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# *Alliance tax policy: Getting it right*

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for a single tax rate  
was badly flawed

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With this column, Tom Flanagan, the distinguished political scientist from University of Calgary and author of best-selling books on aboriginal issues and the Reform party, joins the *National Post* as a regular contributor.

Being a good political leader means recognizing mistakes and correcting them before damage becomes irreversible. Canadian Alliance leader Stockwell Day recently demonstrated that ability when he released an election platform postponing, at least for the foreseeable future, his party's proposal for a single federal income tax rate of 17%. Contrary to the view taken last Friday by the *National Post's* editorial writers, this is a rectification, not a retreat.

The original proposal, adopted in the enthusiasm of transforming the Reform party into the Canadian Alliance, was badly flawed. In fact, it had three major flaws — two economic and one political.

Its first flaw was that it did nothing to prune the thicket of credits and exemptions now luxuriating in the tax code. All serious designs in other countries for a single-rate tax have proposed to eliminate as many of these as possible, partly because they amount to governmental micromanagement of individual economic decisions, and partly because they tend to be regressive. That is, the really large exemptions, such as the ones for RRSPs, confer a benefit only on those with enough disposable income to take advantage of them.

Exemptions and credits, once in place, create vested interests that are extremely difficult to dislodge, so it is understandable the drafters of the original Alliance single-rate proposal wanted to avoid a fight with tenacious defenders of the status quo. The result, nonetheless, was a flawed policy.

The second economic problem with the original proposal was that it neglected the complexity of the Canadian tax system. It properly posited the goal of a single rate of tax for all, but it forgot that taxes in Canada are imposed by at least four types of authorities: federal, provincial, and local governments, plus school boards. And there are not only many jurisdictions, but also many types of taxes in addition to the income tax — sales taxes, excise taxes, property taxes, payroll taxes, to mention only the most obvious.

Most of these impositions bear more heavily on low-income people than on those with higher incomes. Sales and excise taxes target consumption, which takes up almost all the income of people at the lower end of the scale, whereas people at the higher end have

money left over for savings and investment. Property taxes target housing, which is a particular kind of consumption. And payroll taxes, such as Employment Insurance, Canada Pension Plan and, medicare premiums in some provinces, are always capped at a certain level, rendering them regressive in their incidence.

Friedrich Hayek, the intellectual mentor of modern conservatism, recognized this problem in his classic work *The Constitution of Liberty*, where he wrote that "some progression in personal income taxation is probably justified as a way of compensating for the effects of indirect taxation." The current Canadian differential between the highest marginal rate — 29% — and the lowest — 17% — is undoubtedly too high, and the Alliance platform is on the right track in reducing the highest rate to 25%. In time, the top rate could probably decline even further; but as long as Canadians have to pay so many other regressive taxes, the federal income tax should remain mildly progressive.

The long-term goal of tax reform should be a system in which all Canadians (except the very poorest, who should be exempt from taxation altogether) pay the same average rate. But attaining that goal for the system as a whole requires retaining a mild graduation of rates in the federal income tax.

This is a fairly subtle point of economic theory, and it is not surprising that Mr. Day missed it earlier in the year, when he was flushed with the success of converting the Alberta income tax to a single rate. But a justifiable change in provincial taxation cannot simply be extrapolated to the federal level without taking these other complexities into account. Mr. Day and his advisers may not yet have

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## THE FEDERAL INCOME TAX SHOULD REMAIN MILDLY PROGRESSIVE

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grasped this point; they are defending their new stance with arguments about what can be afforded, not what is just. But there is plenty of time for them to master the nuances now that the fundamental direction has been properly chosen.

Finally, the third flaw in the Alliance's original proposal was that it overlooked the political difficulty of persuading public opinion of the merits of a single rate of taxation. The welfare state, unfortunately, has so institutionalized the politics of envy that many Canadians would reject a cut in their own taxes if they felt someone else was getting a bigger reduction. It will take some time to persuade the public that a reduction in confiscatory marginal rates is not an unfair benefit to those with higher incomes but rather the lifting of an unjust penalty that should never have been imposed in the first place.

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