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IS CANADA'S TAX BURDEN REALLY SO HIGH?

THERE ARE VERY FEW AREAS in which men are as willing to sacrifice the national interest for their own self-interest as in taxation. As is evident from even a very superficial reading of the briefs submitted before the various tax commissions and committees, each man thinks that his tax problem is, without doubt, the most pressing one and that he is the victim of a gross injustice. If only this or that tax were reduced, if that loophole were only expanded, the tax system would be more equitable and most of our nation's problems would soon disappear. We are so preoccupied with the details that we often treat them as if they were the be-all and end-all—as if, to quote a now old phrase, “What’s good for General Motors is good for the U.S.A.” This comment was not necessarily true then and there, nor is it necessarily true here and now. We cannot hope to understand the real significance of our tax system simply by concentrating on its parts. At some point, it becomes necessary to forget about the individual trees and to look only at the forest.

Perhaps more than members of any other profession, economists must function in an environment in which everyone thinks himself to be well-versed in the intricacies of their trade. And this popular confidence extends to principles, though not to the details, of taxation. Few people would try to tackle an intricate personal tax problem without first consulting their lawyer or accountant; but when it comes to complex economic relationships, there are many who are willing to take definite positions at the drop of a hat. Without examining the facts, or understanding the theory, laymen, particularly businessmen and newspaper editors, somehow feel that they have acquired through osmosis, revelation, or inheritance the ability to pontificate on the economic affairs of men and governments, despite the fact that modern-day economics is a highly complex discipline. This can lead, and often has led, to the widespread acceptance of completely untenable positions, or at best half-truths. The business community has been prone to accept superficial and very circumstantial evidence which has sometimes resulted in the assumption of a completely incorrect

sequence of causation. The real danger is that such misinformation may be repeated so frequently that it becomes, like popular fallacies concerning fertility rites, a part of folklore—a collection of myths so sacrosanct that they go unchallenged. Despite their questionable validity, we are expected to make many important personal, business, and public decisions on the basis of these wrong assumptions.

For one reason or another, the economics of taxation holds a prominent position among myth-makers, and it is my intention here to examine and perhaps puncture some of the widespread beliefs pertaining to the nation's tax burden. The timeliness of such a discussion could hardly be greater, in the light of the great concern over taxes which is presently exhibited in Canada. With several provincial investigations and a federal Royal Commission, everyone has been given the opportunity to proclaim his favourite slogan in public, and indeed many have taken advantage of that opportunity.

We begin with an examination of how the burden of Canada's taxes has changed with the years, and particularly in more recent years. Whatever else can be said about taxes, one thing is certain—the total number of tax dollars received by the various governments in Canada has been rising since Confederation. In 1866 total tax collections amounted to under \$16 million; in 1964 it would amount to more than \$11 billion. But no point could be served by going back into the last century. Limiting our discussion to the post-World-War-II period, we can observe the same development, namely that the tax levy has increased. From approximately \$2¾ billion at the end of the war, it has undergone about a four-fold increase to the present \$11 billion level. The figures for selected years are presented in Table I.

TABLE I

TOTAL TAXES¹ IN CANADA (CURRENT DOLLARS) AND AS A PERCENTAGE OF GROSS NATIONAL PRODUCT FOR SELECTED YEARS, 1944-1963

<i>Year</i>	<i>All Governments (in millions of dollars)</i>	<i>All Governments as a Percentage of GNP</i>
1944	2,842	24.0
1945	2,703	22.8
1946	2,985	25.2
1947	3,313	25.2
1950	3,840	21.3
1951	5,099	24.1

1952	5,579	23.3
1953	5,727	22.9
1954	5,610	22.6
1955	6,157	22.7
1956	6,973	22.8
1957	7,314	22.9
1958	7,186	21.8
1959	8,207	23.5
1960	8,707	24.0
1961	9,209	24.6
1962	10,141	25.1
1963 ²	10,850	25.1

¹ Does not include employer and employee contributions to social insurance and government pension funds.

² Preliminary.

SOURCE: Canadian Tax Foundation, *The National Finances* (Toronto, 1963).

Now it would be very easy, though somewhat naïve, to conclude from these figures alone that the tax burden—the impact of these taxes on our economic lives—has become greater. I suspect that many amateur observers do just this. They reason that since the figures have become greater, the burden must be a heavier one. But how logical is it to look simply at absolute numbers? The present tax receipts in the United States amount to about \$130 billion, or twelve times more than tax receipts in Canada. Does this mean that taxes are twelve times more oppressive on the American economy than on the Canadian? Obviously not! First of all, we are talking about different dollars, but this is also true in comparing 1944 Canadian dollars with 1964 Canadian dollars. Secondly, if we are concerned with the impact of this burden on individuals, then we would have to take account of the fact that there is a considerably larger population in the United States to share the total tax burden. But this, too, is true in comparing 1944 taxes in Canada with 1964 taxes in Canada. The present tax burden can be divided up among a larger number of Canadians. Thirdly, if we are interested in the impact on the total economy, then we would quickly recognize that while the Americans pay more dollars to their governments, they can take these out of a much larger total income. But once more the same is true over the years for Canada. While total taxes have risen, the source of these taxes, the nation's income, has also risen so that one is not justi-

fied in concluding anything about the change in the tax burden without first relating it to the nation's income. The important question in measuring the national burden is not simply what has been happening to absolute tax dollars, but rather what has been happening to the proportion of the nation's output taken up by taxes. What is the percentage of total taxes to Gross National Product? These percentages are presented in Table I above. In 1944 taxes absorbed 24 per cent of GNP, and have fluctuated around this level ever since. At present they are running around 25 per cent. Rather than any distinct secular (or "long-term") trend, this ratio appears—probably because of the built-in flexibility of some of our taxes—to be more closely a function of the economy's cyclical movements. Taxes tend to fall more rapidly than GNP in periods of recession, and they rise more rapidly during prosperous times. Such movements, of course, are completely consistent with a desirable fiscal policy.

It appears, therefore, that the Canadian tax burden, expressed in any meaningful way, has in fact hardly increased in recent decades. Instead it has exhibited a somewhat surprising stability. Yet, in spite of the facts, there is a widely accepted opinion circulating in Canada that it is our *rising* tax burden which accounts for our economic difficulties.

We now turn to a second though related aspect of the Canadian tax burden which is equally the subject of discussion. In an open economy such as Canada's, it is hardly surprising that a great deal of attention is given to our position *vis-à-vis* other countries. In recent years, during which our balance of payments has often experienced deterioration, there has been a growing number of people who have pointed to the tax burden as the source of the trouble. In several briefs to the Carter Royal Commission, reference was made to the relatively high tax burdens in Canada. Other countries, it was suggested, have a price advantage and a higher growth rate because they have been able to maintain a tax burden somewhat lower than ours. But how valid is this assumption? Does an examination of the relevant statistics support the proposition that Canada is a relatively "high-tax" nation? In order to permit a meaningful comparison, one must obtain data which reflect a high degree of consistency. Fortunately, several publications of the United Nations provide us with such data. In order to avoid any misrepresentations caused by such unusual developments as an election, the figures presented here are averages for the ten-year period 1950-1960, or, if less than ten, for as many years as possible.

TABLE II
TAX BURDENS AND ECONOMIC GROWTH RATES
OF SELECTED COUNTRIES
(AVERAGES 1950-1960)

<i>Country</i>	<i>Taxes as a Percentage of GNP</i>	<i>Average Annual Growth Rate in Real Per Capita Product</i>
West Germany	32.9	6.0
France	32.6	3.4
Austria	31.0	5.6
Finland	30.8	3.6
Norway	30.6	2.4
Netherlands	30.4	3.4
Luxembourg	30.2	2.6
United Kingdom	29.5	2.2
Sweden	28.1	3.2
Italy	27.5	5.4
New Zealand	26.7	
United States	26.1	.9
CANADA	24.3	.6
Denmark	23.6	3.1
Belgium	23.0	2.0
Australia	22.9	
Ireland	22.0	2.0
Japan	20.6	8.4
Greece	19.2	5.2
Barbados	18.8	
Chile	17.4	.9
Portugal	17.1	4.2
China (Taiwan)	16.0	3.7
South Africa	15.6	
Malta	15.3	
Burma	14.7	4.6
Trinidad and Tobago	14.6	6.0
Ecuador	14.3	1.4
Mauritius	14.3	

Costa Rica	133	
Panama	126	
Peru	126	7
Spain	124	
Jamaica	123	63
Colombia	112	22
South Korea	108	25
Philippines	95	24
Honduras	93	.4
India	83	13
Nigeria	83	

SOURCE: Based upon United Nations data.

The national tax burdens for some forty countries, depicted by the ratio of total taxes to Gross National Product, are presented in Table II. If we rank these burdens from highest to lowest, Canada ranks thirteenth. Now it would first appear that this ranking places Canada in an unfortunate position, but on closer inspection it will be noticed that the lower burdens are almost invariably carried by newly emerging nations. Compared with her equals in the Western industrial world, Canada appears as a nation that carries one of the lowest tax burdens. Since by far the largest part of our trade is carried out with these higher-tax-burden nations, it is not readily evident why we should place so much of the blame upon taxes for a deterioration in our foreign balances. In the first place, therefore, the statement that Canada is a high-tax nation is not completely true, if we limit our comparison to the nations that really count.

Second, how does this comparison support the hypothesis that our high tax burden accounts for our low growth? Included in Table II is a measure of growth for countries in which such a measure was readily available. On the basis of this measure alone, there is certainly no statistical proof that low tax burdens are more conducive to economic growth than are high tax burdens. West Germany with a higher tax burden than ours has had a rate of increase in real per capita product about ten times greater than our own. In fact, *every* country whose burden has been higher has had a better performance. At the same time, there are many countries with lower tax burdens than ours who have *also* been able to exceed our per capita growth. Tax data by themselves are therefore not sufficient to explain the effect of taxes on growth. This was most succinctly expressed in the brief submitted to the Carter Tax Commission by the Canadian Tax Foundation:

It would simplify matters considerably if it were possible to prove beyond a doubt that the key to a country's economic growth is to be found in taxation. However, the most that it appears possible to say is that it is one key among many. Other factors play a role at least as large, and quite possibly larger, in determining a country's growth rate, and all are interrelated.

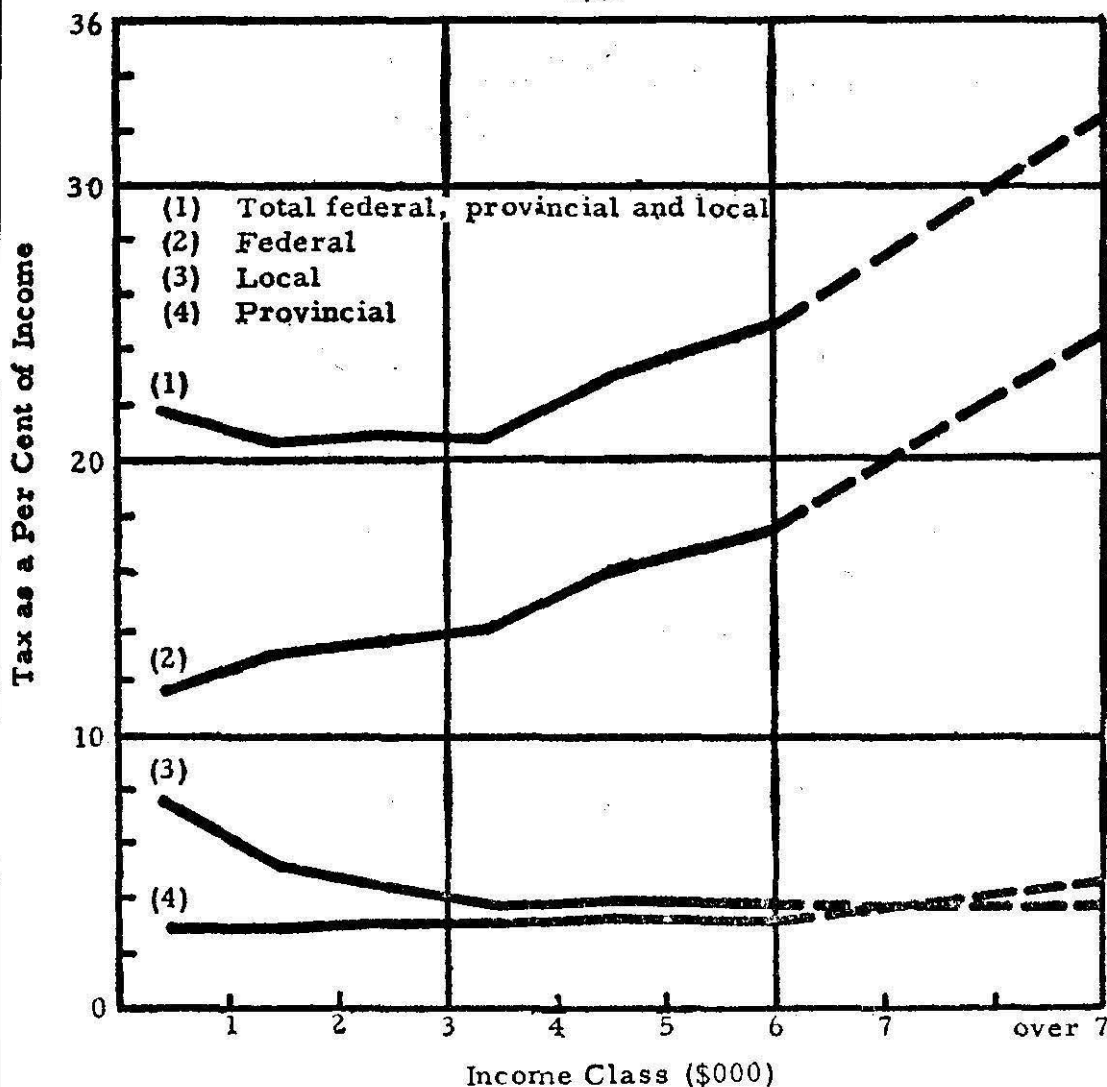
Undoubtedly an important interrelationship is that between taxes and government expenditures. In fact, it is true that, taken by themselves, taxes can only have a negative impact upon growth, but it is completely improper to consider them by themselves. They are only one side of an equation, with spending comprising the other. Thus, the relevant question is not how taxes have affected our economic growth, but rather how it has been affected by the total fiscal process. The answer is neither simple nor settled, but it will depend upon whether our instability has been due to inadequate *aggregate* demand or to structural changes, and whether greater increases in our future productive capacity can be had by encouraging private investment or by accelerating public investment in such areas as education and research. Considerations such as these will bear upon whether a higher tax burden would help or hinder our economic performance. At the present time, we simply do not have sufficient knowledge to make incontestable statements, so that when many of our business leaders state unequivocally that our high tax burden is to blame for our problems, they have neither statistical nor theoretical support for their position.

Up to now we have been examining some aspects of our tax burden in terms of its national magnitude and impact. But whatever the actual or desirable level of the total tax burden, even assuming we have been able to agree on what is desirable, every society is faced with another question, namely, how is the total burden to be distributed among the population? Or more simply stated, who is to pay these taxes and on what basis should we arrive at this decision? Regardless of the way the tax law is written or how a tax is collected, in the final analysis all taxes are paid by people, not by corporations, not by property, not by automobiles, but rather by people in their roles as wage-earners, stockholders, consumers, or home-owners. This has long been recognized by economic thinkers, yet too often one seems to sense that it has been forgotten. We sometimes behave as if the legal impact of the tax, the action or institution which constitutes the base for collection, is the only thing that really counts. What *is* important in the final analysis is not simply what the law dictates, but rather how this law works itself out in the economic process, how the tax may be shifted from one group to another, from corporations to consumers, from employers to employees. In other words, the final distribution

of the tax burden is not necessarily what the law implies it to be; rather it is based on human behaviour and the laws of economics.

Several years ago the writer carried out a study of the way the Canadian tax burden was distributed among the various income classes.* On the basis of official government information on the distribution of income and spending, and applying the most up-to-date economic theories of shifting and incidence, each federal, provincial, and local tax levied in Canada was distributed among the various classes. When all these taxes were combined, the average burden was found to rise from a low of \$173 for those earning less than \$1000 to a high of \$3986 for those with incomes above \$7000. A more appropriate manner of expressing these findings is in terms of "effective rates"—that is, total taxes as a percentage of income. These are described by income class and by level of government in Chart 1 below.

CHART I
EFFECTIVE RATES OF TAXES
BY LEVEL OF GOVERNMENT
1957



**The Burden of Canadian Taxation*, Canadian Tax Foundation, Tax Paper #29 (Toronto, 1962).

The overall effective rates in Canada may be summarized as follows: the federal rate structure is somewhat progressive throughout the income range; the municipal rate structure is moderately regressive throughout the income range; and the provincial structure appears to be close to proportional. The effective rate schedule for all levels of government combined indicates slight regression among the lower groups, proportion for the middle ranges, and moderate progression thereafter. In other words, the percentage of income which goes to taxes tends to decline at first, and after remaining rather stable for a span of income, exhibits an upward slope. While those earning below \$1000 pay 21.9 per cent, the rate subsequently declines slightly up to \$4000. Above \$4000 the rate increases steadily to a maximum of 32.4 per cent on incomes over \$7000. Thus the curve depicting these effective rates takes on a somewhat modified U-shape.

Now it should be recognized that this method of measuring tax burdens introduces a serious limitation because of aggregation, for within each income class, significant variations exist in actual burdens of specific taxpayers. Factors such as family size, location, source of income, and even spending behaviour will affect one's tax bill. My estimates relate to an "average" taxpayer in each class and are subject to the restrictions which are legitimately associated with the arithmetic mean. Granted, therefore, that there certainly are exceptions, still the relative tax burden does not appear to vary greatly for most Canadians. It amounts to little less than one-fourth of their incomes for low-income recipients, less than one-third for those receiving the high incomes. The steep progression, therefore, which appears in the statutory income-tax-rate structure is modified considerably by the other taxes which governments in Canada rely on. It seems reasonable to conclude that from the standpoint of vertical equity—the fair treatment of unequals—the overall effective tax rates in Canada are well within the confines of social acceptability and are certainly not as objectionable as many observers have been led to believe.

While there are, of course, inequities, and while anyone who is faced with a *marginal* rate of 50 or 60 per cent is probably justified in his complaints, perhaps the most serious problems are related to the matter of "horizontal equity". The fact is that the most widely accepted tax principle and the one that grows naturally out of a democratic concept—the equal treatment of equals—is currently being violated in Canada. The special treatment of certain individuals as well as certain corporations merely because they choose to earn their income in a certain manner or because they prefer spending it in one way rather than another is objectionable, not only because it runs counter to horizontal equity, but because it also has the effect of destroying the neutrality of the tax system. In other words, decisions which would

have been optimal, or most efficient, in the absence of a tax should not be distorted because of the existence of a tax. But indeed the privileges and devices for avoiding taxes that are built into our tax codes do, in fact, have an influence on our personal and business behaviour. Because such devices are no more than a form of government subsidy, albeit a hidden subsidy, we may be diverting more of our resources into certain activities and industries than we otherwise would. Such provisions as personal deductions, capital gains, depletion allowances, and dividend tax credits rest on very dubious grounds in economic theory and may be causing serious misallocation of the nation's resources. Moreover, if these hidden subsidies are supposed to be a reflection of need, it is somewhat confusing when one finds that these tend to yield greater benefits as the need declines. This whole aspect of the tax problem is in dire need of a complete overhaul, and one would hope that the Carter Commission Report will recognize this need.

We conclude with a summary of the findings described above. First, the national tax burden in Canada has not experienced any significantly consistent increases over the past two decades but has hovered at around one-quarter of GNP. Second, the Canadian aggregate situation is not excessive in relation to comparable countries; if anything, Canada's burden is one of the lowest in the Western world. Despite this, or possibly even partly because of it, Canada's economic performance has been inferior to most. Third, even though the personal income tax has given the impression of extreme progression, the many loopholes and tax favours, and, even more important, the remaining taxes other than income, are so designed as to counteract the income-tax burdens of the upper-income groups. As a result, the overall tax system is rather mildly progressive.

Although these conclusions are based on some readily available data, this does not mean that there is no room for controversy. Indeed, different data or different theoretical positions could yield different results. But any objections based on such differences can ultimately be resolved through the careful use of logical analysis. No such resolution, however, is possible if these conclusions are unacceptable simply because they do not conform to the prevailing shibboleths.