favour the less fortunate. The major redistributive spending programs we have – pensions, health care, employment

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<sup>20</sup> For a clear discussion of this point with respect to health care in Canada, see Culyer (1997). An international overview of the evidence may be found in Tanzi and Schuknecht (2000).

<sup>21</sup> Calculations to be updated and methodology explained in later version of paper.

insurance - are intended more to insure the not-so-poor against foreseeable risks than to alleviate poverty as such. As incomes have risen, we as a society have in effect chosen to purchase more social insurance in part to offset the marked loosening of family and community ties that have accompanied growth.<sup>22</sup> Health care, education, employment, and retirement are all matters of direct and personal interest to most: everyone fears becoming ill, losing a job, lacking adequate qualifications for employment, and having to look after the elderly (including themselves). It is not surprising the redistribution from the well to the sick, the employed to the unemployed, and workers to retirees dominates social spending and hence accounts for most of the tax burden. These major social outlays are easily understood by and justified to taxpayers as insurance from which they and their immediate families may, if needed benefit.

For much the same reason, however, strengthening the 'targeting' of subsidies may at times weaken rather than strengthen public support for redistribution. Some assert that public policy should ensure that all public services, including provision of income support, should be made equally available to all. But public policy can only survive if it is supported by a sufficiently broad coalition, and it is far from clear that this objective has sufficient support to be sustainable over time. Canada, for example, has been much more reluctant to introduce any kind of a 'two-tier' health care system than most European countries. One rationale for this reluctance is perhaps the belief that allowing better-off consumers (and more providers) to opt out may lead not only to a decline in service quality but also weaken the existing strong majority support for the public health system. From the 'fiscal contracting' perspective mentioned earlier, at the extreme the result of letting the better-off opt out of the public system may be to weaken the social contract holding the country together.<sup>23</sup>

What happens to taxes is driven largely by spending decisions, and spending decisions in recent decades have been driven largely by social policy. But in the perception of many people, if not experts in the field, there are arguably two distinct types of social policy. The dominant driver of social spending -- and hence tax increases -- in Canada has been to provide public services that most people consider worthwhile -- health, education, support for the elderly, and probably employment insurance. To maintain broad popular support, most such policies are not narrowly targeted to the poor and in addition some subsidization for private outlays for these purposes is provided through the tax system. In contrast, the second kind of social policy

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<sup>22</sup> An argument made clearly by, for example, Burbidge (1987).

<sup>23</sup> An even more worrying development, though not one further discussed here, is the striking move of many better-off families out of the public education system. This move may not only reduce support for public education -- and the taxes that support it -- but also lower its quality by removing some of the more articulate parents from the mix. It may also undesirably lead to a growing class division as those who have not mixed as children with people much different from themselves may as adults know -- or even care -- little about how the 'other half' lives. This is no way to build a sustainable state.

– notably social assistance – seems to be seen by many as being less of potential benefit to themselves and to be sort of a conscience-salving ‘public charity.’ Whether one finds it morally acceptable or not, such policies seem generally to be most strongly supported when, like the Elizabethan Poor Law of 1601, they are seen to be both narrowly targeted to the ‘deserving poor’ and strictly enforced to exclude others.<sup>24</sup>

Most people seem to support increased progressivity when it means taxing the ‘rich’ more, provided they are not persuaded that one result may be reduced employment opportunities or lower income growth. But few are eager to increase progressivity in the middle-income range (where most think they are), especially if they think the additional revenues will flow to people with whom they do not easily identify. Tax policy is difficult; but social policy is more difficult, and the need to consider more closely the interaction of the two needs to be taken more explicitly into account in formulating policy than most tax analysts seem to recognize, as is, of course, the critical problem of how tax changes can be sold to a seldom sympathetic audience. Redistribution may be what taxes are, in a sense, all about, but redistribution, like taxation itself, is a many-faceted and complex subject with important economic, political, and social dimensions, all of which need to be factored - somehow – into good tax policy.

### **What Does All This Mean for Future Tax Policy?**

Much current discussion of tax policy is focused on the international dimension. This is clearly important, but from a Canadian perspective about all we can do is to watch closely what is going on out there, try to influence outcomes when we can, and, above all, be ready to adapt quickly and make changes as necessary when the world throws trouble our way. It is of course easier to say this than to do it, especially in a federal country, but that is the game we are in. The ‘big boys’ have long set the rules in international taxation, and they are likely to continue to do so (Bird 1994). But with sufficient knowledge of what is going on, ‘small frogs’ that sufficiently cultivate the agility and skill to respond quickly and flexibility may continue to play and even prosper in a changing and uncertain world.

In any case, even if the world pushes one way or another Canada is the master of its own tax fate. Unless war or drastic environmental or international events force a drastic change in the level of taxes, we may perhaps stay more or less close to the present level at least for the next few years. However, the tax mix may change. For example, if additional revenue is needed at either the federal or provincial level, from a purely economic perspective perhaps the best way to get it would be to increase the GST/HST rate. After all, the main reason this tax exists is

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<sup>24</sup> Add reference to comparative enforcement of tax and social assistance programs?

solely to raise revenue in a relatively efficient way. However, given the past history of this tax in Canada, it is unlikely that much more revenue will be obtained from this source unless some fiscal crisis forces governments to do so. One possible move would be to reduce the visible blow by emulating the rest of the world and move away from separate quotation of the tax. Although this step would make governments even less accountable than they now are (Bird 2010), it might be a price worth paying in political terms if it made it possible to sustain our binding social policies. Short of a crisis, about the most we could perhaps do politically would be to creep gradually a bit towards broadening the GST tax base until crisis or demography finally forces us to face an explicit rate increase to finance health care and pensions. Other gradual, and desirable, reforms might also of course be made in other taxes – excises, payroll taxes, and property taxes, for example – but this is not the place to go into these matters.<sup>25</sup>

However, something has to be said about the personal income tax, which is not only the most important tax but the one of which people seem to be most aware and which, arguably, can be seen as a ‘mirror of democracy’ that provides, albeit ‘through a glass, darkly’, a useful view of the nature of state-society relations.<sup>26</sup> Recent concern about increases in inequality and other developments has already led to some mild increases in personal income tax rates, and tax changes in the near future seem likely to continue to focus on this tax. Some have argued that much more can and should be done along this line. But is making the personal income tax more explicitly progressive the best or most likely to be acceptable way to share the burden of financing government fairly? What about taxing capital income more heavily (and more evenly)? Or perhaps even (re-)Imposing some form of wealth tax? Tightening tax enforcement? All the preceding, and more? Is Focusing raising the top rate the best way to go? In fact, the highest effective marginal rates are imposed near the bottom of the rate scale owing to the imperfect and differentiated way in which personal taxes and transfers are integrated. More attention to cleaning up this mess at the bottom, most of which reflects poor design and unintegrated administrative systems would likely have a higher payoff in terms of both efficiency and distribution than simply increasing rates at the top, though admittedly this approach would likely be politically harder to sell.

Doing anything sensible about tax-transfer integration would of course also require a much higher degree of coordination and cooperation between federal and provincial governments than seems likely. But we need to work at this simply in order to cope more adequately with the

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<sup>25</sup> Similarly, the corporate income tax clearly could and should be reformed, but my views on this, if anyone is interested, may be found in Bird and Wilson (2018).

<sup>26</sup> The cited phrase comes from Weber and Wildavsky (1986, p.526, who interpreted the extent to which a country relied on visible income taxes as a symbol of the strength of egalitarianism and commitment to social justice. My argument here is that it is the second of these characteristics that is more important in Canada than the first.

changing world. In the end, whether it is the world or domestic factors that make significant tax changes necessary, we may even – though like all good Canadians, I hate to think of opening this can of worms again – have to consider how provincial interests might be better represented at the federal level. Even when there is such representation, federal countries often find it much more difficult to implement effective policies to cope with an uncertain world; but without it, life is definitely more difficult.