

# ESTIMATING THE TRUE SIZE OF GOVERNMENT

## Adjusting for Tax Expenditures

Munir A. Sheikh



MACDONALD-LAURIER INSTITUTE



MACDONALD-LAURIER INSTITUTE

True North in Canadian Public Policy



## Board of Directors

---

### CHAIR

#### **Rob Wildeboer**

Executive Chairman, Martinrea International Inc.,  
Vaughan

### VICE CHAIR

#### **Jacquelyn Thayer Scott**

Past President and Professor, Cape Breton University,  
Sydney

### MANAGING DIRECTOR

#### **Brian Lee Crowley**

Former Clifford Clark Visiting Economist  
at Finance Canada

### SECRETARY

#### **Lincoln Caylor**

Partner, Bennett Jones LLP, Toronto

### TREASURER

#### **Martin MacKinnon**

CFO, Co-Founder & Chief Financial Officer,  
b4checkin, Halifax

### DIRECTORS

#### **John Beck**

Chairman and CEO, Aecon Construction Ltd.,  
Toronto

#### **Pierre Casgrain**

Director and Corporate Secretary of Casgrain  
& Company Limited, Montreal

#### **Erin Chutter**

President and CEO of Global Cobalt Corp., Vancouver

#### **Navjeet (Bob) Dhillon**

President and CEO, Mainstreet Equity Corp., Calgary

#### **Keith Gillam**

President and CEO, Envirogreen Materials Corp.,  
Scottsdale

#### **Wayne Gudbranson**

CEO, Branham Group Inc., Ottawa

#### **Stanley Hartt**

Counsel, Norton Rose Fulbright, Toronto

#### **Peter John Nicholson**

Former President, Canadian Council of Academies,  
Ottawa

## Advisory Council

---

#### **Purdy Crawford**

Former CEO, Imasco, Counsel at Osler Hoskins

#### **Jim Dinning**

Former Treasurer of Alberta

#### **Don Drummond**

Economics Advisor to the TD Bank, Matthews Fellow  
in Global Policy and Distinguished Visiting Scholar at  
the School of Policy Studies at Queen's University

#### **Brian Flemming**

International lawyer, writer and policy advisor

#### **Robert Fulford**

Former editor of *Saturday Night* magazine, columnist  
with the *National Post*, Toronto

#### **Calvin Helin**

Aboriginal author and entrepreneur, Vancouver

#### **Hon. Jim Peterson**

Former federal cabinet minister, Partner at  
Fasken Martineau, Toronto

#### **Maurice B. Tobin**

The Tobin Foundation, Washington DC

## Research Advisory Board

---

#### **Janet Aizenstat**

Professor Emeritus of Politics, McMaster University

#### **Brian Ferguson**

Professor, health care economics, University of  
Guelph

#### **Jack Granatstein**

Historian and former head of the Canadian  
War Museum

#### **Patrick James**

Professor, University of Southern California

#### **Rainer Knopff**

Professor of Politics, University of Calgary

#### **Larry Martin**

George Morris Centre, University of Guelph

#### **Christopher Sands**

Senior Fellow, Hudson Institute, Washington DC

#### **William Watson**

Associate Professor of Economics, McGill University



# Table of Contents

Executive Summary.....	2
Sommaire .....	3
Introduction.....	5
Section One	
Tax Expenditures: Challenges and Solutions .....	6
Section Two	
Estimates of the Size of Government Adjusted for Tax Expenditures .....	11
Section Three	
The Case For and Against Using Tax Expenditures.....	16
Conclusions.....	22
Author Biography.....	23
References .....	24
Endnotes .....	25

*The author of this document has worked independently and is solely responsible for the views presented here. The opinions are not necessarily those of the Macdonald-Laurier Institute, its Directors or Supporters.*

# Executive Summary

---

Governments across the world play pervasive roles in achieving a range of economic, social, environmental, and security objectives. A popular indicator generally used to reflect on the size of government is direct government expenditures as a share of gross domestic product (GDP), but that understates the true size of government in the presence of *tax expenditures*: governments often simply allow selected citizens to keep some of the monies they would otherwise have paid in taxes *if* they themselves use those monies for things the government would otherwise have provided directly. If a government converts a direct expenditure into a tax expenditure program, the result would be less government expenditure, fewer taxes, and a smaller government without any difference in the extent of the role government plays. This is clearly an inappropriate outcome.

A number of major challenges in estimating tax expenditures explain this state of affairs. However, we should deal with these challenges, rather than avoid them, so that public policies are

Tax expenditures obfuscate the true size of government.

based on the best possible facts about the most important variables. This paper is an effort to overcome these challenges to the extent possible, and provide what are believed to be the first estimates of the size of government adjusted for tax expenditures.

Adding tax expenditures in the three tax bases of personal and corporate income and sales tax to direct expenditures increases the size of the federal government by about 50 percent, or 7.4 percent of GDP, which is not a small number. The

author's estimate of the provincial tax expenditure to GDP ratio is 4.3 percent of GDP, significantly less than the federal ratio, as provinces rely less on income and sales taxes combined than does the federal government. The combined federal-provincial tax expenditure to GDP ratio is 10.1 percent once account is taken of intergovernmental transfers.

The size of government in Canada is about a quarter higher than generally reported.

Adding total government tax expenditures to direct expenditures shows that the size of government in Canada is about a quarter higher than generally reported, at about 54 percent of GDP rather than 44 percent of GDP. Furthermore, there is no downward trend in the tax-expenditure-inclusive size of government that is evident in the direct government expenditure to GDP ratio. This paper's estimates still understate the size of government since there is no information available on a significant portion of tax expenditures.

This raises the question of whether or not governments should rely on tax expenditures to achieve their policy goals.

There are a number of valid circumstances when the use of tax expenditures would be the most efficient instrument to achieve public policy objectives. There are also many reasons why their use is problematic. The author provides both the case for and against their use and then draws certain guidelines that, if followed, should allow tax expenditures to be used in an appropriate manner.

Ideally budgets should report both the actual direct government expenditure to GDP ratio, which substantially understates the true size of government, and the estimated total expenditures to GDP ratio including tax expenditures that better reflects on the true size of government, but is less precise. This requires a lot of work but, given the importance of knowing how large or small the government is, let this work begin. The author hopes this paper generates a serious debate on estimating the true size of government.

A better understanding of the true size of government is important for the appropriate conduct of public policy. Governments provide many improvements to outcomes in a variety of areas but these actions necessitate the collection of taxes that have negative economic effects. It is vital to be fully informed of these costs and benefits while making public policy decisions. This requires a better understanding of the true size of government. Transparency and accountability in taxation are important.

## Sommaire

---

Partout dans le monde, les gouvernements jouent un rôle prépondérant pour permettre la réalisation d'une diversité d'objectifs dans les domaines économiques, sociaux, environnementaux et en matière de sécurité. En général, l'indicateur très populaire auquel on fait appel pour mesurer la taille des gouvernements est la proportion des dépenses directes des administrations publiques dans le produit intérieur brut (PIB). Cependant, cette mesure sous-estime l'importance réelle des gouvernements en présence des *dépenses fiscales*, c'est-à-dire là où les gouvernements permettent généralement à certaines catégories de citoyens de payer moins d'impôt si ces économies servent à financer ce qu'ils auraient pu leur fournir directement. Or, lorsqu'un gouvernement transforme une dépense directe en programme de dépenses fiscales, il en résulte une baisse de ses dépenses totales, une diminution des impôts qu'il perçoit et un recul de sa taille, sans que cela influe sur le rôle qu'il joue. Il s'agit d'une situation nettement discutable.

Cette situation s'explique par les difficultés majeures à estimer les dépenses fiscales. Néanmoins, nous devons nous résoudre à surmonter ces défis pour que les politiques publiques soient fondées sur les faits les plus exacts possible entourant les variables les plus importantes. C'est ce que nous tentons de faire dans cette étude, dans la mesure où il est possible de fournir ce que nous croyons être les premières estimations de la taille du gouvernement qui tiennent compte des dépenses fiscales.

Les dépenses fiscales masquent la taille réelle du gouvernement

Lorsque sont ajoutées aux dépenses directes les trois composantes des dépenses fiscales, qui sont liées à l'impôt des particuliers, l'impôt des sociétés et les taxes directes, la taille du gouvernement fédéral s'élève d'environ 50 %, ou dans une proportion équivalant à 7,4 pour cent du PIB, ce qui n'est pas minuscule. Selon les estimations de l'auteur, la part des dépenses fiscales provinciales dans le PIB est de 4,3 %, un chiffre

moins élevé que la part fédérale, car les provinces dépendent beaucoup moins de l'ensemble des impôts perçus sur les revenus et des taxes de vente que le gouvernement fédéral. Les dépenses fiscales fédérales et provinciales combinées comptent pour 10,1 % du PIB, une fois les transferts intergouvernementaux pris en compte.

En ajoutant les dépenses fiscales aux dépenses directes des gouvernements, la taille des gouvernements au Canada passe à une proportion qui dépasse du quart environ celle qui est déclarée. Cette proportion s'établit donc à environ 54 % du PIB, plutôt qu'à 44 %. En outre, aucune tendance à la baisse n'est observée dans cette mesure inclusive des dépenses (dépenses directes et fiscales), contrairement à celle établie en fonction des seules dépenses directes. La présente étude sous-estime tout de même la taille du gouvernement, puisqu'aucune information n'est disponible sur une portion importante des dépenses fiscales.

Au Canada, la taille des gouvernements dépasse du quart environ les estimations déclarées.

Cet écart soulève la question de savoir si les gouvernements devraient dépendre ou non des dépenses fiscales pour atteindre leurs objectifs de politique.

Dans un certain nombre de circonstances, le recours aux dépenses fiscales constitue la manière la plus efficace d'atteindre les objectifs de politique publique. Dans d'autres, pour plusieurs raisons, elles sont problématiques. Tout en pesant le pour et le contre, l'auteur élabore quelques

lignes directrices qui, si elles étaient suivies, assureraient que les dépenses fiscales soient utilisées judicieusement.

Idéalement, les budgets des gouvernements devraient divulguer à la fois la part du PIB qui revient aux dépenses gouvernementales directes actuelles – laquelle sous-estime considérablement la taille véritable du gouvernement – et celle qui revient aux dépenses totales – une estimation moins précise, mais davantage représentative, car elle englobe les dépenses fiscales. Cet exercice exige beaucoup de travail, mais, compte tenu de l'importance de savoir si un gouvernement est petit ou grand, il importe de le commencer. L'auteur souhaite que la présente étude provoque un débat sérieux sur la façon d'estimer la taille véritable du gouvernement.

Il importe de mieux connaître la taille véritable du gouvernement pour que la politique publique soit mieux inspirée. Le gouvernement réussit à améliorer les résultats dans une grande variété de domaines, mais ces initiatives exigent des perceptions fiscales qui ont des effets économiques négatifs. Pour prendre de bonnes décisions en matière de politique publique, il faut être pleinement informé de leurs coûts et de leurs bénéfices. Cette tâche exige de mieux connaître la taille du gouvernement. En matière de fiscalité, la transparence et l'imputabilité sont des objectifs incontournables.

# Introduction<sup>1</sup>

---

Governments all across the world play pervasive roles in achieving a range of economic, social, environmental, and security objectives. They use a variety of instruments to achieve their objectives including direct spending, the tax system, and regulations.

In modern societies there is considerable interest regarding the question of the size of government as indicative of the extent to which the government intervenes in the functioning of the marketplace to achieve outcomes different from what the markets would produce. Naturally, views differ among citizens, and their political representatives, on the appropriate degree of government intervention.

However, the actual size of the government is impervious to ideology, and is information that should be easily accessible. An average citizen may be forgiven for believing that one of the very first things policy makers would have information on is how big or small the government is. Unfortunately that is a mistaken belief.

A popular indicator used for a view on the size of government is the amount of money a government spends directly in relation to the size of the economy; in other words, direct government expenditures as a share of gross domestic product (GDP). This indicator appears prominently in budget documents and its change over time is tracked as an indication of a change in the role of government in the economy.

This indicator can substantially understate the size of government in the presence of *tax expenditures*: governments often simply allow selected citizens to keep some of the monies they would otherwise have paid in taxes *if* they themselves use those monies for things the government would otherwise have provided directly. Tax expenditures are similar to direct expenditures and are used to achieve similar policy objectives. Thus, if a government decides to convert a substantial direct expenditure program into a tax expenditure program, the accounting result would be less government expenditure, fewer taxes, and a smaller government without there being any difference in the extent of the role government plays. It is clearly an inappropriate state of affairs if tax expenditures are treated differently from direct expenditures in the formulation of public policy.

Tax expenditures must be included in estimates of the size of government.

A number of major challenges in estimating tax expenditures explain this state of affairs. However, we should deal with these challenges, rather than avoid them, so that public policies are based on the best possible facts about the most important variables.

This paper provides estimates of the size of government by taking into account the existence of tax expenditures. To the author's knowledge, this is the first time such an attempt has been made. This is done by using the tax expenditure data that are only partially available for Canada, making reasonable but conservative assumptions to estimate some of the data that are not collected, and adding these estimates to the published direct expenditures data to get a better handle on the true size of government. By necessity, what the author therefore presents are estimates, which are materially different from actual direct expenditure data. As a result, there is some degree of uncertainty attached to the alternative estimates of the size of government the author presents. It is this author's view that it is important to estimate data that are

closer to the true picture of the size of government, rather than base policy exclusively on data that are known without doubt to substantially understate it. There are two reasons behind this view. First, transparency is essential for the development of good public policies. As an example, not knowing the stock of tax expenditure programs and their cost means they escape evaluation of their worthiness and hinder our ability to compare them with programs based on direct expenditures. Second, there is an economic cost of taxation that needs to be compared to the benefits to society for which the tax money is being spent.

## → SECTION ONE

# Tax Expenditures: Challenges and Solutions

---

**A** number of countries report tax expenditure data for some programs and there is some effort in many countries to sporadically use the available tax expenditure data as input into policy development. However, there is no country that uses tax expenditure data on par with direct expenditures in the development of public policy on an ongoing basis. This is indicative of systemic issues and challenges in dealing with tax expenditures.

This section discusses five challenges in estimating a more accurate picture of the size of government in the presence of tax expenditures and offers solutions where possible. These challenges include: defining tax expenditures; aggregating individual tax expenditures into an overall value; getting estimates of tax expenditures for all revenue sources; getting estimates of tax expenditures for all levels of government; and, finally, adding the aggregate value of tax expenditures to direct government expenditure to get a more accurate picture of the size of government.

## Defining Tax Expenditures

### The Challenge

Conceptually, defining tax expenditures is easy.<sup>2</sup> For example, Anderson defines it, as reported by the Organization of Economic Co-operation and Development, as steps to “reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax” (2010, 12).

Making this definition operational is where the difficulty is. Since a tax expenditure is a reduction or postponement of a tax, it is important to define the tax anchor to which this reduction or postponement is being compared. There is no agreed upon benchmark tax system. Take two extremes where one end of the range could be a textbook-type ideal tax system and the other could be the actual tax system in place. Compared to the first, which may suggest that all capital taxes are inefficient and a consumption tax desirable, the size of tax expenditures in any country would be very large indeed.



At the other extreme, if the actual tax system is considered the benchmark, because that is what the population has accepted to be the practically desirable system, then, by definition, there are no tax expenditures.

The somewhat subjective nature of defining tax expenditures has always been a source of controversy regarding the usefulness of the tax expenditure concept. The US Joint Committee on Taxation (2008) provides a useful analysis of the controversy. Most of the controversy revolves around two concerns: the subjectivity of the benchmark tax system, and the worry that the adopted definitions may be driven more by political agendas than by tax policy considerations, with those believing in small governments more comfortable with a narrow benchmark so that there are many tax expenditures while those embracing large roles for the government are more comfortable with exceptions to a textbook-type structure being a part of the benchmark.

### **The Solution**

In contrast to the extremes noted above, most countries use pragmatic approaches in defining tax expenditures. As an example, Canada (2010) has defined a benchmark system against which it publishes annual estimates of a number of (though not all) tax expenditures both for federal income and sales tax.

According to Canada,

The benchmark for the personal and corporate income tax systems is defined by considering the tax base, existing tax rates and brackets, the unit of taxation, the time frame of taxation, and the treatment of inflation for calculating income. In addition, the benchmark includes measures that reduce or eliminate double taxation, recognize expenses incurred to earn business income, and allow business losses to be claimed over a number of years. Finally, the constitutional immunity of Canada and the provinces from taxation is recognized as part of the benchmark system for income taxation. (2010)

Furthermore, “[t]he benchmark for the GST is a broadly based, multi-stage value-added tax collected according to the destination principle and using a tax credit mechanism to relieve the tax in the case of business inputs” (Canada 2010).

Fortunately, therefore, the controversial question of what precisely is tax expenditure should not be a point of political or academic debate in Canada as there is a generally accepted definition that has been around for many years.

### **Examples of Tax Expenditures**

There are a number of policy tools available to the government to provide tax relief to a targeted group of citizens. In Canada, these include *exemptions* from the tax base, so that these items do not form part of income, *deductions* from the tax base that reduce taxable income, *credits* that are similar to deductions with the difference that tax relief is not always provided at the taxpayers’ marginal rate of tax, *tax rate relief*, and *tax deferral*.

Canada (2012) lists federal tax expenditures in the areas of federal personal income tax, corporate income tax, and the goods and services tax (GST). In recent years, the number of tax expenditures has been close to 200.

Examples of tax expenditures using instruments described above include the following:

- Scholarships, fellowships, and bursaries are exempt from inclusion in income.
- Contributions to registered retirement savings plans, child care, and employment expenses are deducted from income to calculate taxable income.

- Credits include those for tuition fees and charitable donations.
- Rate relief occurs with the partial inclusion of capital gains.
- Tax deferral occurs with the taxation of capital gains upon realization and the deduction at contributions to, and taxation on withdrawals from, the registered retirement savings plans.

## Estimating Individual Tax Expenditures

Anderson (2008), quoted by the OECD (2010, 13), lists a variety of methods that can be used for estimating tax expenditure. These include initial revenue loss, final revenue loss, and outlay equivalence.

The initial revenue loss method is the simplest and calculates the direct loss in tax revenue associated with a tax expenditure program and may ignore other consequences that may follow including automatic effects that may occur in other related tax revenues, the impact of change in behaviour, and potential impacts on revenue through a change in the level of economic activity. Some tax expenditure calculations may capture some of these effects, which we may want to label as a modified initial revenue loss method. The Canadian estimates (2012) capture some of the automatic impacts in an accounting sense, as a number of these estimates are developed using a micro simulation model. For example, the removal of a tax deduction would change the level of taxable income that in turn could affect taxation in an accounting manner in a number of other areas. These effects are captured in the Canadian model based estimates.

The final revenue loss method, which would be a more complex exercise, would capture all the elements described above that are ignored in the initial revenue loss method.

The most useful method is the outlay equivalence method. Since the purpose of estimation is to determine the cost to the government of a tax expenditure action, if that action was delivered directly through government expenditure, this method comes closest to meeting the objective. However, in practice, it is impossible to apply given its complexity and the level of subjectivity attached to it. There are no estimates available in Canada or many other countries using this method.

## Aggregating Individual Tax Expenditures

### The Challenge

Canada (2010) cautions against adding estimates of various tax expenditures for two reasons: first, “[t]he simultaneous elimination of more than one personal income tax expenditure would generate larger estimates because of progressive income tax rates”; and, second, “[g]iven the interaction of certain tax measures, the revenue impact of eliminating two or more measures simultaneously would differ from taking the independently estimated numbers published in this document and aggregating them”.

On the first factor, any aggregate value of tax expenditure would be an underestimate since eliminating them would likely push taxpayers into a higher tax bracket, generating more revenue than the simple sum of all tax expenditures would suggest.

On the second factor, summing up tax expenditures could be an overestimate of their aggregate value. Consider, for example, a service that is exempt from the GST. The provider of that service does not charge the GST (say \$100) and collects a rebate on the input taxes he pays (say \$50). Adding them up would seem to suggest the aggregate value of tax expenditure is \$150, when in reality that would be double counting. Eliminating the exemption would mean the government would collect net GST of \$50 (as the difference between GST collected and the input tax credit) and not have to pay the GST rebate, another \$50, for an aggregate tax expenditure of \$100.<sup>3</sup>

## The Solution

The author dealt with this challenge by accepting the aggregated value of tax expenditures from the OECD (2011). This study is based on the OECD inviting a group of 10 countries to provide the OECD with tax expenditure data for the central government.<sup>4</sup> It provides two sets of estimates for these countries: the country's own estimates and estimates based on some very basic adjustments to make country data more comparable. The OECD, however, cautions that definitions of tax expenditures and methodologies used across countries are so different as to make comparisons not very informative.

## Tax Expenditures for all Revenue Sources

### The Challenge

Almost a quarter of close to 200 Canadian federal tax expenditure measures have no quantitative estimates because, as Canada (2012a) puts it, “data are not available to support a meaningful estimate/projection”.

Furthermore, tax expenditure estimates are available only for three tax types: personal and corporate income tax and the goods and services tax. As the OECD (2010, 72) reports, some countries (for example Germany, Korea, and the Netherlands) estimate tax expenditures for all types of taxes.

### The Solution

The author has not been able to find a solution for the missing information for a significant portion of the tax bases. As a result, estimates would still understate the true size of overall tax expenditures.

## Getting Tax Expenditure Estimates for all Governments

### The Challenge

Five provinces report tax expenditures. In contrast to the federal government, some of the provinces provide estimates for more than the three revenue sources for which the federal government provides estimates. Ontario reports its tax expenditure in an annual document called *Transparency in Taxation*. As with the federal government, individual tax expenditure estimates are not added up. There are close to 200 tax expenditure measures of which enough information was not available to estimate almost 80 items. Quebec publishes an annual report, also independent of the budget, called *Quebec Tax Expenditure*. In contrast to the federal government and Ontario, the Quebec report does provide an aggregate estimate. Three other provinces, Alberta, British Columbia, and Newfoundland and Labrador, publish tax expenditure estimates as information items in their budget as annexes. They are also not aggregated. The tax expenditure estimates are not, as in other provinces and the federal government, integrated with the formulation of the budget. One should keep in mind as well that each of these jurisdictions has its own definition and methodology to calculate tax expenditures, so the information provided is not strictly comparable.

### The Solution

The author considered using available provincial tax expenditures for the purpose of this estimation. However, there are a number of challenges in doing this. First, not all provinces provide estimates. Second, even those that do publish these estimates use methodologies that may differ from one province to the other. Third, the author finds there are large parts of provincial tax expenditures for which data are not estimated. Fourth, the presentations of these estimates are quite different from

one province to the next. Some provide estimates of their top-ups to the federal system only; others provide a breakdown of tax expenditures generated as a result of the application of the federal tax structure in a province combined with provincial actions. Still others provide estimates that are difficult to interpret in the context of the contribution of the federal versus provincial actions.

Fortunately, in Canada, federal and provincial tax systems are harmonized to a considerable extent using the *Tax Collection Agreements*. Under the *TCAs*,<sup>5</sup> all provinces use the federal definition of personal taxable income. This means that all tax expenditures related to federal personal income tax exemptions and deductions automatically become provincial tax expenditures as well. Provinces have generally followed the federal government's lead in the use of tax credits although the rates they have used can be determined independently of the federal government. The same is true of the deferral of some income tax payable.

The same applies to the provincial corporate tax where most provinces, with the exception of Alberta and Quebec, are parties to the *TCAs* and use the federal definition of taxable income. In the area of sales tax, with Ontario, Quebec, and the Atlantic provinces all part of the harmonized sales tax system, circumstances are fairly similar to those for the personal income tax.<sup>6</sup>

In view of these features of the Canadian tax structure, the author estimates provincial tax expenditures in the aggregate, proportionally to the federal tax expenditures, with the proportions to be determined as ratios of provincial tax revenues in personal income, corporate income, and sales tax fields to federal taxes in these fields. In this author's view, such a methodology would provide relatively reliable estimates.

## **Adding Tax Expenditures to Direct Government Expenditures To Get a Measure of the Size of Government**

### **The Challenge**

Finally, there is the challenge of whether any estimated aggregate value of tax expenditure can be added to direct expenditures to get a more accurate indication of the real size of government. Views on it may differ on the basis that it is not clear which of the tax expenditures are a substitute for direct spending and which ones are not.

### **The Solution**

The author feels one can do an add-up since tax expenditures are a *deviation* from a benchmark tax system.

An alternative picture of the true size of government can be developed by using the GDP share of government revenue instead of direct expenditure. The rationale for this is the following: a benchmark tax structure determines the true revenue yield, which is what we need to know but don't; tax expenditures – or tax concessions – tell us the amount of revenue that the tax system collected but then gave back in tax concessions; adding tax expenditure/concessions to the actual revenue yield, therefore, gives us an adjusted estimate that reflects the true revenue yield of the benchmark tax structure. Such an estimation of a tax-expenditure-adjusted size of government from the revenue side should produce results very similar to the estimates obtained from the expenditure side as government revenue and expenditure levels are fairly similar when there are relatively small imbalances between the two.

# Estimates of the Size of Government Adjusted for Tax Expenditures

First, estimates are developed for the federal government, followed by estimates for the total government.

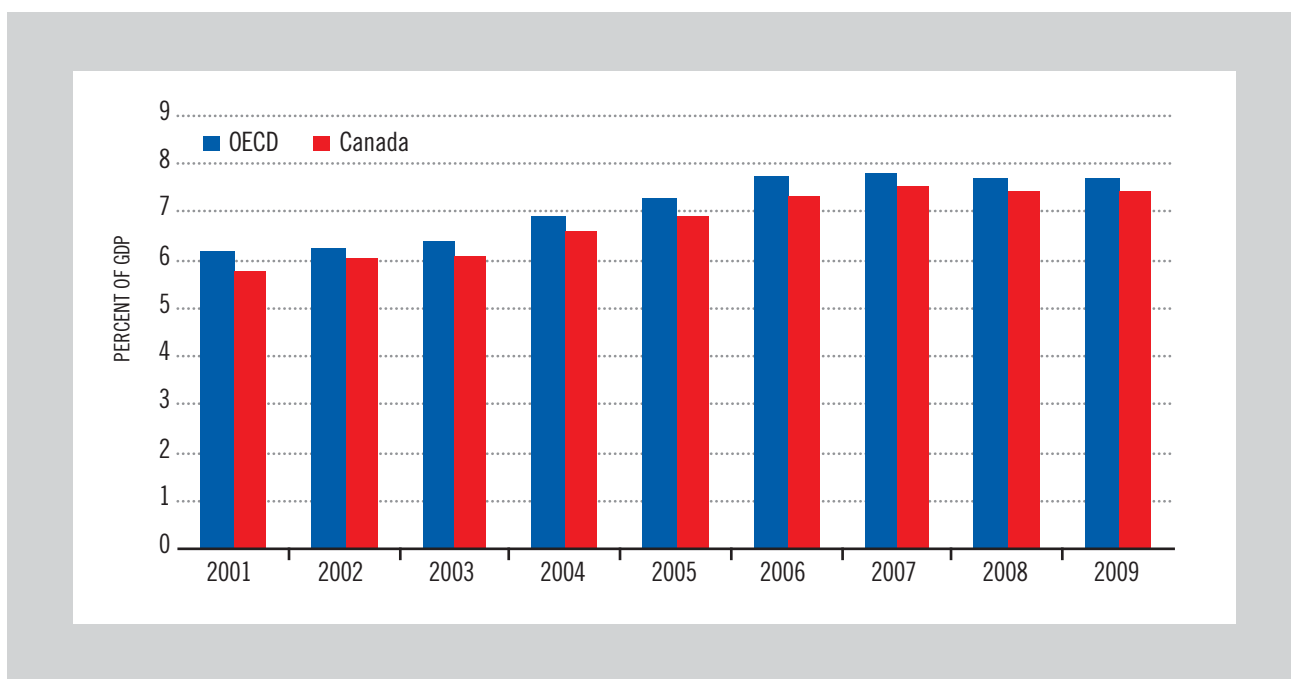
## Federal Tax Expenditure and the Size of the Federal Government

Chart 1 shows two estimates of federal tax expenditures reported by the OECD (2010, 172-181). One estimate is based on data submitted by Canada to the OECD and the other is OECD adjusted numbers.

Canadian and OECD estimates of Canadian federal tax expenditures are similar, with the OECD estimates slightly larger. The key difference is that Canadian estimates consider the dividend tax credit to be a part of the benchmark tax system in contrast to the OECD's estimates. Both estimates towards the end of the reported period are in the range of 7.5 percent of GDP.

The OECD estimates are available up to 2009. While estimates surely have changed since, a review of changes in the Canadian tax expenditure reports published since 2009 suggests that the latest estimates in chart 1 are broadly representative of their size at this time.<sup>7</sup>

**CHART 1: Estimates of Canadian federal tax expenditures: Canadian and OECD sources**



Source: OECD (2010).

Table 1 provides the distribution of tax expenditure as reported by Canada to the OECD for three years, 2001, 2005, and 2009. The largest increases have taken place in retirement incomes,<sup>8</sup> housing,<sup>9</sup> general business incentives<sup>10</sup> (at the expense of specific tax relief<sup>11</sup>), R&D,<sup>12</sup> and work-related incentives.<sup>13</sup> GST-related tax expenditures<sup>14</sup> have actually declined in contrast to income tax-related tax expenditures, which have increased significantly.

**TABLE 1: Canadian federal government tax expenditures as a share of GDP (%), 2001, 2005, and 2009**

PURPOSE	2001	2005	2009
Income Tax			
General tax relief	.16	.14	.23
Low-income non-work-related	.02	.02	.02
Retirement	.65	1.87	2.03
Work-related	.12	.11	.12
Education	.12	.11	.12
Health	.24	.25	.27
Housing	.06	.25	.27
General business incentives	1.00	.97	1.10
R&D	.22	.25	.33
Specific industry relief	.21	.02	.07
Intergovernmental relations	1.63	1.56	1.60
Charity	.20	.20	.20
Other	.02	.02	.03
Make-work pay	.00	.01	.16
<b>Total income</b>	<b>4.67</b>	<b>5.77</b>	<b>6.54</b>
<b>GST-related</b>	<b>1.11</b>	<b>1.17</b>	<b>.90</b>
<b>Total</b>	<b>5.78</b>	<b>6.93</b>	<b>7.44</b>

Note: Tax expenditure as reported by Canada to the OECD.

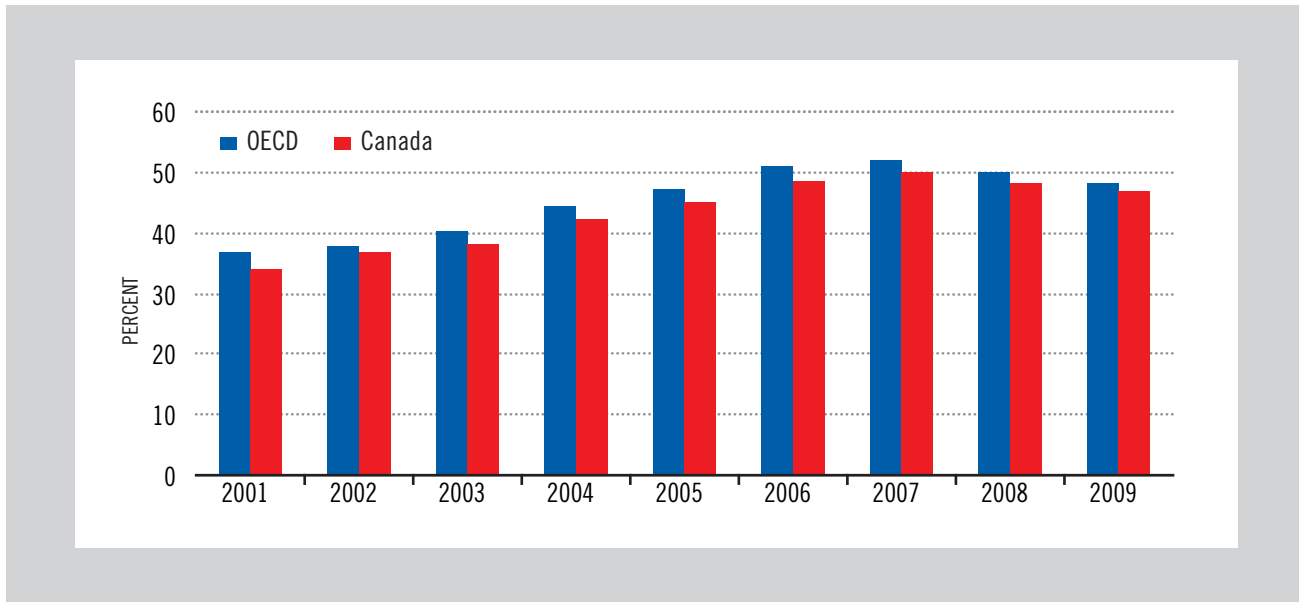
Source: OECD (2010).

Chart 2 provides estimates of the increase in the size of the federal government with the addition of tax expenditure to direct expenditure. Two observations can be quickly made. First, the increase

Including tax expenditures increases the given size of the federal government by 50 percent.

in the size of the federal government, by adding tax expenditures to direct expenditures as a ratio of GDP, is about 50 percent, not a small number. Second, the increase over time in the size of the federal government so adjusted is quite noticeable. Over this period, the share of direct expenditures in GDP has continued to trend down, from 17 percent in 2000 to 15.9 percent in 2009. However, this downward trend is more than offset by the rising trend of tax expenditures to GDP ratio.

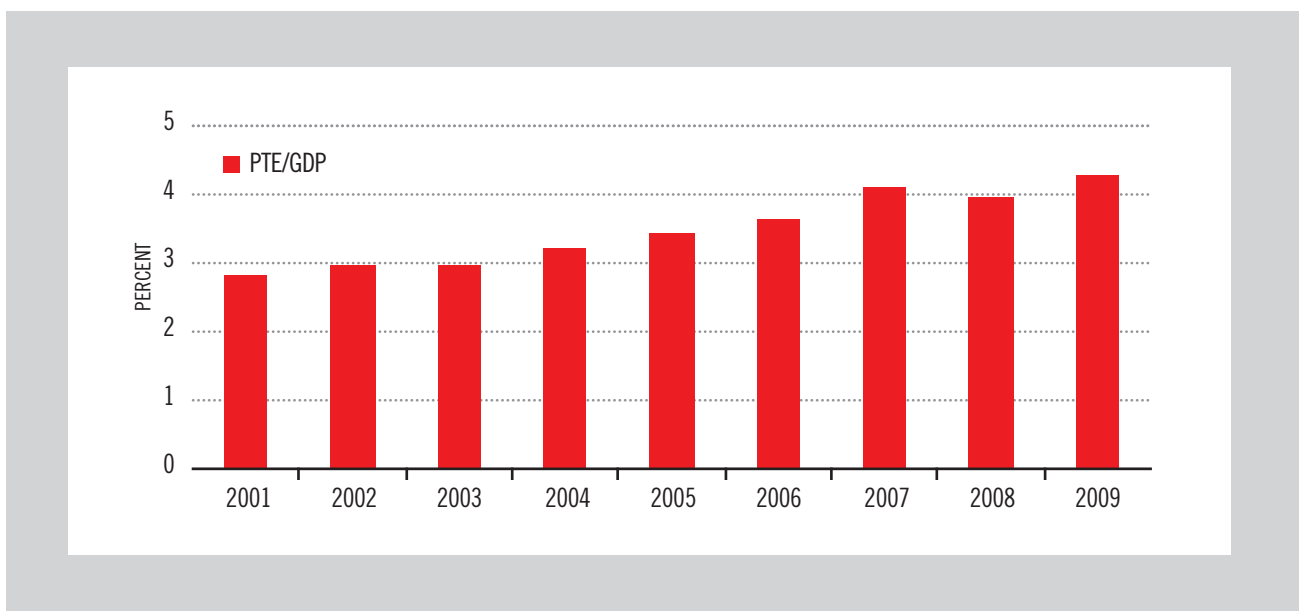
**CHART 2: Percent increase in the size of the federal government with the inclusion of tax expenditure**



Sources: OECD (2010) for tax expenditure; Statistics Canada (CANSIM 385-0001) for the percentage share of direct expenditure in GDP.

Next, the contribution of the tax expenditures of provinces and territories to the size of total government are taken into account. Chart 3 shows the provincial tax expenditure to GDP ratio is 4.3 percent of GDP. This is significantly less than the federal ratio. The explanation is that provinces rely much less on the tax bases being examined for tax expenditures relative to income tax and sales taxes. The federal share of these tax bases combined to total revenue is about 75 percent while the provincial share is 39 percent, according to Statistics Canada data (CANSIM table 385-0001). However, in view of the fact that other provincial sources of revenue have tax expenditures as well, this estimate of provincial tax expenditure to GDP ratio is likely to be an underestimate.

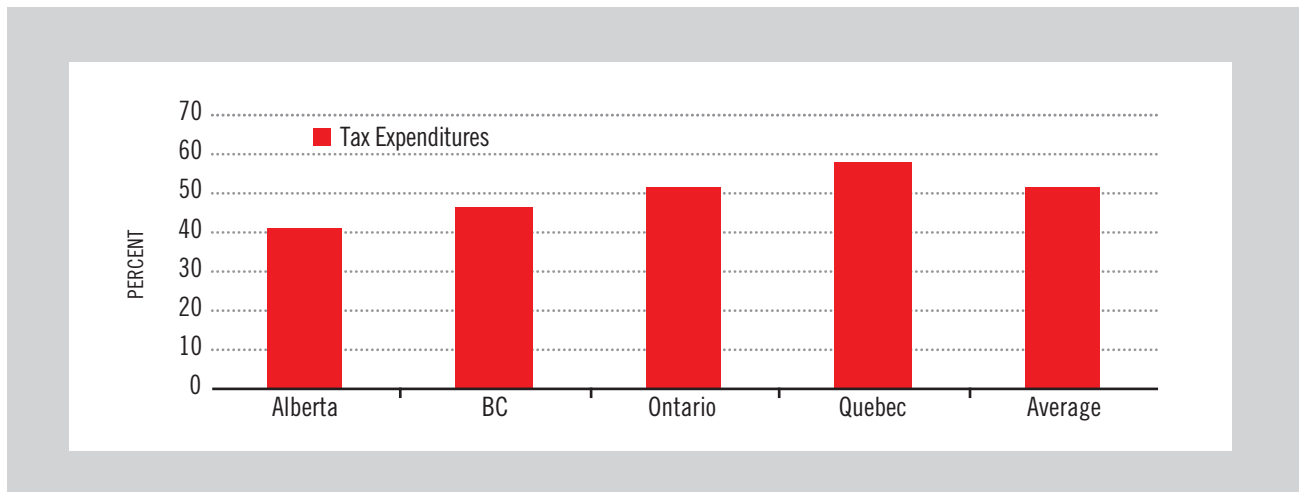
**CHART 3: Estimates of provincial tax expenditure to GDP ratios**



Sources: Author's calculations based on data from the OECD (2010) and Statistics Canada (CANSIM table 385-0001) as described in the text.

It is useful, as reference, to review the ratios of provincial tax expenditures related to income and sales taxes to their respective tax bases. This is done for Alberta, British Columbia, Ontario, and Quebec individually and in aggregate in chart 4. These ratios range from 41 percent in Alberta to 58 percent in Quebec with an average ratio of 51 percent.

**CHART 4: Ratios of tax expenditures for provincial income and sales tax to their tax bases**

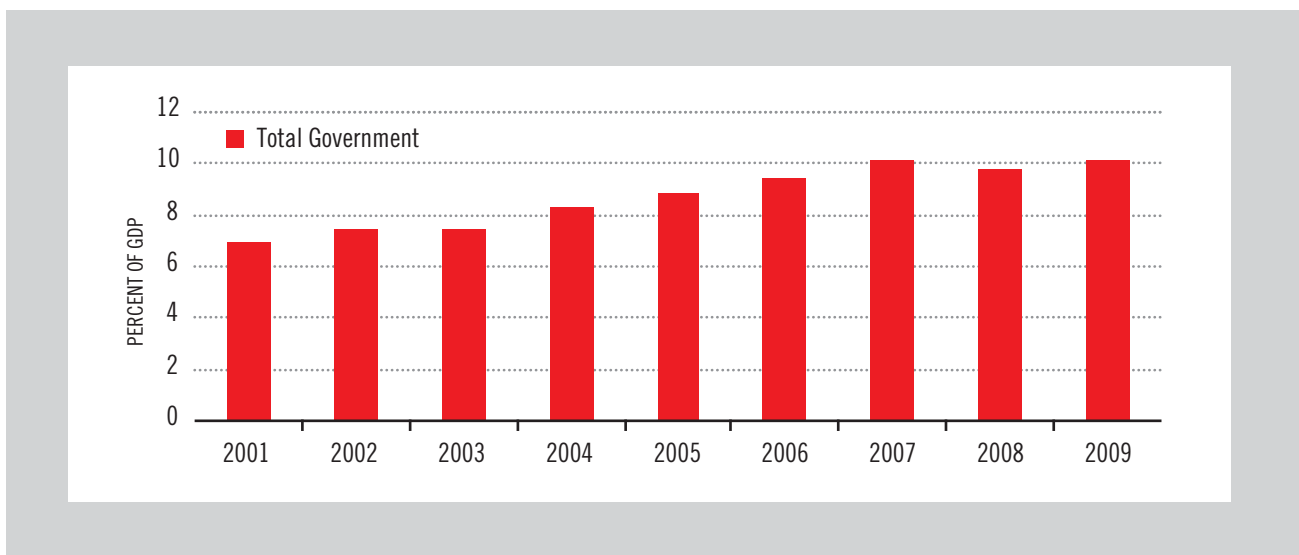


Note: The ratios are for the latest years for which data are available. Although data are available for Newfoundland and Labrador (2013), they seem to be calculated on a vastly different basis than other provinces and therefore not comparable. Even for provinces reported in the chart, comparisons may be difficult because of different coverage and methodologies.

Sources: Alberta (2013, 117-118); British Columbia (2013, 113-18); Ontario (2012); Quebec (2011).

Next, in chart 5, the author adds tax expenditures for federal and provincial governments for income and sales tax, leaving out federal tax expenditures related to intergovernmental transfers. In chart 5, the share of tax expenditures to GDP is over 10 percent at the total government level. Chart 6 uses information in chart 5 to estimate an alternative size of government by adding direct expenditures and tax expenditures as shares of GDP.

**CHART 5: Total government income and sales tax expenditures**

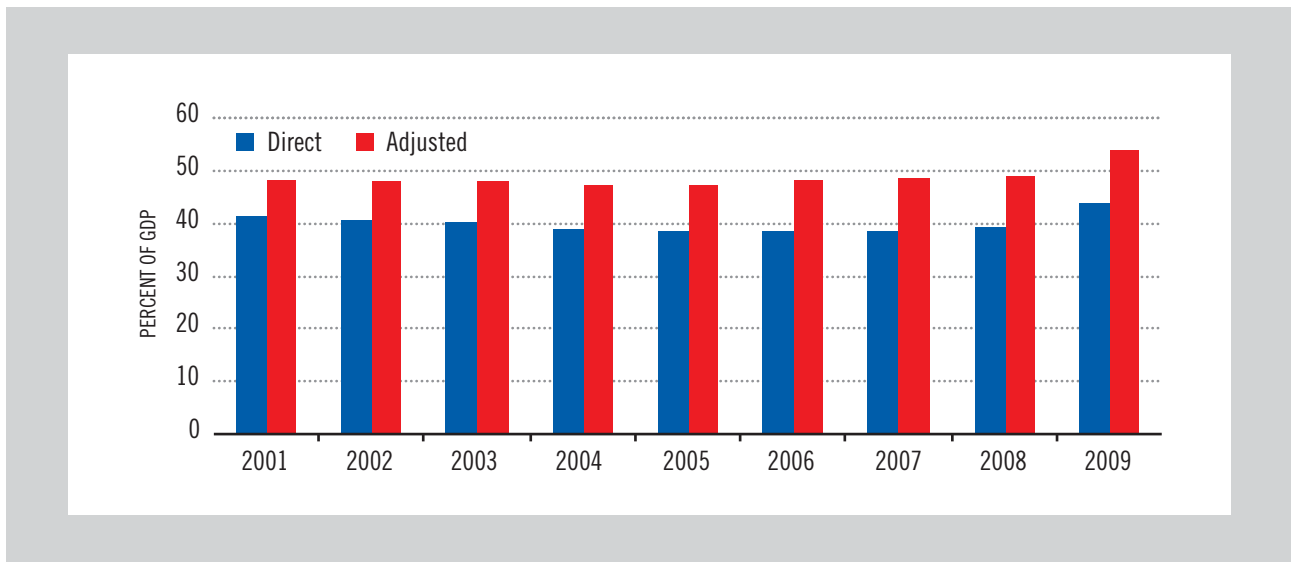


Sources: Charts 2 and 3. For the federal government the author chose the Canadian estimate of tax expenditures.



Chart 6 shows that the size of government is about a quarter higher than otherwise including tax expenditures, at about 54 percent of GDP rather than 44 percent of GDP. There is also a clear upward trend in the size of government adjusted for tax expenditures in contrast to a downward trend in the unadjusted size, ignoring 2009, a year affected by increased spending in response to the economic recession.

**CHART 6: Size of total government adjusted for income and sales tax expenditure**

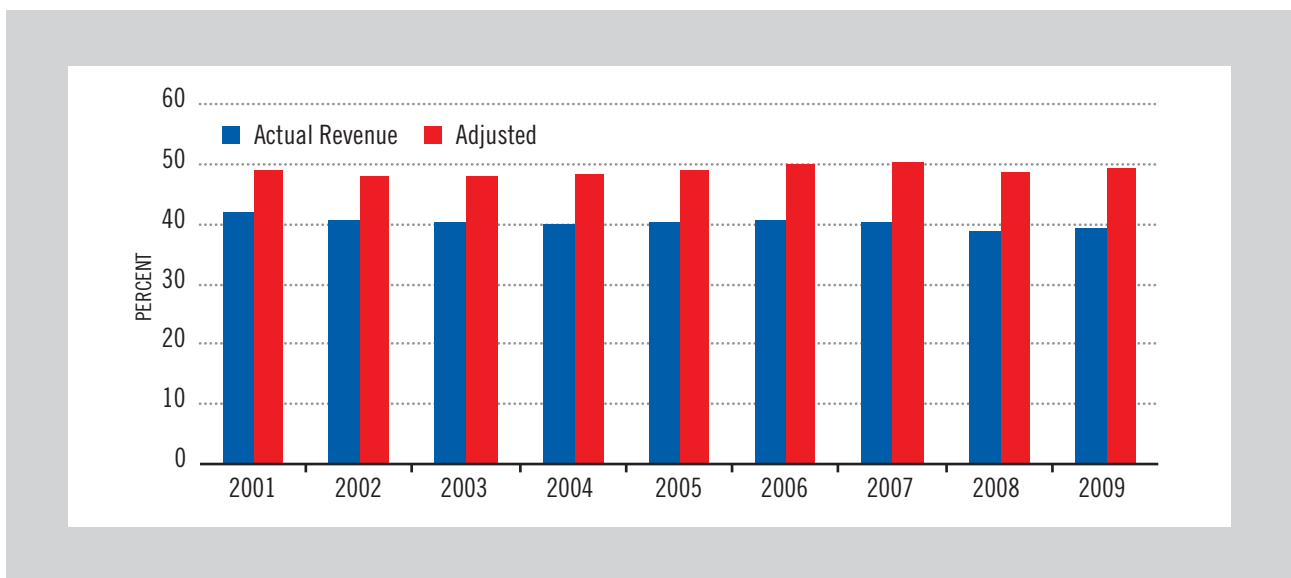


Sources: OECD (2013, Table 25) and chart 5.

What do these estimates mean for the economic cost of tax expenditures in terms of lost output (the deadweight loss of taxation), sidestepping the issue of the benefits of these expenditures, which must be taken into account in determining their net value as a policy tool? Recent research that includes Dahlby and Ferede (2011) and Kesselman and Spiro (2014) suggests that the economic cost for at least some tax bases can be large.

Chart 7 provides the alternative estimate of the size of government from the revenue side. The conclusions drawn above based on the expenditure side remain intact with this alternative estimation.

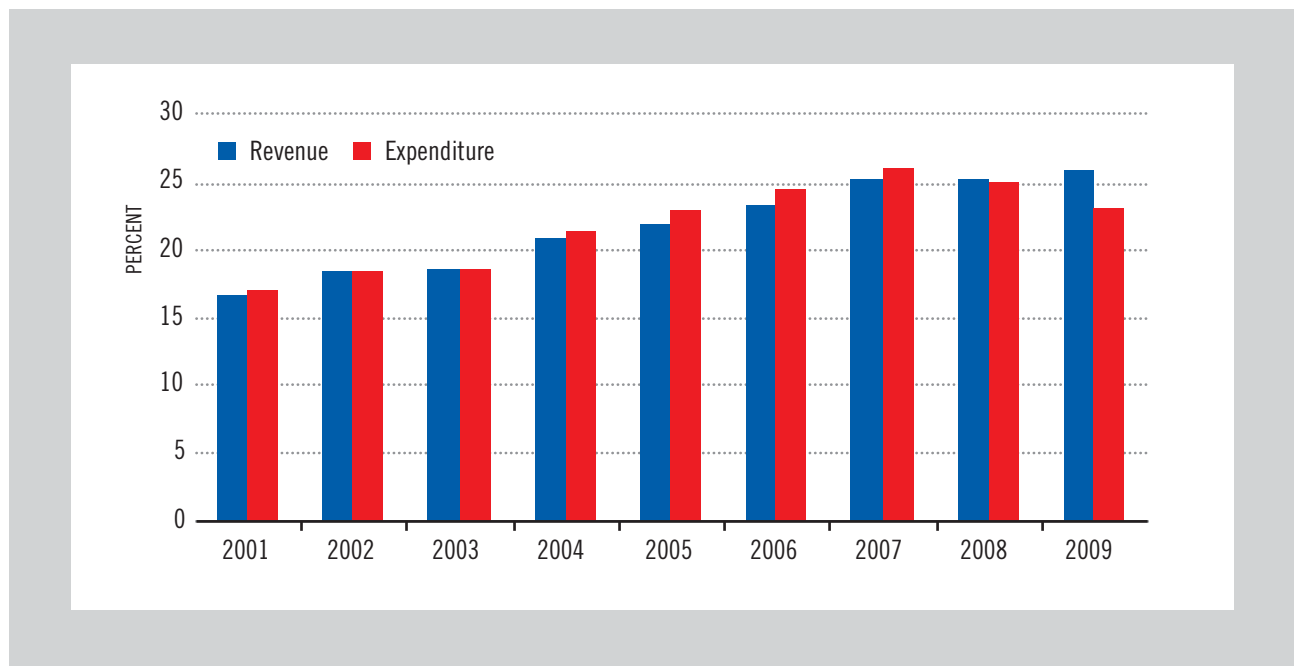
**CHART 7: Size of government based on government revenue**



Sources: OECD (2013, Table 26) and chart 5.

Chart 8 compares the change in the size of government from both the revenue and expenditure perspectives as discussed above.

**Chart 8: Percent change in the size of government from the revenue and expenditure perspectives**



Sources: OECD (2010, Tables 25, 26) and chart 5.

The percent increases in the size of government from these two perspectives are similar.

### → SECTION THREE

## The Case For and Against Using Tax Expenditures

The analysis presented above highlights the challenges that the existence of tax expenditures creates in accurately determining the size of government. This raises the question of whether or not governments should rely on tax expenditures to achieve their policy goals.

There are a number of valid circumstances when the use of tax expenditures would be the most efficient instrument to achieve public policy objectives. There are also many reasons why their use is problematic. Below, both the case for and against their use is made and then certain guidelines are given that, if followed, should allow tax expenditures to be used in an appropriate manner.

## The Case for Tax Expenditure

### Lower Administration Cost

There are circumstances where using tax expenditures instead of a direct expenditure program would be administratively more efficient.

Consider the tax expenditure related to the exemption of scholarships, fellowships, and bursaries from taxation. Assuming the government has a valid reason to help students who receive this type of income, the choice is between an exemption (a tax expenditure) and direct expenditure support. The former would not require any administrative cost since all that students need to do is to not report this income for taxation. The latter would require the setting up of an administrative mechanism, after the students have reported such income for taxation, to determine the amount of direct expenditure support and then find a delivery mechanism to get this support to students. Both these steps in a direct expenditure program would increase administration cost.

Tax expenditures can diminish the chance of fraud.

Lower administration costs for a tax expenditure may occur as well in those circumstances where information verification needed to determine financial support to a citizen is already available as part of the filing of tax information. Consider the tax expenditure related to the half inclusion rate for capital gains for income taxation. Again assuming that there is a valid reason for the public support of asset purchases, the revenue collection agency would receive information on share

trading directly from a financial institution as part of their own tax reporting. Hence there would be no need for setting up another agency to gather this information as part of a direct expenditure program if that alternative was to be followed.

In addition to reduced administration costs related to circumstances where verifiable information is automatically made available to the revenue collection agency, the chances of anyone engaging in fraud or misuse are diminished through the use of tax expenditures in contrast to a direct expenditure program where a separate agency would need to collect and verify such information.

### Identification of Groups of Citizens who Qualify for Public Support

The government needs to have criteria in determining who should qualify for public support. If these criteria are related to income, it may be efficient to use tax expenditures rather than direct spending programs in more effectively reaching this group.

A deduction from income would be more effective in encouraging retirement savings.

Consider the case of the medical expense tax credit that is provided to those whose medical expenses, not covered by the public health care system, exceed 3 percent of their taxable income. A tax expenditure program would be more effective in reaching all such individuals in contrast to a direct expenditure program.

Consider another example where the objective is to help people save for retirement in relation to their income. Again, a deduction from income up to a certain limit in relation to taxable income would be a more effective means of reaching this group than a direct expenditure program.

## Providing Public Support to Only Those Who Pay Tax

If the stated goal of a public policy is to provide support only in those circumstances when a citizen is paying tax and the level of that support is linked to the amount of tax paid, then a tax expenditure program is the most appropriate option and a direct expenditure program, while it would be technically feasible to develop, would be quite inefficient. Canada has many non-refundable tax credits that reduce the amount of tax otherwise payable. Examples include tax credits related to education, health, and charitable donations.

## The Case Against Tax Expenditure

The arguments against the use of tax expenditures are many and based on concerns related to the increased complexity of the tax system, unfairness, misrepresenting the size and therefore the cost of government, difficulty of determining the revenue lost, ineffective reporting in the context of the budget process, lack of accountability on using the tax dollar, and the relative ease of their introduction, leading to their inappropriate growth over time.

### Complexity of the Tax System

There are already close to 200 tax expenditures.

The piling up of tax expenditures in a tax system that is already quite complex makes the system so complex as to be beyond the reach of many taxpayers. This could naturally lead to interactions among components of the tax system that were never intended. Note that the issue of complexity is quite serious: as an example, there are close to 200 tax expenditures just for three federal tax bases and information is not available even for many of these (Canada 2012).

### Unfairness

Tax expenditures can be unfair. One source of unfairness results from the complexity of the tax system itself. Low-income taxpayers are more likely to not be able to navigate through complexity and take advantage of the myriads of tax expenditures. They also do not have the resources to seek financial expertise from high-priced tax specialists.

Another source of unfairness arises when a tax expenditure may be linked to the amount of income and tax paid that may yield inappropriate results. Consider the case of the disability tax credit. The cost of steps taken to deal with a disability is independent of the level of income and tax paid. The credit, by reducing the amount of tax paid up to a maximum amount, means that the higher someone's income the more one can recover the cost of dealing with the disability. Those with no or low incomes, therefore, may get less or no public help compared to those with higher incomes.

A tax expenditure linked to the amount of income and tax paid may yield inappropriate results.

The cost of steps taken to deal with a disability is independent of the level of income and tax paid. The credit, by reducing the amount of tax paid up to a maximum amount, means that the higher someone's income the more one can recover the cost of dealing with the disability. Those with no or low incomes, therefore, may get less or no public help compared to those with higher incomes.

A third source of unfairness is the likelihood that those who are well off may be more able to get a government to introduce or enhance a tax expenditure suitable for their circumstances compared to those who are not well off. Higher income taxpayers are more able to present their case to the government even for direct expenditure programs. However, given the reduced focus and scrutiny that

tax expenditures generate, chances of unfair outcomes are likely higher with tax expenditures than with direct spending programs.

### **Misrepresenting the Size and Cost of Government**

Tax expenditures, by reducing the reported amount of total tax revenue collected, with no impact on the size of direct expenditure, misrepresent the size of government. As shown in the previous section, the extent of this misrepresentation is potentially quite large.

Ideally, public policy should strive to achieve a size of government such that, at the margin, the economic cost of taxation is equal to the benefit of government spending. While the economic cost of taxation can be calculated quantitatively in most cases, the benefits of government spending that are related to social, environmental, and security objectives may be difficult to calculate quantitatively. However, even in these cases where the benefit considerations may be only qualitative, the availability of tax cost estimates may provide a useful reference point for decision making.

Tax expenditures, which cannot always be estimated and are not generally added together to get a global figure, make it impossible to determine the amount of revenue that is collected before the cost of tax expenditure is subtracted from them. This means that the economic cost of overall taxation cannot be estimated. This further implies that even the analysis where qualitative benefits of various types of spending are compared to the quantitative economic cost of taxation is not possible to undertake. Needless to say, this has an adverse impact on the quality of public policy decision making. The economic cost of taxation, at least for some revenue sources, can be significant as documented by Dahlby and Ferde (2011) and Kesselman and Spiro (2014).

### **Difficulty of Determining Revenue Lost**

There are a number of complications in estimating the revenue loss from tax expenditures. Canada (2010) uses microsimulation models to estimate their impact on revenues and warns readers that these revenue estimates may change dramatically with changes in methodologies. As well they warn that the estimates are prepared with some restrictive assumptions, hence one should be careful how this information is used.

Relevant information is not available to calculate lost revenue.

Canada (2012) does not report the value of tax expenditures for about a quarter of the programs because relevant information to calculate these values is not available.

Beyond the three tax bases for which Canada provides information annually, tax expenditures for the rest of federal revenue collection are not listed. Hence they can not be costed.

A few Canadian provinces report the values of their tax expenditures. Others do not, most likely because of the difficulty of estimation.

### **Lack of Reporting as Part of Budgets**

Ideally one would like to have information on direct expenditures and tax expenditures side by side in a government's budget to allow getting a handle on total spending, preparing evaluation of whether support is provided in an appropriate manner and determining the relative merits of items in the two forms of spending when resource reallocation issues are examined as part of the budget. In such an ideal world, tax expenditures would receive the same level of review and scrutiny and be

reported with the same frequency as direct government expenditures. They would have the same standing and same data quality as direct expenditures.

Reporting of data alone, however, is not sufficient. One needs rigorous and ongoing analysis of the usefulness of tax expenditures as part of a budget document as well. These evaluations may be done within the public service or independently by private sector researchers or arms length public bodies.

How does Canada compare with this ideal? To begin with, tax expenditure estimates are not a feature of annual federal budgets so the need to treat direct spending and tax expenditure on an equal footing is not met. Reporting tax expenditures is not a legal federal responsibility. However, Canada publishes an annual document that provides estimates of the initial revenue lost for many of the approximately 200 tax expenditures for which the calculation of estimates is considered feasible.

Reporting tax expenditures is not a legal federal responsibility.

As for the introduction of new tax expenditures, or changes to existing ones, the annual federal budget is the vehicle for these actions. There is no constraint on how many tax expenditures can be introduced and at what cost. While there is a notional objective in controlling the growth of direct expenditures, that objective does not apply to tax expenditures since, by definition, they reduce revenue. In general, there is no time limit on the life of tax expenditures.

There are no formal reviews of tax expenditures by the government or by Parliament. While not legislatively required, Canada undertakes periodic reviews of some tax expenditures. A case in point is two research reports on the tax-free savings accounts and the accelerated deduction of capital cost allowances in the Canada (2012) report. The OECD comments that Canada has produced “on an hoc basis ...impressive research products” (2010, 49).

Commenting on this subject, the Canadian Parliamentary Budget Office concluded:

Given separate reporting structures for tax expenditures, **parliamentarians are never presented with a comprehensive view of overall expenditures** [emphasis theirs]. This could hinder deliberation on budgetary choices. In addition, while Parliament has established processes for review of the Estimates via the Business of Supply, no comparable process exists for tax expenditures. (2011)

### Lack of Accountability

A collection of factors described above is indicative of a lack of accountability related to expenditures undertaken through the tax system. The absence of a full estimation of their cost, their large numbers that make it difficult to get a handle on them individually and collectively, their interaction with an already complex tax system and the lack of reporting in the budget and of comparison with direct expenditures mean that taxpayers neither know accurately how much tax they are paying nor do they have any knowledge of the many ways their tax dollars are being spent, and with what effectiveness.

Lester has suggested integrating tax expenditures with the federal government’s expenditure management system to “to ensure that programs are aligned with federal responsibilities and priorities, and that they are efficiently delivered and performing effectively” (2012).

### Ease of Their Introduction and Strong Growth in Their Numbers

The OECD (2010, chapter 2) provides a number of arguments suggesting it is far easier to introduce tax expenditures than undertake spending directly on those programs.

First, it may be easier to add generally unrelated provisions in a tax bill, drafted by tax specialists rather than by program experts, that do not have a singular focus on a program objective that would invite greater scrutiny. Second, there is the likelihood of small marginally useful tax reliefs added to the budget compared to spending programs where the merit criteria for approval are likely to be stiffer. Third, there is in general greater tolerance to accept tax cuts than to increase spending. For example, it may be easier to get consensus on tax expenditures across followers of all political philosophies compared to direct expenditure programs: those wanting smaller governments may tolerate tax expenditures, rather than direct expenditures, as they would not increase the size of government; those wanting government intervention may find tax expenditures more appealing as their cost is hidden, the programs would likely be more permanent, and the scrutiny, particularly in the future, less. Specific tax subsidies for many types of business expenses may be particularly appealing for those looking for a smaller government.

In addition to the above arguments, there may be one less layer of a challenge function in the context of a tax expenditure. For an expenditure program proposed by a line department there is the challenge function performed by the Department and the Minister of Finance. A tax expenditure, on the other hand, is in the hands of the Department and the Minister of Finance, meaning less challenge to their introduction.

Estimating the cost of all tax expenditures is a large undertaking and a long-term objective.

The consequence of this phenomenon is the potential risk that the numbers of tax expenditure would grow rapidly and, once introduced, difficult to roll back mainly because they are not on the radar screen as much as direct expenditures. According to the OECD (2010, 180), the number of Canadian federal tax expenditures grew by about 9 percent over the six year period to 2007 (the last year for the OECD data).

## PRINCIPLES FOR AN EFFICIENT USE OF TAX EXPENDITURES

The above provides a list of arguments in favour of and against the use of tax expenditures. What do these arguments tell, on balance, about whether tax expenditures should be used or not?

The author's considered judgment is the answer to the question is not a simple yes or no. Rather, we need a set of principles that should guide a government in deciding whether or not a tax expenditure should be introduced.

The following principles are proposed.

- First, all proposals for tax expenditures must be evaluated by whether or not they would pass the test if they were to be introduced as a direct expenditure program.
- Second, having passed such a test, a proposal would be considered for delivery as a tax expenditure only if it can be demonstrated that this mechanism would be administratively more efficient.
- Third, the proposed tax expenditure program must be costed.
- Fourth, all tax expenditures must be reported in the annual budget with their cost side by side with, and added to, direct expenditures at an appropriate time: estimating the cost of all tax expenditures is a large undertaking and a long-term objective.

# Conclusions

---

A popular indicator of the size of government is the ratio of direct government expenditures to GDP. However, it understates the true size of government in the presence of tax expenditures.

There are many challenges in estimating tax expenditures. However, we need to deal with these challenges, rather than avoid them, so that public policies are based on the best possible facts about the most important variables. This estimate of the size of government inclusive of tax expenditures, which the author believes is the first such effort, suggests that the size of total government is about a quarter higher than otherwise, at about 54 percent rather than 44 percent of GDP in 2009.

Ideally budgets should report both the actual direct government expenditure to GDP ratio, which substantially understates the true size of government, and estimated total expenditures to GDP ratio,

that also includes tax expenditures but is less precise. This creates many challenges but, given the importance of knowing how large or small the government is, let this work begin.

Transparency and accountability in taxation are important.

This paper also makes suggestions about the approach to be followed in policy decisions to introduce new tax expenditures. Simply stated, all new tax expenditure proposals must be evaluated as direct program expenditure proposals to determine their merit. Having passed this test,

they could be introduced as tax expenditures if the tax system provides administrative benefits as a delivery mechanism.

A better understanding of the size of government and the handling of tax expenditures is important for the appropriate conduct of public policy. While government actions provide many improvements to outcomes in a variety of areas – be they economic, social, environmental, or security related – these actions necessitate the collection of taxes that have negative economic effects. It is important to be fully informed of these costs and benefits while making public policy decisions. At a very basic level, taxpayers have a right to know how much they pay in taxes, where the money is spent, and what the benefits and costs of taxation and spending are. Transparency and accountability in taxation are important.



# Author Biography

---



## **Munir Ahmed Sheikh**

Munir Sheikh is an Executive Fellow at the School of Public Policy at the University of Calgary. He recently served as a co-Commissioner of Ontario's Social Assistance Review, which submitted its Report to the Government of Ontario on transforming the program in October 2012.

He served the Government of Canada in many senior level positions including the Chief Statistician of Canada, Deputy Minister of Labour, Deputy Secretary to the Cabinet, Expenditure Review at the Privy Council Office, Associate Deputy Minister, first at Health Canada and then at Finance Canada, and Senior Assistant Deputy Minister, Tax Policy at Finance Canada.

Mr. Sheikh holds a Doctorate in Economics from the University of Western Ontario and a Masters in Economics from McMaster University. He has published extensively in academic journals in the areas of international economics, macroeconomics and public finance. His work has been widely quoted and reproduced in textbooks and included in books of collected readings. He also taught at Queen's University, Carleton University and the University of Ottawa for many years.

# References

---

- Alberta. 2013. *Tax Plan. Budget 2013*. Edmonton.
- British Columbia. 2013. *Budget and Fiscal Plan*. Victoria.
- Canada. 2010. *Tax Expenditures and Evaluations*. Department of Finance.
- Canada. 2012. *Tax Expenditures and Evaluations*. Department of Finance.
- Dahlby, Bev and Ergete Ferede. 2011. “The Effects of Tax Rate Changes on Tax Bases and the Marginal Cost of Public Funds for Provincial Governments.” C.D. Howe Institute, Toronto.
- Joint Committee on Taxation. 2008. *A Reconsideration of Tax Expenditure Analysis*. Congress of the United States.
- Lester, John. 2012. “Managing Tax Expenditure and Government Program Spending: Proposals for Reform.” University of Calgary, Calgary.
- Newfoundland and Labrador. 2013. “Estimates of the Program Expenditure and Revenue of the Consolidated Revenue Fund 2013-14”. St. John’s.
- Ontario. 2012. *Transparency in Taxation*. Toronto. Available at <http://www.fin.gov.on.ca/en/budget/fallstatement/2012/transparency.html>.
- Organisation for Economic Cooperation and Development. 2010. *Tax Expenditures in OECD Countries*. Paris.
- Organisation for Economic Cooperation and Development. 2013. *Economic Outlook Annex Tables*. Paris.
- Parliamentary Budget Office. 2011. *Federal Tax Expenditures: Use, Reporting and Review*. Canada, Ottawa.
- Quebec. 2011. *Quebec Tax Expenditures 2010*. Quebec.
- Sheikh, Munir A. and Michel Carreau. 1999. “A Federal Perspective on the Role and Operation of the Tax Collection Agreements.” *Canadian Tax Journal* 47 (4): 845–860.
- Spiro, Peter and Jonathan Kesselman. 2014. “Challenges in Shifting Canadian Taxation Toward Consumption.” *Canadian Tax Journal* 62 (1): 1–39.
- Statistics Canada. 2013. CANSIM table 385-0001. Available at <http://www5.statcan.gc.ca/cansim/a05?lang=eng&id=3850001&pattern=3850001&searchTypeByValue=1&p2=35>.
- Statistics Canada. 2013. CANSIM table 380-0064. Available at <http://www5.statcan.gc.ca/cansim/a05?lang=eng&id=3800064&pattern=3800064&searchTypeByValue=1&p2=35>.

# Endnotes

---

- 1 The author would like to thank David Watson, Phillip Cross, and three anonymous referees for their excellent comments on an earlier draft of the paper. Any remaining errors are, however, the sole responsibility of the author.
- 2 Lester (2012) suggests the term *tax expenditure* was coined by Stanley Surrey in the 1960s.
- 3 Canada (2010) provides many other examples of challenges in aggregating. Lester (2012) also has a detailed discussion of the issue.
- 4 The 10 countries are: Canada, France, Germany, Japan, Korea, the Netherlands, Spain, Sweden, the United Kingdom, and the United States.
- 5 See, for example, Sheikh and Carreau (1999) for a description of the Canadian *Tax Collection Agreements* that provide federal-provincial tax harmonization.
- 6 Our calculations using the OECD data end in 2009. Ontario was not a party to the harmonized sales tax at that time and joined much later. This does not create a problem for our estimates since we are not using provincial tax expenditure data. By extrapolating the federal tax expenditures related to the *Goods and Services Tax*, we are capturing the current reality and transposing it back in time. In fact, our methodology shows what provincial tax expenditures would have been if they were following the federal tax system in the past, which is exactly the information we need to have at the present time. For corporate tax expenditures, a review of the Alberta and Quebec tax expenditures suggests the methodology we are following is appropriate. See, for example, chart 3.
- 7 A review of Canada's *Tax Expenditure Reports* since 2009 shows there were a number of changes each year with a small cumulative value with one exception: the introduction of the tax free savings accounts cost the federal government \$65 million in 2009, which is already included in our estimates. However, the pick up of this measure has grown substantially over time so its value in 2012 was \$315 million as reported in Canada (2012).
- 8 Policies that were enriched included the age credit, pension income credit, and pension income splitting.
- 9 This resulted from the large appreciation in the value of owner-occupied housing and the non-taxation of capital gains on principal residences.
- 10 The most important change in this area was the reduction in small business taxes.
- 11 Policies that were scaled down included the resource allowance and the non-deductibility of crown royalties and mining taxes and changes to refundable taxes on investment income of private corporations.
- 12 This reflects the enrichment of the Scientific Research and Experimental Development Investment Tax Credit.
- 13 This reflects the impact of the introduction of the Canada Employment Credit.
- 14 There was a reduction in GST tax expenditure in many areas that included changes in the small suppliers threshold, exemption of certain supplies made by charitable and non-profit organizations, the exemption of certain educational services, rebates for schools and universities, zero-rating of basic groceries, and exemptions for certain residential rents.



MACDONALD-LAURIER INSTITUTE

# True North in Canadian Public Policy

## Critically Acclaimed, Award-Winning Institute

The Macdonald-Laurier Institute fills a gap in Canada's democratic infrastructure by focusing our work on the full range of issues that fall under Ottawa's jurisdiction.

- The Macdonald-Laurier Institute fills a gap in Canada's democratic infrastructure by focusing our work on the full range of issues that fall under Ottawa's jurisdiction.
- One of the top three new think tanks in the world according to the University of Pennsylvania.
- Cited by five present and former Canadian Prime Ministers, as well as by David Cameron, the British Prime Minister.
- First book, *The Canadian Century: Moving out of America's Shadow*, won the Sir Antony Fisher International Memorial Award in 2011.
- *Hill Times* says Brian Lee Crowley is one of the 100 most influential people in Ottawa.
- The *Wall Street Journal*, the *Economist*, the *Globe and Mail*, the *National Post* and many other leading national and international publications have quoted the Institute's work.



"The study by Brian Lee Crowley and Ken Coates is a 'home run'. The analysis by Douglas Bland will make many uncomfortable but it is a wake up call that must be read."  
 FORMER CANADIAN PRIME MINISTER PAUL MARTIN ON MLI'S PROJECT ON ABORIGINAL PEOPLE AND THE NATURAL RESOURCE ECONOMY.

## Ideas Change the World

Independent and non-partisan, the Macdonald-Laurier Institute is increasingly recognized as the thought leader on national issues in Canada, prodding governments, opinion leaders and the general public to accept nothing but the very best public policy solutions for the challenges Canada faces.

## Where You've Seen Us



# About the Macdonald-Laurier Institute

## What Do We Do?

When you change how people think, you change what they want and how they act. That is why thought leadership is essential in every field. At MLI, we strip away the complexity that makes policy issues unintelligible and present them in a way that leads to action, to better quality policy decisions, to more effective government, and to a more focused pursuit of the national interest of all Canadians. MLI is the only non-partisan, independent national public policy think tank based in Ottawa that focuses on the full range of issues that fall under the jurisdiction of the federal government.

## What Is in a Name?

The Macdonald-Laurier Institute exists not merely to burnish the splendid legacy of two towering figures in Canadian history – Sir John A. Macdonald and Sir Wilfrid Laurier – but to renew that legacy. A Tory and a Grit, an English speaker and a French speaker – these two men represent the very best of Canada’s fine political tradition. As prime minister, each championed the values that led to Canada assuming her place as one of the world’s leading democracies.

We will continue to vigorously uphold these values, the cornerstones of our nation.



## Working for a Better Canada

Good policy doesn’t just happen; it requires good ideas, hard work, and being in the right place at the right time. In other words, it requires MLI. We pride ourselves on independence, and accept no funding from the government for our research. If you value our work and if you believe in the possibility of a better Canada, consider making a tax-deductible donation. The Macdonald-Laurier Institute is a registered charity.

## Our Issues

The Institute undertakes an impressive programme of thought leadership on public policy. Some of the issues we have tackled recently include:

- Aboriginal people and the management of our natural resources;
- Getting the most out of our petroleum resources;
- Ensuring students have the skills employers need;
- Controlling government debt at all levels;
- The vulnerability of Canada’s critical infrastructure;
- Ottawa’s regulation of foreign investment; and
- How to fix Canadian health care.

# Macdonald-Laurier Institute Publications

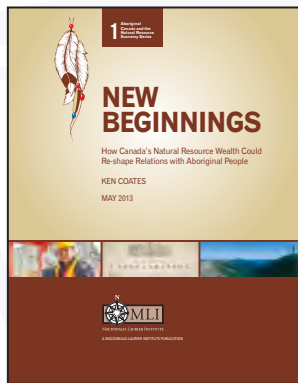


Winner of the Sir Antony Fisher International Memorial Award BEST THINK TANK BOOK IN 2011, as awarded by the Atlas Economic Research Foundation.

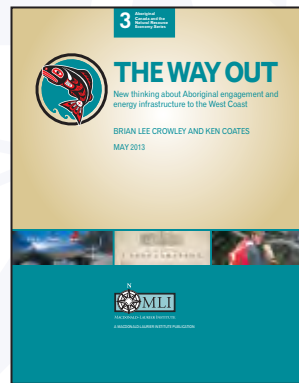
**The Canadian Century**  
By Brian Lee Crowley,  
Jason Clemens, and Niels Veldhuis

Do you want to be first to hear about new policy initiatives? Get the inside scoop on upcoming events? Visit our website [www.MacdonaldLaurier.ca](http://www.MacdonaldLaurier.ca) and sign up for our newsletter.

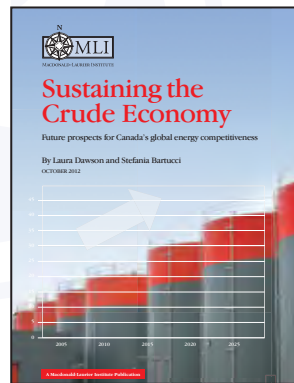
## RESEARCH PAPERS



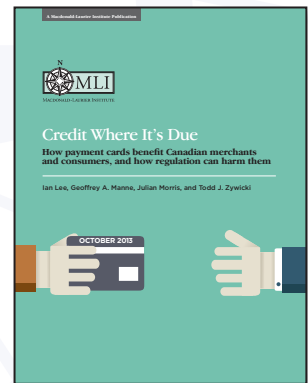
**New Beginnings**  
Ken Coates and Brian Lee Crowley



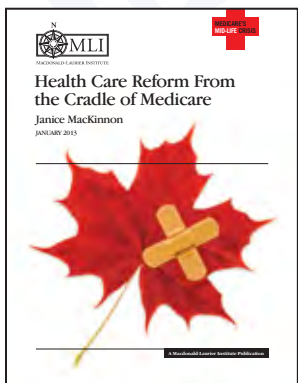
**The Way Out**  
Brian Lee Crowley and Ken Coates



**Sustaining the Crude Economy**  
Laura Dawson and Stefania Bartucci



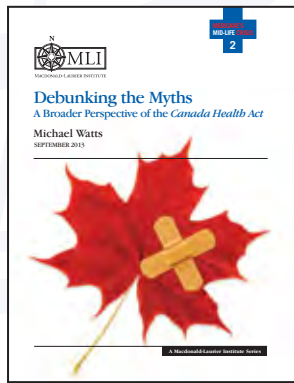
**Credit Where It's Due**  
Ian Lee, Geoffrey A. Manne, Julian Morris, and Todd J. Zywicki



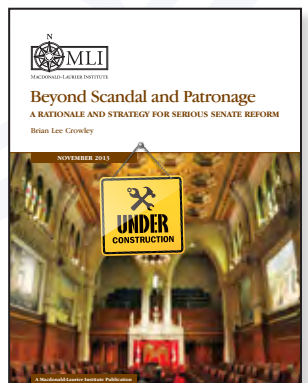
**Health Care Reform From the Cradle of Medicare**  
Janice MacKinnon



**A European Flavour For Medicare**  
Mattias Lundback



**Debunking the Myths**  
Michael Watts



**Beyond Scandal and Patronage**  
Brian Lee Crowley



MACDONALD-LAURIER INSTITUTE

*True North in Canadian Public Policy*

---

**CONTACT US:** Macdonald-Laurier Institute  
8 York Street, Suite 200  
Ottawa, Ontario, Canada K1N 5S6

**TELEPHONE:** (613) 482-8327

**WEBSITE:** [www.MacdonaldLaurier.ca](http://www.MacdonaldLaurier.ca)

**CONNECT  
WITH US:**



@MLInstitute



[www.facebook.com/  
MacdonaldLaurierInstitute](http://www.facebook.com/MacdonaldLaurierInstitute)



[www.youtube.com/  
MLInstitute](http://www.youtube.com/MLInstitute)

## What people are saying about the Macdonald- Laurier Institute

---

*I commend Brian Crowley and the team at MLI for your laudable work as one of the leading policy think tanks in our nation's capital. The Institute has distinguished itself as a thoughtful, empirically-based and non-partisan contributor to our national public discourse.*

PRIME MINISTER STEPHEN HARPER

---

*As the author Brian Lee Crowley has set out, there is a strong argument that the 21st Century could well be the Canadian Century.*

BRITISH PRIME MINISTER DAVID CAMERON

---

*In the global think tank world, MLI has emerged quite suddenly as the "disruptive" innovator, achieving a well-deserved profile in mere months that most of the established players in the field can only envy. In a medium where timely, relevant, and provocative commentary defines value, MLI has already set the bar for think tanks in Canada.*

PETER NICHOLSON, FORMER SENIOR POLICY  
ADVISOR TO PRIME MINISTER PAUL MARTIN

---

*I saw your paper on Senate reform [Beyond Scandal and Patronage] and liked it very much. It was a remarkable and coherent insight – so lacking in this partisan and anger-driven, data-free, ahistorical debate – and very welcome.*

SENATOR HUGH SEGAL, NOVEMBER 25, 2013

---

*Very much enjoyed your presentation this morning. It was first-rate and an excellent way of presenting the options which Canada faces during this period of "choice"... Best regards and keep up the good work.*

PRESTON MANNING, PRESIDENT AND CEO,  
MANNING CENTRE FOR BUILDING DEMOCRACY