Policy Forum: Tax Reform in Canada’s 43rd Parliament—Politics, Policy, and Second-Best Choices

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PRÉCIS

Un Parlement minoritaire à Ottawa demandera du gouvernement et des partis d’opposition qu’ils trouvent des domaines de convergence politique. Un de ces domaines pourrait être la prise de mesures pour effectuer un examen complet du système fiscal fédéral, ce à quoi s’étaient engagés plusieurs partis politiques dans leur campagne électorale. Il est possible de procéder à un exercice d’examen qui améliorera en fin de compte l’efficacité et l’équité du code des impôts fédéral, mais un tel examen devra reconnaître qu’on ne peut pas séparer la politique fiscale de la politique.

Cet article présente une analyse critique des appels à la création d’une commission royale ou à l’adoption du modèle big bang de réforme fiscale. Ces approches à la réforme fiscale supposent que la politique est un obstacle majeur à une réforme fiscale fondée sur des données probantes et que les impulsions politiques doivent être minimisées ou exclues du processus. Cette perspective ne tient pas compte des aspects normatifs de la politique fiscale et de la mesure dans laquelle les choix politiques sont façonnés par un mélange complexe d’intérêts, de préférences et de valeurs.

L’auteur plaide plutôt pour un exercice de réforme qui s’enracine dans les institutions et les processus politiques. Il propose en particulier un modèle progressif mais systématique de réforme fiscale qui s’inspire de l’expérience des « examens stratégiques » des dépenses de programmes au fédéral, menée de 2007 à 2011. Dans ce modèle, le gouvernement procéderait à des examens thématiques des dépenses fiscales (axés, par exemple, sur l’accès à la propriété, la retraite et l’épargne, et les investissements dans les énergies propres) sur une base régulière et continue, afin de rationaliser progressivement le système fiscal fédéral en consolidant et en redéfinissant les dépenses fiscales actuelles. Les résultats peuvent être moins transformateurs à court terme que ceux qui pourraient être obtenus par d’autres approches, mais ils conduiront en fin de compte à une réforme plus durable à long terme.

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ABSTRACT
A minority Parliament in Ottawa will require that the government and the opposition parties search for areas of policy convergence. One area where there is potential for cooperation is action on a comprehensive review of the federal tax system, which was an election commitment by multiple political parties. There is scope for a review exercise that ultimately can enhance the efficiency and equity of the federal tax code. But such a review will need to recognize that tax policy and politics cannot be divorced from one another.

This article presents a critical analysis of calls for a royal commission or adoption of the “big-bang” model for tax reform. These approaches to tax reform assume that politics is a major barrier to evidence-based tax reform and that political impulses need to be minimized or excluded from the process. This perspective neglects the normative aspects of tax policy and the extent to which policy choices are shaped by a complex mix of interests, preferences, and values.

Instead, the author argues for a reform exercise that is rooted in political institutions and processes. In particular, he proposes an incremental yet systematic model for tax reform that draws from the 2007-2011 experience with “strategic reviews” of program spending at the federal level. This model would envision the government conducting thematic reviews of tax expenditures (focusing, for example, on home ownership, retirement and savings, and clean energy investments) on a regular, ongoing basis, in order to gradually rationalize the federal tax system by consolidating and redesigning current tax expenditures. The results may be less transformative in the short term than those potentially achievable by alternative approaches, but will ultimately lead to more durable reform over the long term.

KEYWORDS: TAX REFORM ■ TAX POLICY ■ TAX EXPENDITURES ■ EFFICIENCY ■ EQUITY ■ POLITICAL ECONOMY

CONTENTS
Introduction 36
The Case for Tax Reform 38
Is It Time for a Royal Commission? 39
Conditions for Successful Tax Policy Reform 41
The Strategic Review Model—An Alternative to a Royal Commission 44
Conclusion 47

INTRODUCTION
As we approach the 2020 federal budget, there is plenty of speculation about how the Trudeau government will navigate the interplay between politics and policy that is inherent to budget making in a minority parliament. If “politics is the art of the possible,” as Otto von Bismarck famously observed, designing a budget for a minority context is often an exercise in second-best theory. It will invariably involve a series of political trade-offs.

1 R.G. Lipsey and Kelvin Lancaster, “The General Theory of Second Best” (1956) 24:1 Review of Economic Studies 11-32 (https://doi.org/10.2307/2296233).
In October 2019, Canadians elected a Parliament with a strong Liberal plurality but without sufficient votes to pass legislation or maintain the confidence of the House without support from other parties. Identifying policy and political convergence will therefore be key to the government’s survival. The good news is that there are some areas of broad political convergence that can be the subject of cross-party support in the 43rd Parliament. Perhaps the most significant example is tax policy.

The major political parties differed on various aspects of tax policy in the 2019 campaign, but there were also areas of considerable overlap. There was some combination of support for several policy changes, including lowering personal income taxes for low-income earners,\(^2\) increasing the generosity of the volunteer firefighter tax credit,\(^3\) cracking down on tax loopholes,\(^4\) and modernizing the tax treatment of non-domiciled digital service providers.\(^5\)

The most interesting area of political convergence on tax policy, however, may be the Liberal and Conservative parties’ agreement on the need for a review of the federal tax code. There is certainly scope for such an exercise, as previous Canadian Tax Journal articles have observed.\(^6\) The growing number of tax expenditures has complicated the tax system and in turn made it less efficient and less progressive. A tax reform exercise that sought to achieve rationalization could therefore conceivably achieve both conservative and progressive ends.

But, as this article argues, tax reform will not occur according to the “big-bang” model favoured by some politicians, business organizations, and policy experts. This approach, including the creation of a royal commission, fails to reckon with the extent to which tax policy is informed and shaped by normative factors that cannot be reconciled through technocratic processes or sweeping changes. Instead, tax reform will need to come in the form of an incremental yet systematic model. One might think of it as an ongoing exercise of second-best choices rooted in theory and practice.

\(^2\) Liberal Party of Canada, Forward: A Real Plan for the Middle Class (Ottawa: Liberal Party of Canada, 2019), at 7 (https://2019.liberal.ca/wp-content/uploads/sites/292/2019/09/Forward-A-real-plan-for-the-middle-class.pdf); and Conservative Party of Canada, Andrew Scheer’s Plan for You To Get Ahead (Ottawa: Conservative Party of Canada, 2019), at 3 (https://cpc-platform.s3.ca-central-1.amazonaws.com/CPC_Platform_8.5x11_FINAL_EN_OCT11_web.pdf).

\(^3\) Andrew Scheer’s Plan for You To Get Ahead, supra note 2, at 8; and New Democratic Party of Canada, A New Deal for People: New Democrats’ Commitments to You (Ottawa: NDP, 2019), at 87 (https://action.ndp.ca/page/-/2019/Q2/2019-06-19_Commitments-Doc_EN.pdf).

\(^4\) Forward: A Real Plan for the Middle Class, supra note 2, at 79-80; and A New Deal for People: New Democrats’ Commitments to You, supra note 3, at 44.

\(^5\) Forward: A Real Plan for the Middle Class, supra note 2, at 79; Andrew Scheer’s Plan for You To Get Ahead, supra note 2, at 100; and A New Deal for People: New Democrats’ Commitments to You, supra note 3.

\(^6\) See, for example, Fred O’Riordan, “Policy Forum: Why Canada Needs a Comprehensive Tax Review” (2018) 66:2 Canadian Tax Journal 351-62.
The first section of the discussion that follows will examine the case for tax reform. The second section will consider the limits of an arm’s-length tax review process, including the possible creation of a royal commission, owing in large part to the inherent politics of tax policy. The third section will describe the political economy conditions for successful tax policy reforms. The fourth and final section will set out the case for an incremental yet systematic approach to tax reform that can make steady and ongoing progress in the direction of rationalization.

THE CASE FOR TAX REFORM

It is not surprising that the Liberal Party and the Conservative Party have both committed to a review of the federal tax system. The idea has been percolating in Ottawa for several years. It is the subject of growing support among stakeholders that include the Business Council of Canada\(^7\) and the Canadian Chamber of Commerce,\(^8\) Senate committees,\(^9\) and other high-profile voices.\(^10\) Some have even argued for the establishment of a royal commission.\(^11\)

What is the motivation for tax reform?

The Liberal Party and the Conservative Party have different reasons behind their platform commitments. The Liberal Party’s proposal was framed primarily around enhancing progressivity. The Conservative Party’s case for such a review was mostly focused on improving economic competitiveness. Yet these rationales are not necessarily incompatible. Most stakeholders who have advocated for such a review seem to be motivated by the goals of tax simplification and broad-based tax reform (involving a broader base and flatter rates) that could conceivably improve both efficiency and equity.

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7 Jesse Snyder, “Business Group Calls for Sweeping Tax Reforms Ahead of Federal Election as Competitiveness Worries Deepen,” *National Post*, April 25, 2019 (https://nationalpost.com/news/politics/business-group-calls-for-sweeping-tax-reforms-ahead-of-federal-election-as-competitiveness-worries-deepen).

8 Canadian Chamber of Commerce, “Time To Cut Canada’s Losses on Obsolete Tax System, Says Canadian Chamber of Commerce,” *News Release*, October 4, 2019 (www.chamber.ca/media/news-releases/Time_to_cut_Canada%27s_losses_on_obsolete_tax_system).

9 See, for example, Canada, Senate, *Fair, Simple and Competitive Taxation: The Way Forward for Canada: Report of the Standing Senate Committee on National Finance* (Ottawa: Senate Standing Committee on National Finance, December 2017) (https://sencanada.ca/content/sen/committee/421/NFFN/Reports/NFFN_Tax_Planning_24th_Report_e.pdf).

10 For example, Alan Lanthier, “The $40-Billion Reason Canada Needs Real Corporate Tax Reform,” *Financial Post*, July 16, 2019 (https://business.financialpost.com/opinion/the-40-billion-reason-canada-needs-real-corporate-tax-reform).

11 Gerry Macartney, “Canada Needs a New Royal Commission on Taxation,” *London Free Press*, February 22, 2019 (https://lfpress.com/opinion/columnists/macartney-canada-needs-a-new-royal-commission-on-taxation); Mike Holden, *Restoring Canada’s Advantage: A Need for Tax Reform* (Canadian Manufacturers & Exporters and BDO, June 2018) (https://cme-mec.ca/wp-content/uploads/2018/11/Doc_QC_Restoring-Canadas-Advantage.pdf); and Jim Warren, “It’s Time for a Royal Commission on Taxation,” *Toronto Sun*, November 11, 2017 (https://torontosun.com/opinion/columnists/warren-its-time-for-a-royal-commission-on-taxation).
The case for such reforms is certainly justified. It has been nearly 30 years since the federal government undertook a serious reform of the credits, deductions, and other special provisions included in the tax code. The result is a buildup of tax expenditures that complicate the tax system, narrow the tax base, and harm both efficiency and progressivity.

The cost to government is also significant. Tax expenditures in the federal tax system alone now represent as much as $117.9 billion in forgone revenues or more than half of total revenues from income taxes and the goods and services tax (GST). A 2014 study by former Statistics Canada chief statistician Munir Sheikh estimated that the size of government in Canada when accounting for tax expenditures increased from 44 percent to 54 percent of gross domestic product.

Yet while we have seen regular reviews of program spending over the past 25 years, the federal tax system has not been subjected to the same level of rigour. This amounts to effectively excluding from regular and ongoing scrutiny a set of federal policies that in total represent as much as three-quarters of direct program spending. There is a therefore good case for the federal government to launch a review of the tax system with the goal of making it more efficient, fairer, and simpler.

**IS IT TIME FOR A ROYAL COMMISSION?**

The question of course is, how should such a review be conducted?

The Policy Forum in a 2018 issue of this journal grappled with this question. The “how,” as Jennifer Robson put it in one of the issue’s articles, is as important as the “what” because the format and process will invariably shape the eventual policy outcomes.

The prevailing view among contributors to that Policy Forum was that, on balance, comprehensive reform was preferable to incremental changes and an

12 Canada, Department of Finance, *Report on Federal Tax Expenditures—Concepts, Estimates and Evaluation* 2017 (Ottawa: Department of Finance, 2017) (www.canada.ca/en/department-finance/services/publications/federal-tax-expenditures/2017.html). There are limits to summing up the cumulative costs of tax expenditures because of the interaction of such measures. Changes to the basic personal amount, for instance, would affect revenue costs of other tax credits. Still, the Department of Finance’s estimate of $117.9 billion is a good back-of-the-envelope indication of the magnitude of the federal government’s mix of tax expenditures.

13 Munir A. Sheikh, *Estimating the True Size of Government: Adjusting for Tax Expenditures* (Ottawa: Macdonald-Laurier Institute, February 2014) (www.macdonaldlaurier.ca/files/pdf/MLISheikhPaper02-14-final.pdf).

14 Direct program spending (which excludes transfers to persons and other levels of government) is estimated to be roughly $152 billion in 2019-20: Canada, Department of Finance, 2019 Budget, Budget Plan, March 19, 2019, at 289, table A2.6.

15 “Policy Forum” (2018) 66:2 *Canadian Tax Journal* 349-99.

16 Jennifer Robson, “Policy Forum: Building a Tax Review Body That Is Fit for Purpose—Reconciling the Tradeoffs Between Independence and Impact” (2018) 66:2 *Canadian Tax Journal* 375-86, at 377.
arm’s-length process was preferable to conventional policy making.\(^\text{17}\) Joseph Heath’s article, which proposed a permanent administrative agency that would have delegated responsibility for setting tax policy similar to the Bank of Canada’s role in monetary policy, was the most decidedly in favour of such a technocratic model.\(^\text{18}\) As he wrote, “an ITA [independent tax authority] represents a response to a genuine problem, which is the exploitation by politicians of public ignorance and irrationality with respect to taxes.”\(^\text{19}\)

The underlying assumption for these different models (including a royal commission) is that there is a need to “depoliticize” the review process in particular and tax policy more generally.\(^\text{20}\) The models vary by degree on how to achieve this goal. The common view, though, is that a technocratic process would insulate federal tax policy from the vicissitudes of politics.

This perspective fails, in my view, to properly account for the normative dimension of tax policy. The unit of taxation, the level of progressivity, the trade-off between efficiency and equity, and even definitions of income are informed and shaped by normative forces. Delegating these choices to economists or tax policy experts is asking them to act as moral philosophers.\(^\text{21}\)

Of course, we can attempt to bring empirical analysis to bear in trying to address these questions. Analyses of the costs of taxation or the marginal efficiency costs of different forms of taxation,\(^\text{22}\) or of behavioural responses to changes in marginal tax rates,\(^\text{23}\) are useful inputs into the policy process. But it is misguided to think that data and evidence are all we need to craft an optimal tax policy framework. Most people, including economists, ultimately rely on a complex set of preferences to reconcile the inherent tensions in public policy. It is no surprise, therefore, that research finds that few of us actually hold strict utilitarian views on tax policy.\(^\text{24}\)

\(^{17}\) The exception was Shirley Tillotson, whose contribution was a historical perspective on past tax reform efforts. She argued in favour of “incremental change” because of the inevitable role of politics. See Tillotson, “Policy Forum: Then and Now—A Historical Perspective on the Politics of Comprehensive Tax Reform” (2018) 66:2 Canadian Tax Journal 363-74, at 373-74.

\(^{18}\) Joseph Heath, “Policy Forum: From Independent Tax Commission to Independent Tax Authority” (2018) 66:2 Canadian Tax Journal 387-99.

\(^{19}\) Ibid., at 389.

\(^{20}\) Ibid., at 387.

\(^{21}\) Benjamin B. Lockwood and Matthew Weinzierl, “Positive and Normative Judgments Implicit in U.S. Tax Policy, and the Costs of Unequal Growth and Recessions” (January 2016) 77 Journal of Monetary Economics 30-47.

\(^{22}\) Jason Clemens, Niels Veldhuis, and Milagros Palacios, “Tax Efficiency: Not All Taxes Are Created Equal” [2007] no. 4 Studies in Economic Prosperity (www.fraserinstitute.org/studies/tax-efficiency-not-all-taxes-are-created-equal).

\(^{23}\) Canada, Department of Finance, Tax Expenditures and Evaluations 2010 (Ottawa: Department of Finance, 2010), at 45-65.

\(^{24}\) Matthew Weinzierl, “The Promise of Positive Optimal Taxation: Normative Diversity and a Role for Equal Sacrifice” (2014) 118 Journal of Public Economics 128-42 (http://dx.doi.org/10.1016/j.jpubeco.2014.06.012).
If tax policy is messy and complicated, this is in large part because our competing normative perspectives on the underlying questions are messy and complicated. Decisions on tax policy are, in my view, less about exploitation by politicians of public ignorance\textsuperscript{25} and more about the work of politics to try to reconcile our differences. The outcome may be suboptimal, but optimality is a mostly conceptual question in a world of competing interests, preferences, and values.\textsuperscript{26}

Reconciling these tensions is an inherently political project. It is even more so given that the government’s taxing power is a fundamental part of the social contract between individuals and the state.\textsuperscript{27} We grant the state a taxation capacity to ensure that the distribution of public benefits and public burdens is decided by collective political deliberation rather than by individual actions and choices. Government is then responsible for the protection of property rights, production of public goods, and redistributive goals on our behalf.

It is therefore wrong to think of taxation as merely a technical matter similar to monetary policy. It is more accurate to see it as foundational to our relationship with the government and how the state interacts with individuals and the broader society. Outsourcing responsibility for tax policy’s design, development, and implementation, as Heath and others propose, neglects this fundamental point.

The key takeaway then, in my view, is that efforts to divorce tax policy from politics are both conceptually mistaken and ultimately bound to fail. Politics is the rightful mechanism for tax policy questions.

**CONDITIONS FOR SUCCESSFUL TAX POLICY REFORM**

This, of course, does not mean that the Liberal Party and the Conservative Party should abandon their commitments to carry out a review of the federal tax system. It just means that the process needs to lean into politics rather than try to exclude it.

One way to judge how to best account for the role of politics is to think about conditions for successful tax policy reform. While this may seem counterintuitive, the best approach is to consider the characteristics of failed policy changes. There are, in my experience, three factors associated with unsuccessful tax reforms that can inform how to design a more effective process. It is worth outlining them here before developing a better model for the Trudeau government to deliver on its platform pledge.

\textsuperscript{25} As argued by Heath, supra note 18.

\textsuperscript{26} Sean Speer, “We Need To Restore Our Diminished Politics,” *Policy Options Politique*, September 18, 2019 (https://policyoptions.irpp.org/magazines/september-2019/we-need-to -restore-our-diminished-politics).

\textsuperscript{27} Allison Christians, *Sovereignty, Taxation, and Social Contract*, University of Wisconsin Law School Legal Studies Research Paper no. 1063 (Madison, WI: University of Wisconsin Law School, August 2008) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1259975).
The first factor is that complexity is a vice. Not only is it impossible for taxpayers to understand a complex set of changes; it is also challenging for policymakers to communicate them, and in turn becomes much easier for critics to set the prevailing narrative. Complexity also often leads to longer implementation timelines, which produce more political exposure.28

The second factor is that a government cannot have too many political fronts open at once. Otherwise the government risks creating the perception that it is embattled and increases the probability for a policy reversal. Reform gradualism, by contrast, can enable policymakers to be intentional about targeting different policy areas and taxpayer groups at different times.29

The third factor is that reform cannot be distributionally skewed. It is notable, for instance, that while the totality of the Harper government’s tax policies enhanced the tax system’s progressivity, the government was still criticized for its policy changes that benefited higher-earning households.30 That experience is a reminder that the current political environment will not permit a set of tax changes that are not carefully calibrated to achieve distributional balance or even enhanced progressivity. Such calibration can be more difficult when a government is attempting to manage several reforms involving various tax expenditures and even different forms of taxation.31 The recent US tax reform package in 2017 may present a counter-example to this premise, but that episode might best be explained as a product of the United States’ unique political institutions and its dire need to reform the tax treatment of corporations.

Proponents of “big bang” tax reform tend to argue that it is a better model than incremental change because it can more effectively deal with interactions among parts of the tax system—think, for instance, of the integration between personal and corporate income taxes—and provides policymakers with more tools to trade off efficiency and distributional considerations. These arguments are not without basis. In an idealized world, the “big bang” model would be the most efficient means of producing a better tax system.

But democracy and pluralism are not necessarily prone to efficiency, especially in a world of competing preferences and competing views about the public interest. Those arguing in favour of the “big bang” model or of outsourcing reform decisions to non-political actors do not tend to satisfactorily engage the inherent role of politics in reconciling these differences in tax policy. This is a huge blind spot.

28 Bert Brys, Making Fundamental Tax Reform Happen, OECD Tax Working Papers no. 3 (Paris: OECD, 2011) (https://doi.org/10.1787/22235558), at 20.
29 Paola Profeta and Simona Scabrosetti, “The Political Economy of Taxation in Europe” (2017) 220:1 Hacienda Pública Española/Review of Public Economics 139-72 (www.ief.es/docs/destacados/publicaciones/revistas/hpe/220_Art5.pdf).
30 Trevor Shaw, Revenue and Distributional Analysis of Federal Tax Changes: 2005–2013 (Ottawa: Office of the Parliamentary Budget Officer, May 27, 2014) (www.pbo-dpb.gc.ca/web/default/files/files/files/files/Fiscal_Impact_and_Incidence_EN.pdf).
31 See Brys, supra note 28.
Recent debates about income splitting for two-earner families, or higher rates for top income earners, or carbon taxation, are not evidence of politics run amok. They are examples of politics working through nuanced questions involving a combination of normative and empirical considerations.

Experts, organizations, and scholars in favour of a royal commission (or some variation thereof) also do not satisfactorily engage the political economy challenges associated with instituting sweeping, comprehensive reforms or outsourcing the process to non-political actors. This is another blind spot and is especially problematic in a populist moment when western societies are expressing skepticism about the wisdom of experts. The cultural, political, social, and technological environment has fundamentally changed since the Carter commission. It stands to reason that we similarly need to adjust how we think about the right model for reviewing and reforming the federal tax system.

Managing the risks of complexity, political exposure, and distributional effects is best achieved by an incremental yet systematic model developed through conventional policy making. A focused, targeted approach to tax reform enables policy makers to take on a discrete piece of the tax system and to refine and adjust its design in a relatively short time frame involving a clear and identifiable group of taxfilers. This model allows policy makers to navigate the normative waters of tax policy with fewer challenges than they face when aiming to take on the whole system at once. It will be less ambitious than some stakeholders would prefer and may require second-best choices. But if well-structured and properly executed, it can achieve steady and ongoing progress in the direction of rationalization.

The goal should be to replicate the Trudeau government’s consolidation of caregiving tax expenditures in the 2017 budget across other parts of the tax system. The new Canada caregiver credit consolidated three separate tax expenditures related to caregiving, streamlined the eligibility rules, enhanced the generosity, and ultimately simplified the tax system. These changes were broadly supported by stakeholders as well as tax and social policy experts.

The 2017 measures are a good example of politics and policy reinforcing one another. The government was able to advance a political priority related to caregiving at minimal incremental cost because the three existing tax expenditures were

32 Tom Nichols, “How America Lost Faith in Expertise and Why That’s a Giant Problem,” *Foreign Affairs*, March/April 2017 (www.foreignaffairs.com/articles/united-states/2017-02-13/how-america-lost-faith-expertise).

33 The Royal Commission on Taxation, which issued its six-volume report in 1966-67.

34 Canada, Department of Finance, 2017 Budget, Budget Plan, March 22, 2017, at 204-5.

35 See, for example, Sherri Torjman, Michael Mendelson, and Ken Battle, *The 2017 Farewell Budget* (Ottawa: Caledon Institute of Social Policy, March 2017) (https://maytree.com/wp-content/uploads/1111ENG.pdf); and Canadian Cancer Society, “Federal Budget Investment in Home and Palliative Care a Win for Cancer Patients,” *Press Release*, March 22, 2017 (www.cancer.ca/en/about-us/for-media/media-releases/national/2017/federal-budget-announcement/?region=on).
already costing roughly $185 million per year.36 And in turn we got a simpler, more progressive, and better-functioning tax system.

The government should carry out similar thematic reforms across the federal tax system. It can tackle a specific set of policy themes each year and incrementally yet systematically make progress in the direction of rationalization through a combination of consolidation and redesign.

THE STRATEGIC REVIEW MODEL—AN ALTERNATIVE TO A ROYAL COMMISSION

What model could the government draw from?

The Harper government’s experiment with regularized, annual reviews of program spending may provide a useful model. The “strategic review” process ran from 2007 to 2011 as a bottom-up exercise to scrutinize program spending across federal departments.37 The goal was not primarily focused on fiscal savings but rather on controlling the growth of new spending. Strategic reviews were supposed to identify low-priority spending that could be reallocated to new, higher priorities.

Roughly 25 percent of federal program spending was reviewed annually over a four-year cycle. Programs and services were subjected to various tests—including core federal role, efficiency, and priorities—and 5 percent of departmental spending was to be reallocated from low-performing, low-priority activities to higher ones. Ministers identified fiscal savings in their respective portfolios and were able to put forward proposals suggesting where these savings could be “reinvested” in their departments.

Strategic reviews contributed to some useful reforms and helped to control the growth of new program spending. The results were reflected in the federal budgets from 2008 to 2011.38 In total, $2.8 billion in annual savings was realized and recycled to new and different priorities.39

There is scope to extend the strategic review model to the tax system. It would not be precisely the same for various reasons, including (but not limited to) the concentration of tax expenditures in the Department of Finance. But the government could fulfill its platform commitment by establishing a regularized review process that evaluates and reforms different components of the tax system on an annual basis.

36 The caregiver credit was $100 million, the family caregiver tax credit was $75 million, and the infirm dependant tax credit was $10 million. Canada, Department of Finance, Report on Federal Tax Expenditures—Concepts, Estimates and Evaluations 2016 (Ottawa: Department of Finance, 2016), at 34.

37 Treasury Board of Canada Secretariat, “Strategic Reviews” (www.tbs-sct.gc.ca/sr-es/index-eng.asp).

38 Kevin McCarthy and Sean Speer, “Supporting Ontario’s Fiscal Strategy,” Ontario 360, November 26, 2019 (https://on360.ca/policy-papers/supporting-ontarios-fiscal-strategy).

39 See “Strategic Reviews,” supra note 37.
Rather than targeting a share of spending, a strategic review process for the tax system could operate on a thematic basis similar to the consolidation of caregiving-related tax expenditures. This thematic model could be expanded to include home ownership, post-secondary education, employment, medical expenses, savings and retirement, and aging, as well as fossil fuels, clean energy investments, research and development, capital expenses, and small businesses.

Consider home ownership, for instance. Currently the federal tax code contains at least six housing-related tax expenditures totalling over $7 billion per year in forgone revenues. Accepting that the government intends to continue supporting housing and home ownership through the tax system, one could envision a simpler, more efficient, and fairer approach than the current mix and design of tax expenditures.

One of the benefits of the consolidation approach is that the Department of Finance already organizes its tax expenditures along thematic lines in its annual report on federal tax expenditures. A multi-year review process could be organized on the basis of the report’s themes or a subset of them.

Another benefit is that the consolidation approach aligns with the three political economy conditions for successful reforms. It is relatively simple, since it is limited to a single policy theme; and because it targets an identifiable set of taxpayers, it helps with communications and designing a distributionally neutral package. It also prevents a political lag or policy uncertainty between the elimination of any tax expenditures and the related announcement of new policies.

How would this approach work in practice?

Each year the government could tackle some number of thematic groups with the goal of simplification and greater progressivity in the personal income tax system, and simplification and efficiency in the corporate income tax system. The exercise could target revenue neutrality, aim for net revenue gains as part of an overall fiscal strategy, or even incur net costs if the reforms were part of a broader policy strategy, such as the caregiving example. The reviews could be conducted each summer, and the results could be effectuated in the subsequent budget.

The review process would be managed by the Department of Finance, but it would necessarily involve input and perspective from officials in other departments as well as external experts. The involvement of departmental officials would be important to understanding the interaction of tax-based policies with other, related federal programs and the relative utility of those policies. Think, for instance, of the role of tax expenditures related to home ownership and the Canada Mortgage and

40 These include the first-time home buyers’ tax credit, the non-taxation of capital gains on principal residences, the home buyer’s plan, the GST exemption for certain residential rent, the GST rebate for new housing, and a rebate for new residential property. Canada, Department of Finance, Report on Federal Tax Expenditures—Concepts, Estimates and Evaluations 2019 (Ottawa: Department of Finance, 2019). The list could also include the non-taxation of imputed rent, which is not classified as a tax expenditure by the department but is considered by some economists as a deviation from a pure Haig-Simons tax base.
Housing Corporation’s mortgage insurance. It would also be useful to draw on analyses by external experts to determine the effectiveness of different tax expenditures. Think, for instance, of academic research on the children’s fitness tax credit\(^\text{41}\) or the labour-sponsored venture capital tax credit.\(^\text{42}\)

In order to inform and guide the thematic reviews, the government could make use of a standardized checklist to evaluate tax expenditures. This would help to inform decisions about possible reforms similar to the tests applied to program spending in the strategic review process. The US Government Accountability Office (GAO) has produced a useful checklist for evaluating tax expenditures.\(^\text{43}\) The framework sets out criteria and analytical questions for policy makers to consider in weighing competing priorities and evaluating the merits or effectiveness of a particular tax expenditure.

The checklist consists of five considerations, each involving a series of tests or metrics:

1. What is the tax expenditure’s purpose, and is it being achieved?
2. Even if its purpose is being achieved, is the tax expenditure good policy?
3. How does the tax expenditure relate to other federal programs?
4. What are the consequences of the tax expenditure for the federal budget?
5. How should evaluation of the tax expenditure be managed?

There is room to improve the GAO’s framework. First, item 2 should be changed to add “Is the tax expenditure the best way to achieve this goal?” There may be worthy goals that are not best supported or promoted through the tax system. Second, item 4 should be changed to consider the interaction and effect of federal changes on provincial responsibilities such as health care and education.

The government could use the checklist for internal purposes only, or it could release the results as part of its annual budget, where it would ostensibly enact any resulting policy changes. Making the completed checklists public could have political economy benefits by clearly and comprehensively outlining the justifications for reforms in a standardized form. And it would require the inevitable critics to contend with the substantive results of the review rather than merely criticize the government’s motives.

\(^{41}\) John Spence, Nicholas Holt, Julia Dutove, and Valerie Carson, “Uptake and Effectiveness of the Children’s Fitness Tax Credit in Canada: The Rich Get Richer” (2010) 10 BMC Public Health (https://doi.org/10.1186/1471-2458-10-356).

\(^{42}\) Douglas Cumming, Jeffrey MacIntosh, and Keith Godin, “Crowding Out Private Equity: Canadian Evidence,” Fraser Alert, September 2007 (https://pdfs.semanticscholar.org/bab0/190103eae482746f6c359872024cdef4f247b.pdf).

\(^{43}\) United States, Government Accountability Office, Tax Expenditures: Background and Evaluation Criteria and Questions, document no. GAO-13-167SP (Washington, DC: GAO, November 2012) (www.gao.gov/products/GAO-13-167SP).
The use of such a checklist would not remove the role for preferences and values, but it would root our normative debates in a common set of evidence and facts. This would mitigate one of the biggest challenges arising from the small-business tax controversy in 2017. Normative differences in that case were exacerbated by unclear and competing understandings of the facts.44

Moving through the tax system on an incremental and thematic basis may not produce fundamental change, especially in the short term. But if the government were able to replicate the caregiving-related reforms across the tax system, we would, over time, incrementally get a simpler, more efficient, and fairer tax code. That strikes me as a highly satisfactory second-best outcome.

CONCLUSION

As the federal government determines how to deliver on its commitment to review the federal tax system, it should resist calls for a royal commission or other approaches that would attempt to divorce tax policy from politics. Instead it should pursue a model that leans into politics and political economy insights about the conditions for successful tax reform.

An incremental yet systematic model based on the Harper government’s strategic review process can help the government to make progress on rationalizing the federal tax system. It will be less ambitious than some stakeholders would prefer and may require second-best choices. But this is unavoidable in an environment with a multiplicity of normative perspectives on the goals and design of tax policy. The reform process will necessarily require moderation and compromise. And that requires politics.

Still, if such a process for policy review and reform is well structured and properly executed, it can achieve steady and ongoing progress in the direction of rationalization of the federal tax system. This ought to be a basis for policy and political convergence in the context of a minority Parliament and into the future.

44 Sean Speer, “Who’s Right in the Small Business Tax Controversy?” Macdonald-Laurier Institute Inside Policy, September 15, 2017 (www.macdonaldlaurier.ca/whos-right-small-business-tax-controversy-sean-speer-inside-policy).
