

Intelligence MEMOS



From: Kevin Milligan
To: Bill Morneau, Minister of Finance
Date: November 19, 2018
Re: **IT'S TIME FOR A TAX REFORM TWO-STEP**

Your fall economic update on Wednesday is expected to deliver changes to Canadian corporate taxes. In a previous [Intelligence Memo](#), I made the case for a Canadian response to the US tax reform by front-loading the tax incentive to invest through accelerated depreciation allowances. Canadians will soon find out what changes you have in store, but before those details arrive it's a good time to take stock of the overall state of Canada's tax system and its direction.

We face many fiscal challenges in Canada. Here's a few that come to mind:

- Our tax system is complex, which generates compliance costs and hinders transparency.
- With globally mobile financial and human capital, we have to stay in touch with tax changes in competing countries.
- Our provinces are struggling with increasing health costs.

Canadians have diverse views on fiscal fairness and whether we should aim to redistribute more to those who struggle.

Over the last three decades, Canadian governments have responded to rising challenges with incremental, one-off reforms. I laid out a blueprint for a more fundamental and comprehensive tax reform in the 2014 C.D. Howe [Benefactors' Lecture](#).

More recently, many prominent voices have argued for a new royal commission on taxation to solve our problems, in the spirit of the Carter Commission from the 1960s. While a new commission may help in some ways, I think the case is far from clear cut. In this Intelligence Memo, I weigh the arguments for and against a new tax commission and then plot a path forward.

A commission could benefit Canadians in three ways. First, it can take a renewed look at Canada and the global economy and set a framework and goals for what we want a 21st century tax system to achieve. Second, assembled experts could offer technical solutions to technical problems in the tax law, by drawing on expertise that complements the knowledge of finance ministry officials. Finally, a tax commission can take a comprehensive view, which matters for taking account of interactions between different parts of the tax system.

While this case sounds promising, we need to also grapple with three shortcomings of going for a comprehensive 'big bang' approach to tax reform. First is timeliness. The Carter Commission took 10 years from beginning to implementation. The problem here is that emerging issues – such as a response to the US tax reform – need fast action and can't wait for a commission. Second is our capacity for wholesale change. The policy work that needs to be done to lay the groundwork for a successful tax reform is simply too vast to be undertaken all at once. Third is politics. The implementation of the Carter Commission recommendations led to intense lobbying efforts that delayed reforms by years and substantially weakened their intended impact. Now, 50 years on, the political uproar that would greet a big tax reform will only be greater. A tax commission would be a magnet for politics rather than a shield.

Given this mixed case, it is hard to argue for a 21st century replication of the 10-year Carter Commission process. Instead, we should take a two-tier approach. The first tier is the 'big picture' study of Canada's fiscal position and the goals we need to set to thrive. What are the ways our fiscal system is holding us back, and how can it be redesigned to push us forward? The second tier is implementation. In my view, this is best done incrementally by ad hoc committees that tackle individual issues. The incremental approach allows us to draw on field-specific expertise, consult effectively with stakeholders, and take the time to design good policy one piece at a time rather than be overwhelmed with wholesale changes.

For this reason, Canada would benefit from putting more structure on how we handle incremental tax reforms like we'll see in the fall economic update. Moreover, with the near-certainty of a buffet of tax changes to be offered by all parties in the 2019 federal election, the case for setting out clear goals and a robust framework is reinforced. In that context, a 'big picture' tax commission that differs from the Carter

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