Tax Policy and Tax Research in Canada

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Introduction

Many people seem to think that taxation is like the weather. Everyone talks about it but no one does anything about it. This common impression is quite wrong for Canada. Even excluding such major upheavals as the 1971 income tax revision that followed the report of the Carter Commission, almost every year the federal government does something about the tax system: it introduces new levies or alters existing taxes by changing their rates or bases. Sometimes such changes amount to little more than tinkering. Sometimes they indicate major changes in direction. In recent years, provincial governments too have made more and more tax policy changes — introducing an incentive here, adjusting a rate or base there, or, occasionally, making major changes such as "provincializing" all or some of the property tax or changing from a "tax-on-tax" to a "tax-on-base" approach to personal income taxation.

To what extent are such tax policy changes based upon, or supported by, economic research? This is the question that we consider in this paper. It is an important question, not least because one of the main results emerging from much recent research in public economics is that taxes affect economic incentives in many complex, sometimes unexpected, and often significant ways. One effect of the Carter Commission in the 1960s was that a group of serious and well-informed academic analysts of tax policy became established in Canadian universities. Did the subsequent output of serious research papers

on tax matters affect tax policy?[1] Why do some research results seem to have been largely ignored, while others appear to have had much more impact? Are there academically respectable ways in which the work of researchers might be rendered more productive in terms of public policy impact? These are some of the questions raised, if not always answered very satisfactorily, in this brief paper.

Personal Income Taxes

An outstanding feature of Canadian tax policy in the last decade of the twentieth century was the extent to which Canada, almost alone among the Organisation for Economic Co-operation and Development (OECD) countries, attacked its deficit problem by increasing the share of personal income taxes in gross domestic product (GDP). Despite the importance economists typically assign to the incentive effects of income taxes, this trend received surprisingly little attention in academic or policy circles through much of the period. Although the effects of taxes on out-migration from Canada seem small (Helliwell, 1999) relative to their impact on purely domestic decision-making, it was more perceptions of a "brain drain" than concern for the effects of taxes on the domestic economy that led to tax rates becoming a focus of recent political debate.

High marginal tax rates (MTRs) induce a variety of changes in the behaviour of taxpayers, with resulting economic costs. Changes in hours worked and in labour force participation — the standard preoccupations of the theory of income taxation — are, of course, especially important, but tax-induced changes may also include a variety of tax avoidance devices, such as substitution from taxable to non-taxable consumption, changes in the timing of income realizations, changes in the form of compensation (including incorporation), use of deferred compensation and other tax shelters, and increases in tax evasion. Understanding the magnitude of such behavioural responses to tax rate changes is critical to forecasting the effects of tax reforms on government revenues. It is also essential to measuring the *excess burden* of taxation — the loss in welfare due to the tax system in excess of the revenue raised for government.

As marginal tax rates rose through the 1990s, economists increasingly measured their levels and debated their effects on economic activity. Davies and Zhang (1996), for instance, analyzed the changes in MTR schedules over

[1] An earlier paper touching on this question is Bird and Wilson (1999).

the post-war period. They stressed the long upward trend in the average of marginal tax rates faced by all taxpayers since 1949, but particularly in the 1960s and 1970s. Davies (1998) extended the analysis to address recent tax reforms. He provides a useful review of the economic principles that might guide the design of an income tax system and the evaluation of existing MTR schedules. High MTRs are unambiguously undesirable in efficiency terms, as they create disincentives to work and pay taxes. On the other hand, although high MTRs do not per se increase the progressivity in the tax system, high MTRs for *some* taxpayers are a necessary condition for a progressive income tax. If the tax system is to apply low or negative *average* tax rates to low-income families and higher average tax rates to those with higher incomes, it follows that some taxpayers with intermediate incomes must face high *marginal* tax rates.

These statements may be uncontroversial. Unfortunately, they are also not particularly useful. The difficult practical question concerns where in the income distribution those high MTRs should be levied. Economists argue there are three basic principles that should govern this choice. First, the economic cost of a high MTR is proportionally larger the more people there are in the relevant tax bracket. Second, the cost of a high MTR is also worse the higher the wage rate received by taxpayers in the relevant bracket. Although this simply reflects the fact that work disincentives are more costly to the economy the more valuable is the labour that is lost, the notion that we should spend more time worrying about tax disincentives faced by stock-brokers than by high school dropouts is not one that goes over well in public discussion. Third, a high MTR is more costly when applied to a tax base that is more responsive to tax rates — when, for example, affected taxpayers may easily substitute from paid work to unpaid family care, or from conventional employment to activities in the less-taxed informal sector, or they may even move to another country.

A convenient summary statistic of behavioural responses to taxation is the "elasticity of taxable income" proposed by Feldstein (1995) — the average percentage decrease in a taxpayer's taxable income due to all behavioural responses when the taxpayer's marginal share (one minus the marginal tax rate) is decreased by 1 per cent. Examining the effects of the 1986 U.S. tax reform on a sample of taxpayers, Feldstein estimated the elasticity of taxable income to be quite large, with preferred estimates ranging from 1.0 to 1.5. To put these estimates in perspective, note that an elasticity of one implies that government revenues would reach their maximum level at a tax rate of 50 per cent; further tax increases would actually decrease revenues. Feldstein's work might to some extent be viewed as an attempt to give some academic respectability to the supply-side arguments of the 1980s. Nonetheless, it

provides a useful tool that may help make old arguments about efficiency more meaningful and palatable to policymakers.

Recently, several authors have used similar tools to study the effects of taxation in Canada, providing robust evidence of tax avoidance behaviour. Silaama and Veall (2001) apply a refined version of Feldstein's method to Canadian data and find evidence of much smaller, though still substantial, responsiveness of taxable income to marginal tax rates. Analogous to Feldstein's approach, they look for changes in the reported incomes of a group of taxpayers following the 1988 personal tax reform, which flattened marginal tax rate schedules. Their point estimate of the elasticity for Canada is 0.25.[2] Silaama and Veall also find evidence of far greater responsiveness to taxes for the self-employed, for workers nearing retirement age, and for high-income taxpayers. Gagné, Nadeau and Vaillancourt (2001) adopt a different approach. They measure the response to tax rate changes of total taxable income in each province and in a number of income ranges for the 1972–96 period. While their results are not directly comparable to Silaama and Veall's, they also find robust evidence that taxable income responds to tax rate changes. Despite this empirical support for the "economists' prescription" of an optimal income tax rate structure sketched above, it is far from clear that such arguments have as yet had any significant influence on the tax policy debate in Canada. The average MTR has certainly come down over time, but the structure of MTRs hardly accords with what analysis suggests.

A second major change in Canadian personal income taxation during the 1990s was the introduction of substantial income-tested tax credits for families with children, now known as the National Child Benefit (NCB) system. These child tax benefits are "clawed back" from families with incomes between about 50 and 80 per cent of median family income at rates as high as 30 per cent before applying standard personal income tax rates. The result is that high marginal tax rates are no longer the exclusive province of high-income taxpayers in Canada. Somewhat similar "claw-back" systems are applied to both Employment Insurance (EI) and Old Age Security (OAS) payments.

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[2]Cast in the same "Laffer curve" terms as the Feldstein estimate cited earlier, this implies a revenue-maximizing tax rate for Canada of 80 per cent.

The refundable credit system seems to have been conceived at least in part as an attempt to integrate the tax treatment of children with provincial social assistance and, in the process, dismantle the "welfare wall" that created work disincentives for poor families with children. While the policies may have such salutary effects — there appears to be no clear evidence one way or the other — they may at the same time be bringing the problems of traditional welfare programs into the tax system and, increasingly, subjecting the average Canadian family to the perverse incentives that were once reserved for welfare recipients.[3] Poschmann and Richards (2000) argue forcefully that this is indeed the case. They analyze the clawbacks associated with various federal and provincial family benefit programs and show that marginal tax rates typically range from 50 to 70 per cent (and are, in some cases, even higher), even for moderately low family incomes.

If clawbacks are indeed driving MTRs too high, two very different directions of reform might be contemplated. First, the clawback rates might be reduced, mitigating the disincentive effects and spreading them over a greater number of taxpayers.[4] Alternatively, and perhaps paradoxically, clawback rates could instead be *increased*, thus concentrating disincentive effects on a narrower income band and therefore affecting fewer taxpayers. Enhancing the targeting of family benefits in this way might achieve desired redistribution while confining MTRs to the places in the income distribution where they would do the least harm, in economic (if not necessarily political) terms.

Economists appear divided on this issue. A recent study by the C.D. Howe Institute, for example, calls for reductions in clawback rates (Robson, Mintz and Poschmann, 2000). Others have expressed caution about this tendency for the clawbacks to creep their way up the income distribution (Boadway, 1999; Davies, 1999). This debate leads to few definitive conclusions. One reason may be because the focus of the recent debate on marginal tax rates misses some important complexities in the analysis of disincentive effects.

A high MTR discourages an individual from working additional hours (and may have other effects as well, such as on work in the informal or underground economy, self-employment, and so on). But the decision as to whether to participate in the labour force — and the choice between full-time

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[3] See Battle and Torjman (1994) on the implicit tax rates facing welfare recipients in Ontario.

[4] This strategy is implicit in the government's recent decision to raise the break-even threshold for the NCB to $35,000, which will reduce MTRs for an affected family with two children by about eight percentage points.

and part-time work — depends more on the difference in *average* tax rates between low and middle income levels than on the MTRs levied at specific points in the distribution. A policy that clawed back more benefits from low and middle income families might have undesirable effects on participation, particularly of secondary earners. This may be especially true now that the federal Working Income Supplement has been abolished.

The trade-off between disincentives to hours worked and disincentives to participation thus needs to be evaluated carefully in designing the tax system. Which effect is more important is fundamentally an empirical matter. Unfortunately, there is little evidence for Canada that might inform the current debate. In particular, the literature provides no hard evidence about the effects of the reforms of the 1990s on the labour supply patterns of affected families in Canada. *Faute de mieux* — and not for the first time — policy analysts in Canada must rely on research into the effects of similar programs in the United States to assess the impact of family tax benefits. Fortunately, the U.S. Earned Income Tax Credit (EITC) closely resembles Canada's child tax benefits, with a maximum benefit of about C$5,500. The EITC generated MTRs in the clawback range in excess of 50 per cent, high by U.S. standards, but well below the tax rates currently induced by the corresponding Canadian programs.

To assess the behavioural consequences of the EITC, Eissa and Liebman (1996) examined its effects using the "natural experiment" approach that is now the workhorse of empirical policy evaluation. In this instance, the idea is that the policy change should affect single women with children (who were eligible for EITC), but not single women without children. These two groups should be affected in about the same way on average by changing labour market conditions or other changes during the reform period. The data thus provide "treatment" and "control" groups, on the basis of which the separate effects of the policy can be discerned. Eissa and Liebman found substantial effects on participation by single women with children, relative to that of single women without children. At the same time, there was no discernible drop in hours worked by mothers already in the labour force, despite the disincentives associated with the clawback and the income effects of the transfer.[5]

[5]More recently, Meyer and Rosenbaum (2000) found even greater increases in participation by single mothers (relative to the appropriate control groups) following much larger reforms in incentives during the 1990s.

One must of course be careful in applying these results to Canada.[6] For example, the labour supply of women is often estimated to be more responsive to after-tax wage rates in the United States than in Canada. Moreover, the U.S. policy is directed at single mothers, and married women with children might respond very differently to the Canadian policy. For example, the clawback might influence their choice between full-time and part-time work. Nevertheless, there does appear to be good evidence that participation responds to tax incentives more than do hours. If so, the high MTRs in the current system may be less important than the effects on participation that might result from a badly designed targeting system.

As provincial governments reform their own earned-income supplements, following the introduction of the National Child Benefit system and the abolition of the federal Working Income Supplement, the need for a closer look for concrete evidence about the costs and benefits of this strategy seems obvious. This is one area in which policymakers are obviously groping for a workable and acceptable solution, and good analysis and empirical evidence may well have a beneficial impact on policy.

Payroll Taxes

In part perhaps because many people do not really think of them as taxes, governments in Canada have come to rely increasingly on payroll taxes to the point where they are now the third most important source of revenue, after personal income and sales taxes. Indeed, as Dahlby (1993) reported some years ago, payroll taxes have for some time created a larger "tax wedge" for workers below median income than do personal income taxes. This trend seems certain to continue. Payroll tax rates will be ramped up in future years as contribution rates for the Canada and Quebec Pension Plans (CPP/QPP) and for provincial workers' compensation programs are increased. Although contribution rates for Employment Insurance, in contrast, are still near cyclical highs and are likely to decrease in future, a net increase in payroll taxes seems inevitable.[7]

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[6]For a more extensive review of this literature and its implications for Canada, see Mendelson (1997).

[7]In addition, several provinces (particularly Quebec) levy payroll taxes on employers. These taxes too may creep up over time.

Perhaps in part because tax lawyers and accountants have not been much concerned with payroll taxes, economists have, unusually, played a leading role in the debate over payroll taxation. Fortunately, payroll taxes are particularly amenable to empirical analysis. Much of the work which has been done has focused on determining the economic incidence of payroll taxes and their effects on employment. In the simplest terms, a payroll tax reduces employers' demand for labour, which may result in a fall in after-tax wages, if labour is supplied inelastically, or in a fall in employment, if labour supply is relatively elastic.

Business groups in Canada have tended to stress the employment effects of the tax, decrying payroll taxes as "job killers". In his work for the Ontario Fair Tax Commission, Dahlby (1993) pointed out that this effect was often overstated, however. Surveying previous evidence on the elasticities of labour supply and demand, he argued that labour likely bears more than 80 per cent of the burden of payroll taxes in the long run. In other words, the total compensation costs paid by employers are largely unaffected by payroll taxes, so that the employment effects of such taxes should be correspond-ingly small.

Direct empirical evidence for Canada reaches a more mixed conclusion. Di Matteo and Shannon (1995) used annual time-series data to estimate the impact of all taxes, including payroll taxes, on real wages and employment in Canada. According to their estimates, the burden of payroll tax increases is approximately equally shared between labour and employers. A 1 per cent rise in the payroll tax rate would cause real after-tax wages to fall by 0.44 per cent and employment to fall by 0.32 per cent. While these estimates may not be particularly robust, they suggest a greater impact of payroll taxation on employment than Dahlby's study.

Of course, the economic effects of payroll taxes are unlikely to be much different on average than those of personal income or, for that matter, sales taxes (although there is no evidence that this thought has influenced tax policy). All these taxes drive a similar wedge between the cost of labour to employers and the return to employment of workers. In some respects, however, payroll taxes seem likely to have effects not shared by other taxes on labour and are worthy of further study.

The ceiling provisions in the major federal payroll tax systems (CPP/QPP and EI), for example, imply the taxes are distortionary only for workers with below-average earnings. For workers above the ceilings, although contributions are still a tax on employment, they act as lump-sum taxes, with no impact on the return to additional hours worked. Coupled with the evidence on wage and employment effects cited above, this suggests that the current structure of payroll taxes may be one factor contributing to rising

wage inequality among Canadian workers. In addition, it may also encourage employment of high-wage, full-time workers, at the expense of low-wage and part-time workers (Lin, Picot and Beach, 1996).

On the other hand, some payroll taxes act to a certain extent as benefit taxes, in that the benefits accruing to workers from additional hours of employment are roughly commensurate with additional tax liabilities. If the link from benefits to contributions were exact, then such taxes would in principle have no distortionary effect on employment decisions. In practice, however, some distortions inevitably persist, since contribution rates are not actuarially fair for individual workers and tax increases are often not linked to corresponding benefit increases. Nevertheless, some payroll taxes, where the link between contributions and benefits is strongest, may have different effects than others owing to this benefit connection. For instance, Vaillancourt and Marceau (1990), found some evidence that the incidence of workers' compensation taxes was different than for other payroll taxes, a finding which they attributed to its benefit tax element. This line of thought also suggests that a case can be made for earmarking payroll taxes for con-tributory social insurance programs, a practice that has otherwise received little support from economists.[8]

One way or another, payroll taxes seem likely to constitute a larger part of the tax mix in Canada in future years, regardless of the findings of economists. In the future, however, such findings may perhaps play a more important role than they have in the past in determining the magnitude of the increases and the design of further reforms.

Taxes on Corporations

Since corporate tax policy in Canada has recently been discussed in detail in the Mintz report (Canada, 1998), not to mention its many supporting technical papers, and since Professor Mintz himself is contributing a paper on taxes and savings to this volume, we shall not dwell on this subject here. We simply note that recent economic discussion of the corporate income tax has strongly supported on efficiency grounds the move towards base broadening and rate flattening advocated in the Mintz report and that these recommendations have been further urged by the growing concern with international tax competition. While the latter argument seems stronger in

[8]For a discussion of earmarking in Canada, see Thirsk and Bird (1994).

rhetoric than in evidence, Canada, like most countries, appears to have largely accepted these recommendations in principle, if not yet fully in practice.

It is easy to show that at the margin investment decisions with respect to industry, location, risk-taking, asset mix, and timing may be influenced by variations in effective tax rates. It is equally easy to show that choices with respect to organizational form, financial structure, and dividend policy may be equally distorted by tax policy. Many economists (e.g., Vickrey, 1991) have drawn the conclusion from such considerations that there is no place for a separate tax on corporate income in a sensible tax system, as indeed did the Carter report.

The case against taxing corporations has not been accepted so far in any country. Close examination (e.g., Bird, 1996) suggests that there are several good reasons to maintain separate taxes on corporations. Nonetheless, the case for reducing and to some extent restructuring such taxes has generally been accepted in recent years at both the federal and provincial levels. It is interesting to speculate whether this acceptance reflects the persuasiveness of economic argument, the politically powerful interests of capitalists, or some other factor. Suggestions have also been made that, while rates may continue their downward trend, bases may again be narrowed through incentives as governments continue their ceaseless search for instruments by which to satisfy their apparent need to be seen to "do something" for politically influential groups.

More interesting, and more peculiar to Canada, has been the growth of non-income taxes on corporations, notably capital taxes, over the last decade or so. As the Mintz report shows, for many firms such taxes are now often more important than corporate income taxes, especially in years in which profits are not rising rapidly. One way in which Canadian governments have made up for the relative decline of corporate income tax revenues has been by imposing new, less profit-sensitive taxes on corporations. While Bird and Mintz (2000) have noted that there may be arguments supporting such taxes in some instances, it is hard to understand the rise of capital taxation in Canada other than as another proof of the adage that the easiest taxes to impose are those of which most people are not aware, those that can, if discovered, be said to penalize the rich and large, and those that no one is really sure who pays. Ignorance, it appears, may at times play as important a role as knowledge in determining tax policy.

Other Taxes

In terms of public perception, if not in revenue terms, undoubtedly the major change in Canadian tax policy in the last decade was the introduction of the Goods and Services Tax (GST) to replace the old Manufacturers' Sales Tax (MST). Economists entered fairly vigorously into the discussion preceding the GST, as usual expounding various views. While most economists, unlike most other participants in the debate, seemed generally sympathetic both to consumption taxes and to the less distorting effects of the GST compared to other forms of indirect taxation, some favoured payroll taxes instead (Kesselman, 1993), some appear to have favoured some other form of reformed sales tax (Whalley and Fretz, 1990), and some were concerned mainly to show that the GST would be either more or less regressive than some other tax to which it was compared.[9]

Unusually, the contribution of economists to the GST was, in the end, decisive. After all, despite the many deficiencies in the GST as finally adopted (Bird, 1994), the evidence seems incontrovertible that the GST was economically less distorting than its predecessor the MST (Kuo, McGirr and Poddar, 1988). Indeed, since this was the only clear gain from introducing the GST, it may be argued that the Mulroney government was the first — and probably the last — in Canadian history willing to sacrifice itself on the altar of economic efficiency. As usual, of course, much of the public discussion of the GST focused not on efficiency issues, but on equity issues. While economists argued on both sides of this issue also, it seems fair to say that their contribution in showing, on the basis of plausible assumptions, that the tax was not seriously regressive helped carry the day.[10] All in all, regardless of what thinks of the GST, its adoption stands as probably the single most important example to date of the influence of economists on Canadian tax policy.

[9]See, for example, Grady (1990, 1991); Gillespie (1991a); and Ruggeri, Van Wart and Howard (1994a).

[10]The importance of the distributional issue is illustrated by the "double whammy" of offsetting policies introduced when the GST was implemented. Although the refundable GST credit allowed under the income tax was sufficient to offset the estimated regressivity of the tax, political pressure led to the exemption also of so-called "basic foods" on distributive grounds, thus substantially reducing the efficiency gains from the tax.

The situation is quite different with respect to property taxes. Although relatively little serious economic research has been carried out in Canada with respect to this tax in recent years,[11] such research has continued to be a major industry below the border, to the point where lengthy review articles debating the significance and interpretation of the results have recently appeared (Zodrow, 2001; Fischel, 2001). One conclusion to be drawn from these reviews is that there is still much to learn about this oldest of taxes. Another, however, is that it is hard to detect much, if any, effect on actual tax policy either south or north of the border as a result of all this research. None of the major changes that have taken place in property tax policy in provinces such as Ontario in recent years, for example, seem to reflect any concern for the issue at the heart of the academic discussion of property taxation — the question of the benefit linkage between local property taxes and local public services, for example — or to demonstrate any knowledge of that literature.[12]

The failure to consider research results in developing tax policy is equally marked with respect to the other ancient tax that still generates significant revenue for governments in Canada, namely, excises. Countless studies — though again few in Canada — have considered the efficiency effects of taxes on alcoholic beverages and tobacco,[13] but such studies have had little perceptible effect on either the level or structure of these taxes. Much the same is true with respect to taxes on vehicles and fuel, despite the substantial economic literature suggesting alternative designs of these levies on efficiency grounds. In this, as in most fields of taxation, it appears that perceived effects on equity and political considerations have trumped, and probably always will trump, efficiency analysis — even if, as has, alas, seldom been true of academic studies, the latter is presented to policymakers in both language and a context to which they can relate.

A last example may be mentioned. While it appears that the advice of economists counted for nothing when Canada led the way in the world by abolishing all estate and inheritance taxes,[14] it seems to have been heeded

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[11]For a review of earlier studies, see Bird and Slack (1978).

[12]In the Ontario case, this is particularly striking because the issue was thoroughly discussed in, for example, Kitchen and Slack (1993).

[13]For a recent survey of the latter, see Cnossen (2001). A rare Canadian example is Raynauld and Vidal (1992).

[14]For the most recent Canadian review of the issues, see Mintz and Pesando (1991). The rest of the world continues to find this subject worthy of study, however, as

amazingly quickly recently with respect to the capital gains taxes, the introduction of which was the stated rationale for abolishing taxes on wealth at death. In particular, Mintz and Wilson (2000) was hardly in press when its major recommendation, to reduce the capital gains inclusion rate, was put into place — and then a few months later strengthened. As in the case of the corporate income tax, however, one may question the extent to which such economic advice influenced the outcome, compared to the politically attractive rhetoric with respect to encouraging savings and investment on one hand and the political importance of the interests thus favoured on the other.[15]

Conclusion

What lessons do we draw from the preceding rather dismal tale of the apparent lack of success of the dismal science in influencing Canadian tax policy in recent years?

The first lesson is, of course, that the tale is not really all that dismal. The glass, it may be argued, is at least half full. The downward pressure on personal and corporate income tax rates has certainly been supported, if not initiated, by the increasing evidence of the distortions caused by high marginal tax rates. Equally, the adoption of the GST can be explained only by the (possibly irrational) acceptance of the federal government of the economic argument that Canada had to change to a value-added tax to reduce economic distortions.[16]

A second lesson, however, is that too much weight should not be attached to the first lesson, because equally convincing (or unconvincing) economic studies of the damage done by poorly-designed excise, property, and payroll taxes do not seem to have met with a similarly receptive audience. It is hard to avoid the conclusion that the adoption of the flatter-rate broader-base income tax strategy is probably better explained by more fundamental political economy considerations than by simple acceptance of the advice of

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evidenced in Pestieau and Poterba (2001).

[15]One rationale for the first reduction in the inclusion rate (in February 2000) was to level out the taxes on dividends and capital gains and hence to restore a certain logic to the personal taxation of corporate-source income. Of course, the further reduction in July 2000 created an imbalance in the other direction and again made the system analytically incoherent.

[16]Admittedly, politicians may have been more influenced by the mercantilist argument that the former sales tax "taxed exports".

economists. If so, as we have already suggested, the GST stands as the major evidence of successful economic advice in the tax area in recent decades — a conclusion that may not make everyone happy and that, to say the least, does not augur well for future success. Politicians who saw the fate of the Progressive Conservative party in the post-GST election will probably be even less likely in the future than in the past to pay much attention to the advice of "efficiency technicians".

More positively, however, three other lessons may perhaps be drawn from the broader post-war experience.[17] The first such lesson is that tax economists who want to influence public policy must pay more attention to the issues that motivate policymakers, even if this means that they may pay somewhat less attention to the techniques that lead to publishable academic papers. This is not a plea for "dumbing down" policy analysis. On the contrary, it is a plea to smarten it up.

In particular, analysis that assumes distributional considerations are either unimportant or can easily be accommodated by (unspecified) adjust-ments somewhere else in the tax-transfer system simply does not resonate in the policy context. Distributional issues matter in tax policy. In fact, often such issues dominate in the minds of those who shape that policy. From this perspective, the general failure of policy economists to say anything very useful about distributional issues has often relegated them, and their evidence, to the sidelines in policy discussion.

Distributional studies such as those in papers by Vermaeten, Gillespie and Vermaeten (1994); and Ruggieri, Van Wart and Howard (1994b) are decidedly out of academic fashion. This is understandable because they are both conceptually and empirically difficult and, as Whalley (1984) memorably demonstrated, extremely assumption-sensitive. But equity continues to lie at the heart of public economics, and unless and until economists can deal more explicitly and satisfactorily with this issue, their success record in influencing public policy seems unlikely to improve much.

A second lesson, as Winer and Hettich (1999) set out at length in theoretical terms and to some extent demonstrate empirically (see also Gillespie, 1991b), is that tax policy is not just about economics but about politics. We must understand the political economy of taxation if we are to understand how economic analyses of tax issues are likely to be perceived to affect policy outcomes. Scholars such as Persson and Tabellini (2000) and Besley and Coate (1997) have made major contributions to this field of study

[17]For a more comprehensive review of postwar experience, see Bird, Perry and Wilson (1998).

in recent years.[18] But there is clearly much more that can and should be done to understand both how the present system works and how it might be altered to improve policy outcomes in economic terms.[19] Some years ago, for example, St. Hilaire and Whalley (1985) made a number of interesting suggestions with respect to how tax reform might be institutionalized to make better use of evidence and produce better results. It seems past time to return to this line of inquiry and to attempt to apply some of the political insights of such Canadian scholars as Winer and Hettich (1999); Hartle (1988); and Breton (1996) to the problem of formulating tax policy in a democratic setting in light of the best scientific knowledge instead of leaving it, as is now generally the case, to the shifting winds of political fashion.

Finally, it may not be out of place to note that if one wishes to affect policy, one must normally write in a way, and in a forum, that will come to the notice of policymakers. Scholars such as Hartle and Mintz, to mention only two prominent examples, have not hesitated to engage in public discussion of key policy issues and to attempt to convince wider audiences of the cogency and importance of the economic analysis of taxation. While not everyone — the present authors, for two — may be constitutionally up to the personal costs imposed by this approach — and, of course, current academic mores render such involvement virtually *ultra vires* for those aspiring to tenure in academic departments of economics, it is, we think, only through such efforts to communicate to policymakers directly or indirectly by engaging with the (small) informed public with which policymakers interact that progress is likely to be made.[20]

Like the scholars we have mentioned, David Slater has for many years epitomized the best of this tradition in his scholarship, in his willingness to be involved in the policy process, and, not least, in his role in recent years in developing the important policy forum that Canadian Business Economics has become. It is only through such efforts that the gap between scholarship and policy action will ever be bridged in the area of taxation, or any other area of public policy.

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[18]McKenzie (2001) has recently reviewed this literature from a Canadian perspective.

[19]See, for quite different perspectives on the Canadian tax policy process, Good (1980); and McQuaig (1987).

[20]To put this another way, we are in effect supporting the view of Harberger (1993) that economists need to pay more attention to their role as policy practitioners if they are to play that role more effectively. Of course, some very deep waters are being skated over rather quickly here: see, for example, the fundamental study of Lindblom (1990) on the role of social scientists in the policy process.

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