INFORMATION TO USERS

This manuscript has been reproduced from the microfilm master. UMI films the text directly from the original or copy submitted. Thus, some thesis and dissertation copies are in typewriter face, while others may be from any type of computer printer.

The quality of this reproduction is dependent upon the quality of the copy submitted. Broken or indistinct print, colored or poor quality illustrations and photographs, print bleedthrough, substandard margins, and improper alignment can adversely affect reproduction.

In the unlikely event that the author did not send UMI a complete manuscript and there are missing pages, these will be noted. Also, if unauthorized copyright material had to be removed, a note will indicate the deletion.

Oversize materials (e.g., maps, drawings, charts) are reproduced by sectioning the original, beginning at the upper left-hand corner and continuing from left to right in equal sections with small overlaps. Each original is also photographed in one exposure and is included in reduced form at the back of the book.

Photographs included in the original manuscript have been reproduced xerographically in this copy. Higher quality 6" x 9" black and white photographic prints are available for any photographs or illustrations appearing in this copy for an additional charge. Contact UMI directly to order.

UMI[®]

Bell & Howell Information and Learning
300 North Zeeb Road, Ann Arbor, MI 48106-1346 USA
800-521-0600

**Beyond the Politics of Anticipation:
Institutional Changes Affecting
The Tax Policy Making Process in Canada**

by
James A. Ralston

A thesis submitted to
the Faculty of Graduate Studies and Research
in partial fulfilment of
the requirements of the degree of

Doctor of Philosophy

Department of Political Science

Carleton University
Ottawa, Ontario
March 1998
© 1998, James A. Ralston

National Library
of Canada

Acquisitions and
Bibliographic Services

395 Wellington Street
Ottawa ON K1A 0N4
Canada

Bibliothèque nationale
du Canada

Acquisitions et
services bibliographiques

395, rue Wellington
Ottawa ON K1A 0N4
Canada

Your file Votre référence

Our file Notre référence

The author has granted a non-exclusive licence allowing the National Library of Canada to reproduce, loan, distribute or sell copies of this thesis in microform, paper or electronic formats.

The author retains ownership of the copyright in this thesis. Neither the thesis nor substantial extracts from it may be printed or otherwise reproduced without the author's permission.

L'auteur a accordé une licence non exclusive permettant à la Bibliothèque nationale du Canada de reproduire, prêter, distribuer ou vendre des copies de cette thèse sous la forme de microfiche/film, de reproduction sur papier ou sur format électronique.

L'auteur conserve la propriété du droit d'auteur qui protège cette thèse. Ni la thèse ni des extraits substantiels de celle-ci ne doivent être imprimés ou autrement reproduits sans son autorisation.

0-612-37053-4

The undersigned hereby recommend to
the Faculty of Graduate Studies and Research
acceptance of the thesis,

BEYOND THE POLITICS OF ANTICIPATION:
INSTITUTIONAL CHANGES AFFECTING THE TAX POLICY MAKING PROCESS
IN CANADA

submitted by

James Ralston, B. Comm., M.A.

in partial fulfilment of the requirements
for the degree of Doctor of Philosophy

Chair, Department of Political Science

Thesis Supervisor

External Examiner

Carleton University
June 11, 1998

Chapter One: Introduction

Tax policy making in Canada has been the subject of sustained examination for over twenty-five years. The first wave of interest dealt with the tax reform of 1971, in particular the Royal Commission on Taxation (the Carter Commission) and the White Paper on Taxation that preceded the tax reform legislation itself. The second wave dealt with what might be called the "normal" revenue budget process of the federal government, in contrast to the "special" process associated with tax reform. The revenue budget process is the traditional vehicle for tax policy making. The third wave consisted of proposals for the reform of the revenue budget process, proposals that were in large part a reaction to the MacEachen Budget of 1981. The latest wave uses what its advocates call a "positive" model of tax policy making, with emphasis on political dynamics, to explain the evolution of the tax structure over an extended period of time.

This study complements earlier work by identifying and explaining changes to the institutions that govern the tax policy making process that have occurred since about 1980. It approaches the problem from the theoretical perspective known as the new institutionalism.

In addition to explaining institutional change, the study explores the consequences of institutional changes for the tax policy making process. One type of consequence is strategic – the effect of institutional rule changes on the way participants in the tax policy making process pursue their objectives. Another type of consequence relates to the way

rule changes affect certain performance characteristics of the policy making process.

Institutional rules are one determinant, but not the only determinant, of the performance characteristics possessed by a policy making system.

1. Outline of the Study

The theoretical framework employed in the study is developed in Chapter 2. The framework consists of a number of parts.

Institutions are patterns of interaction that serve as devices for co-ordinating human action.¹ In politics, this means devices for resolving conflicts and making choices.² The world is full of different kinds of institutions. At the broadest level, these can be categorized as aggregative institutions that use brokerage or exchange to satisfy current preferences of individuals or coalitions of individuals, or integrative institutions that aim to create order based on history, obligation and reason.³ In many cases, different

¹ Michael M. Atkinson, "Introduction: Governing Canada," *Governing Canada: Institutions and Public Policy*, ed. Michael M. Atkinson (Toronto: Harcourt Brace Jovanovich, 1993), p. 6; Andrew Schotter, *The Economic Theory of Social Institutions* (Cambridge: Cambridge University Press, 1981), p. 3.

² Atkinson, "Introduction," p. 6.

³ James G. March and Johan P. Olsen, *Rediscovering Institutions: The Organizational Basis of Politics*, (New York: The Free Press, 1989), chapter 7 (passim).

institutions represent alternative attempts to solve the same or similar types of co-ordination problems.⁴

Heavy reliance is placed on Elinor Ostrom's notion of institutions as sets of rules. Ostrom identifies seven broad types of rules⁵:

- a) *position rules* specifying a set of positions and how many participants hold each position;
- b) *boundary rules* specifying how participants are chosen to hold these positions and how participants leave these positions;
- c) *scope rules* specifying the set of outcomes that may be affected and the external inducements and/or costs assigned to each of these outcomes;
- d) *authority rules* specifying the set of actions assigned to a position at a particular node;
- e) *aggregation rules* specifying the decision function to be used at a particular node to map actions into intermediate or final outcomes;
- f) *information rules* authorizing channels of communication among participants in positions and specifying the language and form in which communication will take place; and

⁴ Michael M. Atkinson, "Public Policy and the New Institutionalism," in *Governing Canada: Institutions and Public Policy*, ed. Michael M. Atkinson (Toronto: Harcourt Brace Jovanovich, 1993), p. 27.

⁵ Elinor Ostrom, "An Agenda for the Study of Institutions," *Public Choice*, 48 (1986), p. 19.

g) *payoff rules* prescribing how benefits and costs are to be distributed to participants in positions.

To this list we add one more type of rule, taken from game theory:

h) *timing rules* defining the sequence of moves or participants' turns.

The academic literature is replete with theories of institutional design, reproduction and change. Not all of these theories are in competition with one another; often, a theory is meant to apply in specific circumstances. Isomorphism refers to the spread of institutional forms through a copycat process as organizations seek to mimic the success of others or to enhance their own legitimacy by being seen to possess institutional characteristics similar to others who are successful. The mimicry may be voluntary or may be the result of coercion by forces in the environment. The extent to which an organization succumbs to coercion to adopt particular institutional forms will depend on why these pressures are being exerted (cause), who is exerting them (constituents), what these pressures are (content), how or by what means they are exerted (control), and where they occur (context).

In contrast to isomorphism, institutional change can occur as a result of innovation. According to one theory, the potential for a positive net benefit in terms of reduced transactions costs will spark the creation of new institutional designs. "Transactions costs" are attributable to the fact that no one has yet designed a perfect institution -- one

that can overcome problems associated with the bounded rationality and opportunistic tendencies of people. Each institutional design has certain transactions costs associated with it. Participants in some activity requiring co-ordination may choose from among available institutional designs the kind of institution that will minimize transactions costs. Also, the presence of high transactions costs may prompt innovators to create new institutional designs.

Whether institutional change occurs through innovation of institutional designs or through a process of isomorphism, the changes tend to be path dependent. Changes are incremental, and the nature and direction of institutional change will depend on the history of past changes and on the current status of the institution to be changed.

The discussion of policy life cycles and action situations is necessary background to what is the secondary focus of the study -- the impact of institutional changes on the tax policy making process. According to Ostrom, institutions do not directly affect behaviour; rather, they affect the action situation, and in that way become one factor among many that will ultimately influence behaviour.⁶

The notion of the life cycle of a policy issue is that policy issues spring from some real world condition or event (the *stimulus*) and are then turned into socially-constructed entities when they capture the *attention* of some person or persons who evaluate the condition or event according to their values, norms, preferences and interests. If this

evaluation signals the existence of a problem to some person or persons who are prone to take action, they will perform further *analysis and* prepare *arguments* to support their interpretation of the problem and to offer proposed solutions. Conflicting accounts are likely to arise, setting up a competition. The issue may then pass into the next phase of the life cycle in which a *decision* is made *and action* is taken toward a solution. In the final phase, the issue returns to the real world in the form of some *outcome*. At this point, a new set of initial conditions is established and the cycle may be repeated.

Decisions of one kind and another are made at various points in the life cycle of an issue by different participants. Each of these points can be thought of as an action situation. The term “action situation” is taken from Ostrom, but the meaning of it is here modified to reflect a synthesis with Cohen, March and Olsen’s⁶ notion of a “garbage can” and with some of my own ideas. The modified structure of the action situation, which is a cross-section of the life cycle of an issue taken at a moment in time, consists of the following:

- a) a set of *initial conditions* which can be traced to a stimulus event;
- b) a set of *participants* having certain values, norms, preferences, interests, knowledge, skills, decision routines, energy and status in the eyes of others;
- c) the state of *technical knowledge* which is derived from an understanding of physical and behavioural laws;

⁶ Ostrom, “An Agenda for the Study of Institutions,” p. 6.

- d) a set of *resources* (exclusive of human, knowledge and information resources, which are listed separately);
- e) a *language and vocabulary* used to communicate information and meaning;
- f) a set of *information*;
- g) a set of *problems*, which are linguistic representations of initial conditions that have associated with them a negative payoff; and,
- h) a set of *solutions*, which are linguistic representations of actions aimed at causing a change to the initial conditions such that the changed conditions have associated with them a positive payoff.

I expect that the institutional changes that have occurred affecting tax policy making will lead to alterations in the strategies employed by participants in the policy making process. I offer no predictions about the way strategy will be altered, but anticipate that alterations will be observed in respect of strategic choices involving the ways in which participants:

- a) gather and disseminate information;
- b) form alliances with each other;
- c) posture or position themselves on issues or in negotiations; and
- d) select the nature and timing of their interventions in the policy making process.

⁷ Michael D. Cohen, James G. March, and Johan P. Olsen, "A Garbage Can Model of Organizational Choice," *Administrative Science Quarterly*, Vol. 17 (1972), pp. :2-3.

I also expect that institutional rule changes, mediated through the variables comprising the action situation, will affect certain performance characteristics of the policy making process. The five performance characteristics that I propose to focus on are: flexibility, capacity, effectiveness, legitimacy and accountability. These are defined as follows:

- a) *flexibility* -- the ability of the policy making system to handle a variety of types of problem and its ability to accommodate a variety of viewpoints with respect to a given problem such that all viewpoints are given a fair hearing and opportunity to influence choices;
- b) *capacity* -- the policy making system's ability to handle more or bigger problems;
- c) *effectiveness* -- the ability of the policy making system to generate policies that are better in some technical sense, having a greater probability of causing the desired changes to the initial conditions;
- d) *legitimacy* -- having wide support among citizens; and
- e) *accountability* -- the extent to which decision makers can be made to answer for their decisions and the resulting outcomes.

Chapter 3 is a review of the literature on tax policy making in Canada. The material is presented at this point in the study to provide a description of the status of the relevant institutions before the occurrence of changes that the subsequent three chapters seek to identify and explain.

Chapters 4 to 7 comprise the empirical portion of the study. Chapters 4 to 6 examine the changes to the eight kinds of institutional rules affecting the tax policy making process in Canada. The focus is on explaining the changes. In Chapter 7, attention turns to the impacts of the institutional changes on the performance of the tax policy making process and to their effect on the strategies employed by participants in the process.

Chapter 4, dealing with scope and payoff rules, argues that the income tax reforms of the mid- to late 1980s, in which the tax base was broadened through the elimination of numerous tax expenditures and tax rates were lowered, are an expression of mimetic isomorphism following a wave of similar reforms elsewhere among western industrialized countries. Supporting this general direction was a significant academic and bureaucratic interest in the analysis of tax expenditures. Also significant was a highly publicized fiasco involving abuses of a tax expenditure known as the Scientific Research Tax Credit.

Underpinning the tax reform movement was an ideological shift in favour of tax systems that purport not to distort business decisions. Essentially, this is the expression in terms of tax policy of the neoconservative philosophy espoused by Thatcher, Reagan and Mulroney. In hand with this view was an increasing preoccupation with the reduction of compliance costs incurred by individuals and businesses as a consequence of their obligations to keep records and report financial information to taxation authorities.

A different source of pressure for change acting on the scope rules was the advent of the *Canadian Charter of Rights and Freedoms*. Charter-based court challenges to tax provisions have been successful with respect to guarantees of security against unreasonable search and seizure but have been unsuccessful with respect to rights regarding freedom of conscience and religion and equality. In one case, an unsuccessful Charter-based court challenge played a key role in bringing about legislative change through political action.

Changes to authority, information and timing rules are covered in Chapter 5. It traces the nature and causes of institutional changes that facilitated or accompanied an opening up of the tax policy making process. The MacEachen budget of 1981 is found to be a principal cause of the changes. Taxpayers, their advisors, politicians and bureaucrats all sought to reduce the transactions costs associated with the extant notion of budget secrecy and which were made obvious in the aftermath of the budget. The MacEachen budget set up an action situation in which previously constructed problems and solutions could be matched and action could be taken to implement desirable rule changes. Powerful interests upon whom the Department of Finance was dependent for support and technical assistance backed the changes.

A new climate was created that was characterized by increased consultation, although the form of consultation has varied over time. At the Ministerial level, the Finance Minister began meeting individually with more and more interest groups, both in Ottawa and around the country. Later, a multilateral or round table format for the

meetings was adopted. For one year, the Finance Minister experimented with conference-style consultations in which an attempt was made to encourage participation by individuals other than interest group representatives.

Parliamentary reforms that gave House of Commons standing committees increased scope for action paved the way for greatly increased attention to tax and budgetary policy by the Standing Committee on Finance, as it is now known. In the days of the Mulroney Progressive Conservative Government, the Committee was a key player in bringing about tax reform. It received an unprecedented number of briefs and heard from an unprecedented number of witnesses and produced reports containing influential recommendations. When the Liberal government of Jean Chrétien came to power, the Committee was assigned the task of holding extensive pre-budget consultations, taking up a practice that had previously been handled by the Minister of Finance.

Increased openness at the political level was matched by increased openness at the bureaucratic level. The number of formal and informal meetings and conversations between Finance officials and interest group representatives grew. Finance officials engaged interest group representatives to assist in working out implementation problems associated with new policy initiatives. Likewise, professional tax advisors were encouraged to help Finance officials identify technical flaws in existing and proposed legislation.

Underlying the greater openness is a reinterpretation or re-education in relation to the doctrine of budget secrecy. Now, strict secrecy is maintained only where possessing knowledge of an upcoming budget announcement would permit someone to garner some pecuniary advantage. In line with this is a separation of matters of tax policy from purely technical matters. The latter are openly discussed and are dealt with outside the budgetary process. The budgetary process has also been reformed to follow a much more predictable timetable, thus facilitating consultation activities.

Openness and debate are also fostered by the provision of increased information resources. The publication of annual tax expenditures estimates has been subject to mixed reviews, but some participants outside government feel the estimates better equip them to engage in debate over tax policy. Also, the government has made available a combination data base/software tool that enables interest groups and academics to model tax proposals and thus contribute to a more sophisticated policy discussion.

Chapter 6 examines changes to position, boundary, and aggregation rules, and concludes that position rules are unchanged from the time of Good's research in the late 1970s while changes to boundary and aggregation rules appear to be consequential to the changes in the authority and information rules. For the latter changes to take effect it is necessary for enabling or accommodating changes to the boundary rules. As for aggregation rules, it of course remains the case that under cabinet government the Minister of Finance has the final word on tax policy. However, he is subject to many more influences, and the information he obtains from the expanded network of

participants cannot help but affect his decision making. It must be acknowledged that, in recent years, the Minister of Finance has had his policy freedom constrained by the economic circumstances facing Canada and that this factor, more than any institutional changes, may explain the performance of the tax policy making system.

Chapter 7 deals with the consequences of institutional change. The theoretical framework considers five performance characteristics potentially affected by institutional change. This chapter substitutes a discussion of proxy measures for the performance characteristics. Two types of consequences are considered: strategies and impacts. The question posed with respect to strategies is: How do institutional rule changes affect the way people pursue their objectives? Under the rubric of “impacts”, the kinds of questions include whether there have been changes to the way the policy agenda is set, to the way policy options are identified, to the capacity of the policy making system to solve the problems that confront it, and to the quality of policy choices themselves. Other important impacts to consider relate to the accountability of decision makers and to the level of public support for, and perceived legitimacy of, the policy outputs emanating from the system.

The study concludes that institutional changes affecting the tax policy making process have provided government with easier access to certain avenues for the acquisition and dissemination of information. Also, the government has some freedom to choose whether legislative amendments are to be classified as either “technical” or “policy” in nature, and this has implications for the route that must be followed in

implementing the amendments. Further, the institutional changes have facilitated the more frequent adoption of cooperative strategies among participants. Finally, interest groups are better able to use parliamentary committees as vehicles for lobbying and for communicating their policy positions to the media, interest group members, the general public, and politicians.

Agenda setting has remained under the primary control of the Department of Finance, although from time to time the Department may have an issue forced upon it as a result of an important decision of the courts or an intervention by the Auditor General.

Similarly, the Department of Finance continues to be the source of detailed proposals to deal with matters that arise on the agenda. However, other participants are now able to be much more active in analyzing such proposals and suggesting changes that will facilitate successful implementation. As for policies that are entrenched in the tax system, the publication of tax expenditures estimates has given participants outside the Department of Finance information that can be used for analysis and commentary.

The continued revelation of tax policy problems -- budgetary and technical, big and small -- combined with greater participation by experts and non-experts from outside the Department of Finance and limited availability of experts within the Department of Finance strains the capacity of the tax policy making system to resolve, in a timely manner, all the issues that come to light. On the other hand, institutional changes (including the advent of the Charter of Rights and Freedoms) have at times had a material

impact on policy choices and have improved the technical quality of legislation, thus paving the way for more successful implementation.

Having a more regularized annual budget process has facilitated coordination of input by the federal and provincial governments and by interest groups. By providing greater opportunities for participants to have input into budget making, the federal government has been rewarded with a generally high level of support for its budgets. The experience of the 1981 MacEachen budget has not been repeated to date.

Chapter 8 consists of two main parts. The first part contains some final reflections that are not central to the argument of the thesis, but are nevertheless relevant and interesting. It begins by noting that the general thrust of the institutional changes affecting the tax policy making process is consistent with a broader movement that encourages institutions to develop in a way that enhances democratic control of government. The institutional changes operate at the margin to relax -- but not release -- the grip held by the "tax community" as defined by Good.⁸ The highly technical nature of much of tax policy will ensure that a select group of experts will always have the greatest influence over the field.

Next, taking a step back from individual categories of positions and looking at the overall structure of relations within the tax policy community, one finds evidence of a

⁸ David A. Good, *The Politics of Anticipation: Making Canadian Federal Tax Policy* (Ottawa: Carleton University School of Public Administration, 1980), p. 45.

variety of network structures in existence, including pluralist, corporatist and state-directed structures. This is attributed to the fact that taxation is used as a policy instrument in a wide spectrum of policy fields. The same is true of budgetary policy. Each policy field contains its own kind of interest group structure, and the degree of organizational development exhibited by interest groups varies across policy fields.

The last point in the first part is that one can question the degree to which the overall increased openness in tax policy making has democratized the process, in the sense of making it more accessible to popular forces. Tax policy, in Canada and elsewhere in the industrialized world, has become exceedingly complex, to the point where it takes a great deal of sophistication to participate competently in tax policy making. It is an activity engaged in by a relatively small group of elite players. The work of the Auditor General, at times, has helped make Department of Finance officials more accountable for their work in tax policy making.

After these final reflections, Chapter 8 ends with a review of the study's conclusions. A brief explanation of the methodology used in the empirical portion of the study is given in an appendix.

Chapter Two: An Institutional Perspective on Policy Making

1. Introduction

In this chapter I develop the framework that will be used in subsequent chapters to identify and explain a number of institutional changes that have had an impact on tax policy making in Canada, and to identify and explain certain impacts of those institutional changes. A review of relevant literature provides most of the building blocks needed to construct the framework, however, the picture needs to be both drawn more explicitly and clearly. In addition to organizing material already contained in the literature, this chapter introduces some new material where required to fill in the blanks.

I first explain that institutions exist as coordinating mechanisms, and that they can be characterized as systems of eight categories of rules. This concept of institutions leads me to draw parallels between institutions and games, which may also be represented as systems of rules. The institutional structure (sets of rules) applies to and, in part, defines the policy making process. This discussion contributes the dependent variables for the major portion of the study, which identifies and explains institutional changes, and contributes the independent variables for the minor portion of the study, which identifies and explains the effects of institutional changes.

I then proceed to a discussion of the ways in which institutions are designed, reproduced and changed. I present two complementary theories, one from the sociology

of organizations and another from transaction cost economics. In general terms, the former deals with the adoption of existing institutional forms while the latter deals with the innovation of institutional forms. It is this body of theory that is the backbone of my study and will be the point of reference for three subsequent empirical chapters.

Next, I present a theoretical framework for the examination of the impacts of institutional changes affecting the tax policy making system. To accomplish my objective, I must first identify the relevant variables. To assist in this discovery I look at policy making in two dimensions. The first is the life cycle of a policy issue. My starting assumption is that the effects of institutional change might be evident at any point in the life cycle and might touch any of the activities comprising the policy making process at one of these points. The process operates upon the issue and the need to treat issues is the *raison d'être* for the process, but the process and the issue life cycle are conceptually distinct from one another. In addition to possibly contributing dependent variables to be used in the study of the effects of institutional change, the analysis of the life cycle provides context necessary for understanding the second dimension.

The second dimension is the structure of the action situation as a moment in time during the life cycle. Besides dealing with a different time interval, the notion of the action situation also shifts focus from the issue as an entity to the human intervention that takes place at various points in time. The structure of the action situation is the source of intermediate dependent variables treated in the framework.

My examination of the effects of institutional changes requires looking at the policy making process from other perspectives. I very briefly introduce the notion that participants in the policy making process pursue strategies that conform to a particular institutional context: change the context and the strategies will be adjusted accordingly.

Finally, I look at certain performance capabilities possessed by a policy making process. The performance capabilities to be considered include the following: its capacity for handling a volume of issues; its flexibility in bringing to bear differing viewpoints on the issue; its effectiveness in resolving issues; the legitimacy of the system in the eyes of those who will be affected by policies that it generates; and, the accountability between principals and agents in the process.

2. Why Institutions Exist

Each institution has its unique function, but if we try to identify something in common about the functions served by all institutions we are probably safe in saying that each one addresses some sort of coordination problem. For example, in the economic realm, Schotter¹ explains that money and markets are institutions that developed out of a need to create efficient means of facilitating multilateral trade, a type of coordination problem. He maintains that every evolutionary economic problem requires some sort of social institution to solve it. It is interesting to note that although the market is itself a

¹ Andrew Schotter, *The Economic Theory of Social Institutions* (Cambridge: Cambridge University Press, 1981), p. 3.

coordinating institution, it has limitations. Many other institutions have arisen to compensate for market failures, which may be revealed by chronic undersupply of public goods or by severe distributional distortions.²

According to Williamson,³ markets are able to deal efficiently with some types of transactions but are unable to deal efficiently with other types. Consider the theoretical construct known as the perfectly competitive market. Its salient features include many buyers and sellers, a homogeneous product, known production technology, consistent preferences, no barriers to entry, and perfect information. Such a market will produce an efficient solution to the coordination problem -- a price for the product will be found that causes the market to clear at an optimum level of production. However, in real-world markets, certain traits of human nature -- bounded rationality and a tendency toward opportunistic behaviour -- result in the presence of "friction" which is absent in the operation of the ideal perfectly competitive market. Bounded rationality -- meaning that people would like to behave rationally but may be unable to because of limited cognitive capacity -- effectively renders the perfect information assumption inoperative.

Opportunistic behaviour also affects the perfect information assumption in respect of expectations of competitors' behaviours. Williamson uses the term "transaction costs" to denote such friction. Where market transaction costs are significant, an alternative mechanism of economic organization may be preferred.

² Michael M. Atkinson, "Public Policy and the New Institutionalism," in *Governing Canada: Institutions and Public Policy*, ed. Michael M. Atkinson (Toronto: Harcourt Brace Jovanovich, 1993), p. 27.

Therefore, the higher the market's transaction costs, the greater the likelihood that other institutions will be needed to assist or replace the market in performing the coordination function.⁴ Schotter⁵ sees social and economic institutions as informational devices that supplement the informational content of competitive prices when these prices alone fail to coordinate economic activity. The effect of these informational devices is to help agents place subjective probability estimates over each other's actions. For example, opportunistic behaviour may be discouraged through the introduction of monitoring functions and controls. In addition, institutions "codify memory" for the agents in the economy; this transformation permits agents to employ strategies that are more efficient informationally. In terms of information storage, retrieval, and computation, an institutionalized norm is extremely efficient because the only information relevant to decision making at any time period is contained in the norm. For example, bounded rationality may lead people to substitute the use of rules of thumb for attempting comprehensively rational calculation.

While the notion of transaction costs and their relation to the development of institutions is explained in an economic context, it seems to have analogies in other contexts. In fact, the image of an institutional response to the presence of weak, irrational

³ Oliver E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, 1985), pp. 41-42; 72-73.

⁴ Richard A. Posner, *Economic Analysis of Law*, Fourth Edition (Boston: Little, Brown and Company, 1992), p. 536.

⁵ Schotter, *The Economic Theory of Social Institutions*, p. 18.

or unsavory human characteristics is reminiscent of the Hobbesian rationale for the existence of the institution of the sovereign or state.

The central idea being developed here is that institutions exist to perform a coordination function, which includes the creation and maintenance of order. March and Olsen⁶ argue that there are two main alternative strategies that institutions might embody. At one level these strategies represent alternative means to achieve the ultimate end of coordination, however, at another level they represent a further elaboration of the end itself. Some institutions exist to aggregate the preferences of individuals, taken as given, and to make decisions based on the aggregated preferences. Democratic election used to effect choices under the principle of majority rule is an example of an aggregative institution. Other institutions exist to shape preferences in a way that individuals are more likely to reach consensus decisions when faced with choices. Such institutions, which March and Olsen denote as "integrative," might include the family and the church.

The notion of the aggregative institution is linked to the idea of using brokerage or exchange to satisfy current preferences of individuals or coalitions of individuals. The time horizon is short term; the outcome is an allocation of resources among competing uses. Aggregative institutions deal with the problem of opportunism by having structures of incentives and controls that are meant to induce people to make choices that satisfy collective interests rather than self interests. Rights, in this context, are either rules

⁶ James G. March and Johan P. Olsen, *Rediscovering Institutions: The Organizational Basis of Politics*, (New York: The Free Press, 1989), Chapter 7, *passim*.

intended to improve the function of exchange or resources that can themselves be used in exchange.

Integrative institutions have as their goal the creation of an order based on history, obligation, and reason. Such institutions fulfill the role of educating people and instilling in them a sense of trusteeship for social traditions and their future preservation. The time horizon is long term; the outcome is personal growth, commitment to a shared purpose and a feeling of trust among individuals. Rather than incentives and controls, reliance is placed on peoples' integrity and sense of duty to one's fellow human beings to forestall opportunistic behaviour. Rights are something with which people are naturally endowed and are not to be bartered.

3. The Nature of Institutions

Institutions are patterns of interaction (systems of rules) established by human beings through which, in the political context, choices are made and conflicts resolved.⁷ The presence of institutions has implications for the study of political science. An approach that emphasizes individual behaviour -- in particular, one that interprets political phenomena as the aggregate consequences of individual behaviour -- risks overlooking the possible institutional determinants of that behaviour.⁸ A behavioural

⁷ Michael M. Atkinson, "Introduction: Governing Canada," in *Governing Canada: Institutions and Public Policy*, ed. Michael M. Atkinson (Toronto: Harcourt Brace Jovanovich, 1993), p. 6.

⁸ March and Olsen, *Rediscovering Institutions*, p. 3.

approach would view institutions such as the bureaucracy, the legislature, and the courts as mere arenas in which individuals pursue their self-interest. In contrast, according to the institutional school, behaviour will be affected, if not at times wholly determined, by the collections of standard operating procedures and structures that establish and maintain the values, norms, interests, identities, and beliefs belonging to the particular institution. As March and Olsen remind us, "[i]nstitutions seem to be neither neutral reflections of exogenous environmental forces nor neutral arenas for the performances of individuals driven by exogenous preferences and expectations."⁹

I wish to examine further what is entailed by this notion of institutions as rules. The work of Elinor Ostrom¹⁰ is extremely useful here. She defines rules as potentially linguistic entities that prescribe the manner by which a set of participants order repetitive, interdependent relationships. According to these prescriptions, certain actions or states of the world are required, prohibited, or permitted. Rules may have been established through the explicit efforts of individuals or may have been formed implicitly. Within defined situations, rules promote order and predictability by creating positions, stating how participants enter or leave positions, stating which actions participants in these positions are required, permitted, or forbidden to take, and stating which outcomes participants are required, permitted, or forbidden to affect.

⁹ James G. March and Johan P. Olsen, "The New Institutionalism: Organizational Factors in Political Life," *American Political Science Review*, Vol. 78 (1984), p. 742.

¹⁰ Elinor Ostrom, "An Agenda for the Study of Institutions," *Public Choice*, 48 (1986), pp. 5-7; 19.

Ostrom draws a distinction between rules, on the one hand, and physical and behavioural laws, on the other hand. The former are subject to human intervention and change while the latter are not. All three -- rules, behavioural laws and physical laws -- affect the outcome of a situation. However, rules are the means by which humans can act to change the structure of incentives in situations. In addition, rules have the property that individuals can be held accountable for failure to observe them.

Note that Ostrom does not speak of rules directly affecting behaviour. She sees them directly affecting only the structure of situations in which actions are selected. A set of rules may dictate that certain actions or outcomes are forbidden, that only actions or outcomes within a permitted set may be chosen, or that a particular action or outcome must be selected. Thus, typically, rules will not be determinative of the action or outcome resulting from the action situation. Adding to the indeterminacy is the fact that the results of a situation in which one rule is applicable will be dependent upon the other rules simultaneously in force. Results are dependent on a configuration of rules, rather than any single rule, underlying an operational situation.

Ostrom identifies seven broad types of rules that could affect the structure of an action situation:

- a) *position rules* specifying a set of positions and how many participants hold each position;

- b) *boundary rules* specifying how participants are chosen to hold these positions and how participants leave these positions;
- c) *scope rules* specifying the set of outcomes that may be affected and the external inducements and/or costs assigned to each of these outcomes;
- d) *authority rules* specifying the set of actions assigned to a position at a particular node;
- e) *aggregation rules* specifying the decision function to be used at a particular node to map actions into intermediate or final outcomes;
- f) *information rules* authorizing channels of communication among participants in positions and specifying the language and form in which communication will take place; and
- g) *payoff rules* prescribing how benefits and costs are to be distributed to participants in positions.

4. Games, Supergames and Institutions

Accepting that institutions can be regarded as rules of the game, it is not surprising to find that Schotter's discussion of the nature of games demonstrates strong parallels to the earlier discussion of the nature of institutions. Schotter defines games as abstract sets of rules constricting behaviour and defining payoffs for players in a given situation of strategic interdependence.¹¹ It follows from this definition that several components combine to describe a game. First, are the set of agents called "players."

Next, the rules of the game should define the sequence of moves or players' turns and define the set of alternative actions available to a particular player at each move. "In addition, since chance is a player, the rules should specify when chance moves, the set of alternatives available to him, and the probability with which any of the alternatives that he could determine could result."¹²

Schotter's remark that the rules of the game should define the sequence of moves or players' turns reveals an omission in Ostrom's set of rules. In my framework, therefore, I will add another category of rules -- timing rules -- to the seven categories given by Ostrom. Later, I will show that changes to timing rules have been a very important feature of the evolution of the tax policy making process in Canada.

The idea of a supergame comes in because Schotter deals not with one-time games, as is typical of game theory, but with recurrent games. He chooses this approach because he sees social institutions as noncooperative equilibria of supergames involving repeated play of a constituent game. According to this understanding, institutions are in equilibrium only with respect to the supergame, not with respect to the constituent games making it up.

Schotter is suggesting that there are games nested within larger games. By analogy, one can see that there are institutions nested within larger institutions. Keeping

¹¹ Schotter, *The Economic Theory of Social Institutions*, p. 110.

¹² Schotter, *The Economic Theory of Social Institutions*, p. 110.

this in mind will be helpful in later chapters that talk about the tax system, which is itself a set of institutional arrangements, and the tax policy-making system or process, which is subject to its own set of institutional arrangements and which has as an output other institutional arrangements (i.e. the tax system).

5. Institutional Design, Reproduction and Change

Many social institutions are created by a social planner (the result of explicit human design) or by the agents of society (such as in a legislature) engaging in multilateral bargaining about the type of institution they would like to see created. Insights from game theory have proven to be useful in designing institutions.¹³ I have shown that each social institution can be understood as a set of rules that specify or constrict the behaviour of agents in particular situations. Where these situations can be characterized as games of strategy whose equilibria can be calculated and the planner can specify the type of outcomes desired from the game, an institutional structure (rules of the game) can be found that yields these outcomes as equilibria. The exact institutional form that emerges in such a case is really a stochastic event, because typically there are a variety of potential sets of rules that could be followed.

¹³ Schotter, *The Economic Theory of Social Institutions*, pp. 28-29.

Exhibit 1

Theoretical Framework Used in The Study

Source: Author

Institutions may emerge over time without being explicitly designed. Students of institutions have been fascinated to understand why some institutional forms are reproduced in many different organizations. Theory points to the role of the organizational environment in affecting the spread of institutional forms as well as to characteristics of the adopting organizations themselves.

Meyer and Rowan¹⁴ argue that at a point in time when an institutional form gains general acceptance it takes on the quality of a myth. Organizations, in attempting to demonstrate their fitness to actors in the organizational environment, may be inclined to adopt generally accepted institutional forms because it is understood that this is the appropriate thing to do. In this way an organization demonstrates that it is taking proper and adequate action towards achieving some collectively valued purpose. The organization is thus protected from having its conduct questioned. It acquires legitimacy that serves to strengthen its support by actors in the environment and, in turn, helps to secure its survival.

Stated differently, the adoption of institutionalized structures can be seen as a ceremonial act. It may pay homage to the latest expert thinking or those with the most prestige and in so doing earns credit for the organization. An example from some years ago is the way in which planning programming budgeting systems came to be adopted by

¹⁴ John W. Meyer and Brian Rowan, "Institutionalized Organizations: Formal Structure as Myth and Ceremony," in *The New Institutionalism in Organizational Analysis*, eds. Walter W. Powell and Paul J. DiMaggio (Chicago: University of Chicago Press, 1991), pp. 44; 50-52.

various government bodies after the U.S. defense department pioneered their use.¹⁵

Whether or not resource allocation actually improved was somewhat beside the point -- it was just necessary to show that an effort was being made using the state-of-the-art tools at hand. Here was a case where the "cure" may have indeed had adverse effects on efficiency, due to the resource-intensive nature of the process.

However, not all organizations are equally dependent on legitimacy as a source of survival. Production organizations succeed by virtue of their ability to deliver outputs. Attention is focused on achieving high standards of efficient internal production. Institutionalized organizations depend for their success on the confidence and stability achieved by conformity to the normative codes of the relational networks in which they are embedded. They are judged more by the appropriateness of their form than by their outputs. This illustrates the important point that in institutional environments, organizations compete for social fitness rather than economic efficiency. In a sense, then, the logic of institutions is not the same as the logic of efficiency. Of course, the notion of production organizations versus institutional organizations is a contrast in ideal types. Because elements of both may exist in one real-world organization, we may see that ceremonial activities are decoupled from the technical core of the organization. In this way, output-oriented activities can be pursued with an objective of efficiency because

¹⁵ Herman R. van Gunsteren, *The Quest for Control: A Critique of the Rational-Central-Rule Approach in Public Affairs* (London: John Wiley & Sons, 1976), p. 48.

they are buffered from the environment by the presence of legitimacy-oriented activities.¹⁶

Powell, DiMaggio and Powell, and Scott offer slightly different factors for the ways in which institutions are reproduced.¹⁷ Combining the lists, one comes up with a number of not necessarily exhaustive or mutually-exclusive ways in which institutional forms might spread. These authors are interested in the invention or promotion of new institutional forms, however, it would seem that some, if not all, of the means listed could also apply in a situation of institutional reproduction.

One organization (or environmental agent) may be effectively forced by second organization that is in a position to impose decisions upon it, coerce it, or exercise power over it to adopt an institutional practice or structure. The number of possible sources of power are many, but two obvious examples are a state organization that exercises regulatory authority over a private sector organization or a large private organization that is the major customer of a smaller organization. Closely related, but listed separately by Powell, is the case of "complex interdependencies," say, where a number of organizations are interconnected in a network in which certain standard operating practices are

¹⁶ Walter W. Powell, "Expanding the Scope of Institutional Analysis," in *The New Institutionalism in Organizational Analysis*, eds. Walter W. Powell and Paul J. DiMaggio (Chicago: University of Chicago Press, 1991), p. 184.

¹⁷ Powell, "Expanding the Scope of Institutional Analysis," p. 191; Paul J. DiMaggio and Walter W. Powell, "The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields," in *The New Institutionalism in Organizational Analysis*, eds. Powell and DiMaggio, pp. 66-71; W. Richard Scott, "Unpacking

observed.¹⁸ New entrants to the network would have no choice but to conform even if none of the existing members of the network overtly exerted power over the newcomer to conform. Scott describes another way in which a subtle exercise of power can take place. He speaks of agents using inducement strategies to create structural changes by providing incentives to organizations that are willing to conform to the agent's conditions.¹⁹

Yet another variation is the situation where one organization, perhaps looking to solve a particular problem or to earn social acceptance, simply adopts what is generally considered to be a good practice. Powell calls this the exercise of taken for granted assumptions;²⁰ essentially the same idea is dubbed "mimetic isomorphism" by DiMaggio and Powell.²¹ Again, a distinct but related case is that of "normative isomorphism."²² Here, typically, some professional standard-setting body prescribes good practice and practicing members of the profession introduce these practices into the organizations that employ them. In a similar vein, Scott suggests there are occasions where a so-called "subordinate unit" is not compelled to conform but voluntarily seeks out the attention and approval of an "authorizing agent."²³ Empirical findings in a Canadian study by Gow

Institutional Arguments," in *The New Institutionalism in Organizational Analysis*, eds. Powell and DiMaggio, pp. 175-181.

¹⁸ Powell, "Expanding the Scope of Institutional Analysis," p. 191.

¹⁹ Scott, "Unpacking Institutional Arguments," p. 177.

²⁰ Powell, "Expanding the Scope of Institutional Analysis," p. 191.

²¹ DiMaggio and Powell, "The Iron Cage Revisited," p. 67.

²² DiMaggio and Powell, "The Iron Cage Revisited," p. 67.

²³ Scott, "Unpacking Institutional Arguments," p. 175.

support this view by citing the important role played by central agencies (particular authorizing agents) in developing and proposing administrative innovations.²⁴

To this point, I have talked about forces that favour the adoption of institutional practices or forms. Powell also discusses path-dependent processes that serve not so much to require the adoption of particular practices but to preclude their adoption.²⁵ The idea is that, after certain decisions have been made or commitments entered into, alternatives that might have been considered at an earlier point in time are no longer feasible due to incompatibilities with the now-entrenched structures or practices. March and Olsen²⁶ share somewhat the same view. They see the long-run development of political institutions as a product of incremental adaptation to changing problems with available solutions within gradually evolving structures of meaning. In other words, there are in fact three paths that converge and the outcome is dependent on each one individually and on the "accident" of their convergence at a point in time.

A final point worth noting is that any combination of these factors could be present in any situation. They should not be thought of as alternatives.

An observation by Jepperson and Meyer helps us to discern an element that is common in many of the preceding situations. The influence of environmental agents on

²⁴ James Iain Gow, *Learning from Others: Administrative Innovations Among Canadian Governments* (Toronto: The Institute of Public Administration of Canada, 1994), p. xvi.

²⁵ Powell, "Expanding the Scope of Institutional Analysis," pp. 191; 193-194.

²⁶ March and Olsen, *Rediscovering Institutions*, p. 94.

organizational structure and practices is especially great where the environmental agents are themselves highly rationalized: "...modern actors and their 'interests,' legitimated functions and their functionaries, and agents of the modern collectivity such as state elites, and legal and professional theorists and practitioners."²⁷

Jepperson and Meyer are convinced of the fundamental importance of isomorphism in its various manifestations in explaining institutional change. They claim that as new devices of political coordination or control are created, similar efforts are made everywhere with the result that prediction of institutional change is more reliably based on knowledge of the world environment than on an understanding of the structure of interests that happen to be at play.

However, there are others who contest this view. Atkinson²⁸ insists that institutions are the outcome of conflicts among competing social forces that struggle to imbed their interests in these institutions. Because institutions are created and changed by those who wield power within society and the state, the study of institutions cannot be separated from the study of political interests. In addition, political arguments about what are appropriate arrangements for governance shape institutions. As a result, Atkinson stresses the act of invention rather than the forces of isomorphism in explaining

²⁷ Ronald L. Jepperson and John W. Meyer, "The Public Order and the Construction of Formal Organizations" in *The New Institutionalism in Organizational Analysis*, eds. Walter W. Powell and Paul J. DiMaggio (Chicago: University of Chicago Press, 1991), p. 205.

²⁸ Atkinson, "Introduction," p. 3.

institutional change. However, even Atkinson²⁹ recognizes that participants in the policy process are not constantly contracting for completely new institutions to produce the policy outcomes they want; they are typically restricted to making marginal course adjustments while traveling on a particular institutional path.

The preceding discussion adopts the point of view that environmental agents are in control and that individual organizations have little choice in the way they react to environmental pressures for institutional change. A perspective that shows organizations as having much more choice, at least in certain circumstances, is presented by Oliver.³⁰ She shows that, faced with institutional pressures, organizational response may range from passive conformity to active resistance, depending on the nature and context of the pressures. The five strategic responses put forward by Oliver, in order of increasing resistance, are acquiescence, compromise, avoidance, defiance, and manipulation.

Within the *acquiescence* strategy Oliver identifies three tactics, which we recognize from the foregoing discussion: (1) habitual adherence to taken-for-granted rules or values; (2) imitation of institutional models; (3) conscious compliance with institutional pressures as a means for obtaining specific benefits. Identification of the *compromise* strategy is a recognition that an organization's environment may present it with multiple, conflicting institutional pressures. The organization may try to achieve balance by trying as best as it can to please everyone. Alternatively, it may recognize that

²⁹ Atkinson, "Public Policy and the New Institutionalism," pp. 29-30.

it cannot please everyone and try instead to please as many as possible while pacifying the others whose demands are not met. Thirdly, the organization may try to bargain with environmental agents in order to have them reduce their demands to a manageable level. Note that with these two strategies the environment prevails, either entirely or to a large extent. The remaining three strategies entail a much different result.

In carrying out an *avoidance* strategy, the organization may conceal its noncompliance with institutional pressures by putting up a visible front of apparent compliance. Going a step beyond this, an organization may try to erect buffers so that the environment is unable to inspect whether or not compliance is occurring. Or, the organization may simply leave the environment so as to escape the pressures. The *defiance* strategy, at its most basic level, involves dismissing or ignoring institutional rules and values. A more active tactic is to mount a challenge, a counter-offensive to institutional pressures. At its most intense, challenge evolves into attack. The most active strategy employed in the face of institutional pressures is *manipulation*. Here, the tables are turned and the organization attempts to alter the environment by co-opting certain of its constituents, by shaping environmental values, or by taking control of the environment.

³⁰ Christine Oliver, "Strategic Responses to Institutional Processes," *Academy of Management Review*, Vol. 16, No. 1 (1991), pp. 151-159.

Oliver sets out a series of ten hypotheses relating to the prediction of circumstances under which each of the alternative strategies will be pursued.³¹ According to Oliver, organizational responses to institutional pressures toward conformity will depend on why these pressures are being exerted (cause), who is exerting them (constituents), what these pressures are (content), how or by what means they are exerted (control), and where they occur (context). With respect to cause, the lower the degree of social legitimacy or economic gain to be had from conformity, the greater the likelihood of resistance. With respect to constituents, the greater the extent of conflicting demands and the lower the dependence on the constituents, the greater the likelihood of resistance. Regarding content, the more that institutional norms or requirements are at odds with the organization's own goals and the more that conformity would reduce the organization's freedom to pursue its own goals, the greater the likelihood of resistance. As for control, the lower the degree of legal coercion in support of institutional norms and requirements and the lower the degree of voluntary acceptance of them by others, the greater the likelihood of resistance. Finally, with respect to context, the lower the level of environmental uncertainty and the lower the degree of interconnectedness in the institutional environment, the greater the likelihood of resistance to institutional pressures.

The final theory of institutional change to be discussed is that developed by North, who is an economic historian. North starts from the premise that institutional arrangements combined with other economic constraints (e.g. the state of technology and

³¹ Oliver, "Strategic Responses to Institutional Processes," pp. 159-172.

resource endowments) determine society's opportunities. He theorizes that entrepreneurs in political and economic organizations will innovate institutional arrangements, at the margin, whenever benefit-cost considerations indicate that their well-being can be improved by so doing.³² North adds the caveat that those whose interests would be served by an institutional innovation must possess sufficient bargaining strength to effect the change.³³ In particular, insofar as the innovation may involve redistribution of income it is most unlikely to occur without the backing of the coercive power of government.³⁴

The kinds of benefits to be had from institutional innovation include the achievement of potential economies of scale, the internalization of economic externalities, the reduction of risk and/or transaction costs, and the redistribution of income.³⁵ The difference between North's treatment of transaction costs and that of Williamson is that North sees them as a dependent variable -- something that can be altered through purposeful institutional change -- while Williamson sees them as an independent variable -- given alternative institutional arrangements (e.g. markets and hierarchy), an organization will choose the transaction cost minimizing alternative.³⁶

³² Douglass C. North, *Institutions, Institutional Change and Economic Performance* (New York: Cambridge University Press, 1990), p. 7-8.

³³ North, *Institutions, Institutional Change and Economic Performance*, p. 68.

³⁴ Lance E. Davis and Douglass C. North, *Institutional Change and American Economic Growth*, (New York: Cambridge University Press, 1971), p. 26.

³⁵ Davis and North, *Institutional Change and American Economic Growth*, pp. 11-12.

³⁶ Williamson, *The Economic Institutions of Capitalism*, pp. 41-42; Paul M. Hirsch and Michael D. Lounsbury, "Rediscovering Volition: The Institutional Economics of Douglass C. North," *Academy of Management Review*, Vol. 21, No. 3 (1996), pp. 879-880.

By recognizing the purposeful nature of some institutional change, North is recognizing the role of volition in bringing about change. This, in turn, leads to a recognition that ideology plays an important role in explaining institutional change, since ideology has a strong influence on peoples' wills.³⁷ For North,

"Ideology is an economizing device by which individuals come to terms with their environment and are provided with a 'world view' so that the decision-making process is simplified...

"Ideology is inextricably interwoven with moral and ethical judgments about the fairness of the world the individual perceives...A normative judgment of the 'proper' distribution of income is an important part of an ideology."³⁸

Certain implications derive from North's view of institutions and institutional change. First, because innovations tend to occur at the margin, there will be a path-dependent aspect to the evolution of institutions.³⁹ Second, because the environment is constantly changing (e.g. due to advances in technology), at any point in time it is likely that institutions will be out of step with the environment and, therefore, may be delivering sub-optimal results.⁴⁰

³⁷ Hirsch and Lounsbury, "Rediscovering Volition," pp. 876-877.

³⁸ Douglass C. North, *Structure and Change in Economic History* (New York: W. W. Norton & Company, 1981), p. 49.

³⁹ Malcolm Rutherford, *Institutions in Economics: The Old and the New Institutionalism* (Cambridge: Cambridge University Press, 1994), p. 45.

⁴⁰ Rutherford, *Institutions in Economics*, pp. 75-76.

This concludes the discussion of the theoretical framework used for the major portion of the study dealing with the identification and explanation of institutional changes affecting the tax policy making process in Canada. Next, I discuss the theoretical framework used for the minor portion of the study dealing with the impacts of the institutional changes.

6. The Life Cycle of a Policy Issue

Stanbury provides a short review of literature dealing with the concept of the issue life cycle.⁴¹ Three different descriptions are given, dividing the life cycle into as few as three and as many as seven phases. The shortest, attributed to Nolan, consists of the latent phase, the opinion development phase, and the institutional action phase.⁴² The longest, attributed to Corrado, is made up of the problem, the label, crystallization, answers and solutions, legislation, implementation, and the emergence of new problems.⁴³ In between, Downs suggests the following cycle: the pre-problem stage, alarmed discovery and euphoric enthusiasm, realizing the cost of significant progress, gradual decline of intense public interest, and the post-problem stage.⁴⁴ The discussion that follows presents a

⁴¹ W. T. Stanbury, *Business-Government Relations in Canada: Grappling with Leviathan* (Scarborough: Nelson, 1988), pp. 218-221.

⁴² J. T. Nolan, "Business Beware: Early Warning Signs in the 80s," *Public Opinion*, April-May 1981, pp. 14-17; 57.

⁴³ Frank M. Corrado, *Media for Managers: Communications Strategy for the Eighties*, (Englewood Cliffs: Prentice-Hall, 1984), p. 51.

⁴⁴ Anthony Downs, "Up and Down With Ecology -- the "Issue-Attention Cycle," *The Public Interest*, Vol. 28 (1972), pp. 39-41.

model of the issue cycle which I developed independently of those just cited. It is most like the Corrado model but it is more explicit in its separation of the origins of the issue in objective reality and its origins as a socially-constructed entity.

A policy issue has its genesis in some event that occurs in the physical world. The event could involve a physical object alone or, more likely, some relationship between physical objects. Examples of such events might be when the first tree is harvested from a rainforest or when the first fish becomes contaminated with dangerous levels of mercury. At this point, the "event" is not yet an "issue." Perhaps many thousands of similar events can occur and still no issue will emerge. Nevertheless this phase of an issue's life cycle is critical. I give it the name "stimulus."

The next critical step towards "issuehood" comes when the event or events are noticed by someone. I call this phase in the issue's life-cycle "attention." Much time may pass before notice is taken of the event. Most likely, at virtually the instant that the event is noticed the perceiver performs an intuitive evaluation of the event. The values, norms, preferences, and interests of the perceiver come into play without any conscious effort on the perceiver's part. If the event is judged unfavourably by this evaluation it then becomes a problem or an issue and may proceed to the next phase in the life-cycle; otherwise, it merely passes out of attention. Obviously, the event may be noticed by more than one person, and not everyone who notices it will make similar intuitive evaluations. This fact sets up an important dynamic within the policy making system -- conflict resolution.

If the "problem" has been noticed by an activist perceiver or by activist perceivers, he, she or they may wish to resolve it through some sort of action. To prepare for eventual action the problem has to be subjected to a phase consisting of analysis and argument, the outcome of which is the determination of the meaning to be attached to the event. The intuitive evaluation of the stimulus event must be buttressed with a well-supported, well-reasoned account of the causes of the problem, a potential solution, and the benefits to be realized when the solution is implemented. Activists recognize that this step is important in gaining support for their favoured position on the issue. Others who have not yet perceived the stimulus event must be made to perceive it and to evaluate it in the manner desired by the activists. Where there are different perceptions of the issue a competition will develop to determine the meaning of the stimulus event and the definition of the problem, the solution and its expected benefits.

The competition may go on for a long period of time until the conditions occur that will allow a decision to be taken and a course of action to be implemented. Determination of the point at which the necessary conditions are realized depends upon activity during the preceding phase. A critical mass of support has to be created through the process of argumentation. This decision-action phase is the penultimate milestone in the life-cycle of an issue.

The final phase is the outcome -- a phase that returns the issue to the realm of the physical world where it began as stimulus and takes it out of the socially-constructed

reality characteristic of the attention, analysis-argument and decision-action phases. The actual outcome of the action taken pursuant to the decision may or may not equate to the expected outcome. In any event, but especially where it fails to match expectations, the outcome may take on the role of stimulus and start a successor issue on its life cycle journey.

An important point to understand with respect to the life cycle of a policy issue is that, with the possible exception of the last phase, the passage of one phase to another does not extinguish the antecedent phase. The stimulus remains even after it comes to someone's attention. Attention persists throughout the analysis and argument phase. The analysis and argument remains for reference during the decision-action phase. If action is successful, then the stimulus event or condition will disappear or will be transformed. However, if action is not successful the stimulus remains intact throughout. The image, therefore, is of each phase adding a layer to the policy making terrain. The early-laid layers do not go away, although one's view of them may be obscured.

7. The Action Situation

Having considered policy issues over their entire life cycle, now think of what a snapshot of one policy issue would look like. I call this snapshot the action situation. The notion of an action situation applies to a moment in time. Clearly, the events that have preceded any moment in time are important in shaping the action situation, but for

now we will set them aside. The term is borrowed from Elinor Ostrom,⁴⁵ and although I will keep it because it is very apt, I will modify its definition quite significantly.

In building up to the new definition, first consider Ostrom's definition. To her, the structure of an action situation is defined in terms of seven variables:

- a) the set of positions held by participants;
- b) the set of participants (possibly including a random actor) in each position;
- c) the set of actions that participants can take when faced with a decision;
- d) the set of outcomes that participants jointly affect through their actions;
- e) a set of functions that map actions taken pursuant to decisions into intermediate or final outcomes;
- f) the amount of information available to decision makers; and
- g) the benefits and costs associated with actions and outcomes.

These seven variables plus a model of the decision maker are explicitly or implicitly assumed in any formal model of an interdependent situation. A change in any of these variables results in a different action situation and, possibly, different outcomes. Ostrom also notes that physical and behavioural laws will come into play in determining the outcome caused by actions taken as a result of decisions made.

⁴⁵ Elinor Ostrom, "An Agenda for the Study of Institutions," *Public Choice*, 48 (1986), pp. 17-18.

Ostrom's purpose in developing this framework was to highlight the nature and functions of institutions conceived as sets of rules. She accomplishes this by relating each of the seven variables to a set of rules. Earlier, I made use of Ostrom's categorization of rules. Now, I will discuss the adequacy of her description of an action situation.

Of greatest importance is Ostrom's omission of two factors which together with physical and behavioural laws make up physical reality. These are objects and the relationships among them -- essential components of the initial conditions which provide the impetus for issues and which persist until changed (so they would hope, by the actions of policy makers). It is as if, in describing the action situation prior to a move in a chess match, she mentioned the board and the names and numbers of each the pieces normally included in a chess set, the moves open to each one of them, and the role of the players, but she failed to mention the particular configuration of pieces remaining on the board as a result of the play of the game to that point. Obviously this is important information. One cannot execute a checkmate on the first move of the game; some of the pieces are not even free to move on the first move of the game.

The significance of physical laws, behavioural laws and the model of the decision maker are merely touched upon by Ostrom. She includes physical and behavioural laws in her enumeration of the components of an action situation. Such laws do concern a kind of relationship -- a cause and effect relationship. However, by referring to laws Ostrom is dealing only with abstract relationships, not with relationships between actual

objects as needed to depict the initial conditions. In other words, she is dealing with concepts. Not that concepts are unimportant. Concepts are essential to the participants in an action situation, for it is through concepts as named in language that participants attach meaning to the objects and relationships in the action situation.

In order to determine outcomes, Ostrom supplements the action situation with a model of the decision maker. On reflection, this is odd since the decision maker is presumably a participant and is thus already a part of the action situation. This observation signals another way in which the notion of an action situation needs to be enhanced: by acknowledging the values, norms, preferences and interests held by participants; by recognizing that they possess particular knowledge, skills and energy resources; and, by recognizing that they possess a certain status in the eyes of others -- such as a degree of representativeness or authoritativeness. Values, norms, preferences and interests can be identified with the world of concepts and expressed through language. They are important determinants of the meaning that participants attach to objects and relationships. Participants' knowledge, skills, and energy also help determine how active and effective they will be and what form their activity will take during the attention, analysis-argument, and decision-action phases of an issue's life cycle. The effectiveness of some participants in their role as activists will be affected by whether or not other participants accept that the activists represent their views and have the authority to speak for them or to persuade them that the activists' points of view have merit.

Ostrom differentiates between the set of positions held by participants (as part of the action situation) and position rules that specify a set of positions and how many participants hold each position. These are not two ideas but one, and this one idea, I feel, makes sense as a category of rules but not as part of an action situation. In an action situation the person and the position are inseparable. Therefore, I would combine items (a) and (b) in Ostrom's list.

I find a similar pattern with respect to the set of actions open to participants (part of Ostrom's action situation) and the authority rules that specify the actions available to positions. As before, I wish to retain the concept of authority rules but would like to discard Ostrom's item (c). In fact, I found this item ambiguous and in choosing this course I have made what may be an arbitrary interpretation. The ambiguity is around whether Ostrom means the set of permitted actions or the set of technically feasible actions. I believe she meant the former, in which case I feel my choice makes sense. However, if she meant the latter, all is not lost, for then she is dealing with the state of technology and I believe that this can be effectively captured by another element in the action situation.

In Ostrom's categorization of an action situation she refers to the set of outcomes that participants may affect (item (d)). This is simply the reverse of what I have called the initial conditions, since any "outcome" is a change in the initial conditions. It is the difference between focusing on the changed thing or the thing to be changed. While the two ideas are related, they are not the same. Initial conditions exist in the present while

future outcomes are speculative. Both are appropriate components of the action situation concept, but I prefer to incorporate the outcome concept into the notion of a “solution” (see below).

Item (e) on Ostrom's list likewise should be retained as part of the action situation concept. The notion of a set of functions that map actions into intermediate or final outcomes sounds very much to me like the notion of technology, policy instruments or “know-how.” Something left out by Ostrom is a set of resources available to participants and which constitute the wherewithal for them to perform the actions they desire. Resources can be employed in the implementation of solutions using available technology, policy instruments and know-how, which are subject to physical and behavioural laws. One could argue that these all could be included under the heading of initial conditions. I will return to this point below.

Ostrom's next element of an action situation is the store of information available (item (f)). Stated this way, it is a very broad concept. However, I will shortly define some further action situation elements that are largely informational. Thus I will end up applying the term information to something of a residual.

Ostrom distinguishes between actions and outcomes and the benefits and costs associated with them (item (g)). Therefore, I understand benefits and costs to be expectations or interpretations attached to an outcome. I will keep the idea but will incorporate it under the concepts of “problems” and “solutions,” to be explained later.

Let me briefly review the changes I have made so far to Ostrom's framework. I have combined the separate elements of positions, participants, and the model of the decision maker and have emphasized the importance of leadership attributes possessed by participants. I have eliminated the element dealing with the set of permitted actions. I have added an element called initial conditions to complement the element dealing with outcomes that can be affected. I have recognized that one of Ostrom's elements deals with technology, although she does not use the term, and have noted that this is related to elements named by Ostrom -- physical and behavioural laws. Since action via technology (broadly defined) entails the use of resources, I have recognized the latter as an additional element in the action situation.

The items changed and the items retained in Ostrom's framework to this point represent an intermediate stage of refinement. To see the need for further modifications to the framework, consider Cohen, March and Olsen's⁴⁶ notion of the garbage can. The initial link between the two models is found in the ideas "action situation" and "choice opportunity." By following this link I will show how the garbage can model can be joined with, or folded into, the action situation model. The resulting synthesis of the two ideas is richer than either one individually.

⁴⁶ Michael D. Cohen, James G. March, and Johan P. Olsen, "A Garbage Can Model of Organizational Choice," *Administrative Science Quarterly*, Vol. 17 (1972), pp. 1-3.

Cohen, March and Olsen gave us the concept of organized anarchies, describing them as organizations or decision situations distinguished by three properties. First, it is hard to find a set of preferences that satisfies the consistency requirements normally associated with a theory of choice (problematic preferences). Second, organizational or decision processes are not understood by members or participants (unclear technology). Third, the boundaries of the organization are unclear and changing (fluid participation).

According to the garbage can model, a decision that occurs within an organized anarchy is an outcome or interpretation of four relatively independent streams: problems, solutions, participants, and choice opportunities.

"Elements of organizational structure influence outcomes of a garbage can decision process (a) by affecting the time pattern of the arrival of problems, choices, solutions or decision makers, (b) by determining the allocation of energy by potential participants in the decision, and (c) by establishing linkage among the various streams."⁴⁷

The garbage can model presents a radical alternative to models based on economic rationality. March and Olsen⁴⁸ point out that in this model "rational order" is replaced by one or more different kinds of order. Three of the more significant ones for my purposes are temporal order, normative order and demographic order. The notion of

⁴⁷ Cohen, March and Olsen, "A Garbage Can Model of Organizational Choice," p. 4.

⁴⁸ March and Olsen, "The New Institutionalism," pp. 743-744.

temporal order implies that phenomena are not understood in terms of causal or consequential linkages; instead, things are connected merely by virtue of their simultaneous presence or arrival. The notion of demographic order implies that a human institution can be studied and interpreted as the cross-section of the lives of the people involved. Organizations, according to this view, are affected by turnover of members, by their cohort structures, and by members' pursuit of careers and professional standards. Relating this to Schotter's description of games, one notices the rather large role that chance plays in determining outcomes. Normative order refers to a situation in which action is based on what is perceived to be normatively appropriate behaviour in accordance with duties, obligations, rules, and so on. This is in contrast to a decision based on calculating the return expected from alternative choices.

Ostrom's framework is strictly static; however, the garbage can model is dynamic. Having a dynamic model will be useful when talking about the way changes in institutional rules affect the policy making process. Therefore, it is worthwhile to spend some time considering the properties of the garbage can model, which are applicable as well to my own Ostrom-garbage can synthesis.

In the garbage can model, an organizational decision is the outcome of the interaction among several relatively independent streams, four of which are problems, solutions, participants, and choice opportunities. The image I have is of the four streams pouring into a garbage can, threatening to fill it up as the contents accumulate. But there is also evaporation from the garbage can. Choice opportunities are really just moments in

time and so they evaporate almost as quickly as they enter the garbage can. The other three streams consist of entities that do not evaporate as quickly so that a stock of all three remains in the garbage can over time. Participants are physical entities while problems and solutions are socially constructed, "objectified" entities. Participants evaporate by leaving the organization or policy network, as the case may be. Solutions evaporate by being consumed by decisions or ignored in favour of other solutions being consumed by decisions. Problems evaporate by being resolved, or at least addressed, as a result of decisions taken. All three types of entities could re-enter the garbage can at a later time. Decisions occur after the expenditure of energy by participants. How much energy participants spend and where they spend it determines which problems are resolved or addressed.

This image makes intuitive sense to me, although I have some minor qualifications regarding it. While stimulus events are arguably independent of participants, problems (as objectified entities) are most certainly not independent of participants. However, it is likely that the subset of participants that are active in the attention phase, the subset of participants that are active in the analysis-argument phase and the subset of participants that are active in the decision-action phase will not be identical. At most, one would expect that there would be intersections of each pair of subsets and an intersection of all three subsets. Therefore, in the garbage can model, problems are independent of some but not all participants. A parallel argument can be made in respect of the independence of solutions and participants.

The assertion of the garbage can model that solutions and problems are independent (that is, that there are solutions looking for problems) also strikes me as odd. Surely the sequence must be that a stimulus event prompts the definition of a problem which prompts the design of a solution, as the life cycle model of a policy issue suggests. However, an insight from the new institutionalism provides a partial explanation of this paradox. The world in some respects is one large garbage can, but in other (even most) respects it is divided into many smaller garbage cans. A solution worked out in respect of a problem in one garbage can, existing as it does as an objectified entity, can be introduced into a separate garbage can. This is essentially the process denoted by the new institutionalism as isomorphism. The solution has become institutionalized and it exists as a potential building block available for use by any organization to which it has relevance.

Yet another way in which I find the garbage can model less than totally satisfying has to do with the idea that participants expend energy on decisions and that decisions are made when a particular energy threshold (which for each problem is a unique level) has been reached. This seems to be true as far as it goes, but I argue that participants also spend energy in the attention and analysis-argument phases of the issue life-cycle, not in the decision-action phase alone. It also seems to me that the energy expended by participants can be "stored" by objectified problems and solutions and as the energy content of these objects grow they become more salient. Problems and solutions can also take on energy from the occurrence of stimulus events, that is, as more and more trees are harvested from rainforests or as more and more fish become contaminated with mercury.

This process is mediated by participants in the attention and analysis-argument phases; they draw their energy from the perception of the stimulus events. I would argue that the threshold energy level required for decision is a function of the energy content of the problems and solutions. Thus the demands for energy expenditure by the subset of participants known as decision makers can be traced to the energy expended by the other two subsets of participants and to the energy accumulation traceable to stimulus events.

To summarize, I see streams of participants entering and leaving the garbage can but not all of them fill the role of decision maker; some fill the role of attention director and others the role of analyst-argument builder. A few will fill two or three of these roles. I also see streams of objectified problems and solutions entering the garbage can through a process of isomorphism. In addition, some of the participants inside the garbage can, upon perceiving stimulus events occurring outside the garbage can, will create new problems and solutions. All of this implies that the stream of choice opportunities entering the garbage can is really just the passage of time and the choices to be made do not only involve decisions matching problems and solutions; they also involve choices to direct effort at scanning the environment for stimulus events (and objectified problems), at determining the meaning (as problems) of stimulus events, at drawing others' attention to the problems so-defined, at designing solutions, at scanning the environment for objectified solutions that might be adopted or adapted, and at building arguments that will persuade other participants to select a favoured course of action. Problems and solutions that remain in the garbage can at a point in time are not

"present" to the same extent: some glow with intense energy, others faintly flicker; some are gaining energy, others are losing energy.

My idea of a choice opportunity (in garbage can terminology) is that it is a moment in time. While it is not itself an entity, it is the case that this moment in time is characterized by a particular configuration of entities, including -- but not limited to -- problems, solutions and participants. To distinguish the choice opportunity as a moment in time from the constellation of these other things as they appear at a moment in time I call the latter the structure of the action situation.

Both the Ostrom and the garbage can frameworks contain the notion of "participant." What the garbage can model adds are the notions of problems and solutions. Problems and solutions are linguistic (and, therefore, socially-constructed) entities which include an expectation of a payoff (likely negative in the case of problems and positive in the case of solutions). Payoffs are associated with a set of initial conditions (in the case of problems) and with a set of expected changed conditions (in the case of solutions).

Initial conditions are not socially constructed. Strictly speaking, a subset of the initial conditions consists of the state of available information, technology, know-how and other resources. However, it is useful to think of this subset as something separate, so as to reserve the notion of initial conditions for that set of conditions that have been

interpreted as undesirable in a particular policy context and which have inspired the social construction of a linguistic entity called a problem.

Summarizing the notion of a problem, it is a socially constructed meaning that can be traced to some stimulus event. The problem is a linguistic representation of a set of initial conditions which have been evaluated as entailing a negative payoff if not altered. The purpose behind the linguistic representation is its use by some participants to persuade other participants of the nature and significance of the threat posed by the initial conditions.

In parallel fashion, I define a solution as a socially constructed meaning. It is a linguistic representation of a set of actions to be undertaken using available resources and technologies that will alter the initial conditions in such a way that the negative payoff associated with them can be reduced, avoided or turned into a positive payoff. The purpose behind the linguistic representation is its use by some participants to persuade other participants of the feasibility, efficacy and desirability of the proposed actions.

The idea that problems and solutions can exist as entities capable of entering or leaving the garbage can deserves further comment. Once a problem or a solution to a problem has been articulated, this description or interpretation forms part of the body of

social knowledge. Zucker⁴⁹ explains that institutionalized social knowledge exists as a fact or as part of objective reality. For example, many Canadians likely feel as confident about the "knowledge" that many Newfoundlanders live in a condition of welfare-state-induced dependency as they do about the knowledge that cats are mammals. When two or more people ("subjects") share the same understanding ("*intersubjective meaning*") of a "problem," the definition of the problem requires no more discussion, for them. The same can be said for solutions. Problems and solutions that have been "objectified" (made into objects) in this way form building blocks for decisions.

<div> <div>Exhibit 2</div> <div>Comparison of Elements of the Action Situation:</div> </div>	
As Defined By E. Ostrom	As Revised
<ul style="list-style-type: none"> • Positions • Participants • Available actions • Outcomes • Functions that map actions to outcomes • Available information • Benefits/costs of actions and outcomes 	<ul style="list-style-type: none"> • Initial conditions • Participants • State of technical knowledge • Available resources • Language and vocabulary • Available information • Objectified problems • Objectified solutions

⁴⁹ Lynne G. Zucker, "The Role of Institutionalization in Cultural Persistence," in *The New Institutionalism in Organizational Analysis*, ed. Walter W. Powell and Paul J. DiMaggio (Chicago: University of Chicago Press, 1991), p. 83.

Let me now take stock of where I have ended up with my Ostrom-garbage can synthesis. The revised structure of the action situation, which is a cross-section of the life cycle of an issue taken at a moment in time, consists of the following:

- a) A set of *initial conditions* which can be traced to a stimulus event.
- b) A set of *participants* having certain values, norms, preferences, interests, knowledge, skills, decision routines, energy and status in the eyes of others.
- c) The state of *technical knowledge* which is derived from an understanding of physical and behavioural laws.
- d) A set of *resources* (exclusive of human, knowledge and information resources, which are listed separately).
- e) A *language and vocabulary* used to communicate information and meaning.
- f) A set of *information*.
- g) A set of *problems*, which are linguistic representations of initial conditions that have associated with them a negative payoff.
- h) A set of *solutions*, which are linguistic representations of actions aimed at causing a change to the initial conditions such that the changed conditions have associated with them a positive payoff.

8. The Impact of Institutional Changes

Schelling defines a game of strategy as “a behavior situation in which each player’s best choice of action depends on the action he expects the other to take, which he

knows depends, in turn, on the other's expectations of his own."⁵⁰ Schotter points out that social and economic institutions are informational devices that the agents of societies develop to help them place subjective probability estimates upon each other's actions.⁵¹ This implies that institutions, by altering participants' expectations about each other's behaviour, will alter the strategic choices that participants make. Consistent with this view is Steinmo's conclusion that political institutions provide the basic context in which groups make their strategic choices; any rational political actor will behave differently in different institutional contexts.⁵²

In the empirical portion of this thesis, having examined the institutional changes that have occurred affecting tax policy making, I will take note of alterations in the strategies employed by participants that appear to have been occasioned, at least in part, by the institutional changes. While I offer no predictions about the way strategy will be altered, I will be alert to strategic choices involving the ways in which participants:

- a) gather and disseminate information;
- b) form alliances with each other;
- c) posture or position themselves on issues or in negotiations; and

⁵⁰ Thomas C. Schelling, *The Strategy of Conflict* (New York: Oxford University Press, 1960), p. 86.

⁵¹ Schotter, *The Economic Theory of Social Institutions*, p. 52.

⁵² Sven Steinmo, *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State* (New Haven: Yale University Press, 1993), p. 7.

- a) select the nature and timing of their interventions in the policy making process.⁵³

Exhibit 3

Strategic Importance of Institutions

Source: Author

⁵³ This categorization of the ways in which strategic choices may be revealed is my own.

Barnard applies the term “strategic” in a different way from that in which it is used above. To him, a strategic factor is the one whose control, in the right form, at the right place and time, will establish a new system or set of conditions which meets the purpose of a decision maker.⁵⁴ In other words, strategic factors in relation to some system are ones which place limits on the performance of the system. According to Barnard, at any given time one factor may be limiting, and therefore strategic, and at another time a different factor may be limiting. This can happen if something happens to change the first factor.

In this sense, institutions can be seen as potentially strategic factors. Changes to institutions may either remove or introduce limitations on the system that either were once or have become strategic. In considering the impacts of the institutional changes affecting the tax policy making system, I shall look for changes associated with rules representing strategic factors.

This approach relies on a purely instrumental view of institutional rules; that is, rule changes affect certain performance characteristics of the policy making process. The five performance characteristics that I propose to focus on are: capacity, flexibility,

⁵⁴ Chester I. Barnard, *The Functions of the Executive* (Cambridge, Mass.: Harvard University Press, 1938), pp. 202-205.

effectiveness, legitimacy and accountability.⁵⁵ Institutional rules are one determinant, but not the only determinant, of the performance characteristics possessed by a policy making system.

By *capacity* I mean the policy making system's ability to handle more or bigger problems. As the number of problems facing a society mounts, how well is the policy making system able to cope with them? If some problems are of such proportion that they amount to crises, does the policy making system respond? In such situations, do institutional rules alleviate or exacerbate policy gridlock? Is the policy making system able to reach decisions? One aspect of capacity is efficiency. An efficient policy making process would be able to come to decisions as quickly as possible and with as little wasted effort as possible. This might involve, for example, the policy making system's ability to resolve conflicts among competing interests.

The notion of *flexibility* addresses the ability of the policy making system to accommodate a variety of viewpoints with respect to a given problem such that all viewpoints are given a fair hearing and opportunity to influence choices. Related to this is the source of issues that enter onto the policy agenda. A flexible system would be open to acceptance of issues from a variety of sources.

If the policy making system generates policies that are better in some technical sense, having a greater probability of causing the desired changes to the initial conditions,

⁵⁵ This categorization of performance characteristics is my own.

we would call it *effective*. It is not simply a question of whether policy interventions alter the initial conditions; it is a question of whether the changes occur in the intended direction, realizing the outcomes that were sought after.

Because policy making is an inherently political exercise, one can ask whether the decisions and outcomes generated by the policy making system are viewed as *legitimate*, having wide support among citizens. Also due to the political nature of policy making, one can ask whether policy makers can be held *accountable* for their decisions and the resulting outcomes.

Taking the eight categories of institutional rules governing the policy making process and the five performance characteristics of the policy making process, one can construct hypotheses concerning the impact of rule changes on the action situation and, ultimately, on the performance of the policy making process. We can then judge the effects of changes to a set of institutional rules governing a policy making process by examining the impacts of the changes on the structure of the action situations treated by the process. That is why I have taken pains to derive a satisfactory description of what makes up the structure of an action situation. One needs to know where to look for impacts.

Of the eight elements of the action situation, I regard three of them to be exogenous. These are the *initial conditions*, the set of available *resources*, and the state of *technical knowledge*. The remaining elements can be affected by institutional rules

and by other elements in the action situation. Each of the endogenous elements is discussed below.

The set of *participants* is a function of position rules, boundary rules and authority rules. Together, position and boundary rules determine how many participants there are, what are their roles, and who they are. Position rules, acting in concert with authority rules, in part determine the decision routines that participants employ -- recall March and Olsen's "logic of appropriateness" by which position holders choose their actions according to the norms established for their positions. One can envisage a feedback loop between scope rules on the one hand and position and boundary rules on the other. Whatever the scope of an organization's mandate, one would expect that organization to set up positions and fill them with people who are capable of addressing issues associated with that scope. Conversely, an organization's participants bring interests with them and may work from within to have the organization's mandate adjusted to coincide with those interests.

The set of *information* available to participants and the *language and vocabulary* used by participants in a given policy field are functions of the information rules. The impact of information rules on the policy making process and on policy outcomes is pervasive. Because information rules govern the language and vocabulary used in policy making they affect all communications between participants. They also affect the amount and quality of information available as a resource to be used by participants. In the discussion of other elements of the action situation and the performance characteristics of

the policy making system I will need to refer often to the role of information as a variable.

The set of *problems* is a function of the set of initial conditions, the set of information, the permissible language and vocabulary, the set of participants, scope rules and payoff rules. The life cycle of a policy issue begins with a stimulus, which is one element in the set of initial conditions. In a preliminary way during the attention phase and then thoroughly during the analysis-argument phase of the life cycle, meaning is attached to the stimulus event and an objectified problem is created. During the process of attaching meaning to a stimulus event, participants may adapt or adopt pre-existing objectified problems that are present within the “garbage can.” Seeing that the development of problems is traceable to the evaluation of a stimulus event, it becomes clear how scope and payoff rules have come into play. Where participants direct their attention and, therefore, the likelihood that a stimulus will be noticed will be determined in part by scope rules. Scope rules define the field of interest. Having noticed a stimulus event, participants’ initial and subsequent evaluations of it will be influenced by payoff rules. If it appears that the costs and benefits associated with the stimulus event are not being distributed in accordance with the prevailing payoff rules, the event will receive a negative assessment and be perceived as a problem. Here one can see the importance of information rules in the value-laden dimensions of policy making. Information rules specify the language and form of communication as well as authorize the channels of communication to be employed by participants. Such rules obviously get to the very root of the question of what meaning is to be attached to the initial conditions and how and to

whom can concerns about them be communicated. Information rules govern how problems (and solutions) are framed: what language is used to describe them; what meaning can be expressed with the vocabulary permitted by the rules. That pivotal point in the life cycle of a policy issue -- the "creation" of a problem based on observation of a stimulus event -- is absolutely affected by information rules. (The creation of solutions, which follows, is similarly affected.) An ever-present influence on the definition and objectification of problems is that of the participants themselves. In part, participants' behaviour and attitudes will reflect the body of institutional rules they try to apply but their behaviour and attitudes will also be significantly affected by experiences that originate outside the realm of the policy making system in which they function.

The set of *solutions* is a function of the set of problems, the set of information, the permissible language and vocabulary, the set of technical knowledge, the set of available resources, the set of participants, scope rules, payoff rules and authority rules. Any solutions that are proposed must be focused within the field defined by the scope rules. Solutions must be on target and must not affect areas that are outside the mandate defined by the scope rules. Similarly, the payoff associated with the change to the initial conditions that is to be effected by whatever actions comprise the solution must accord with that specified by the payoff rules. It is logical that if the problem represents a negative assessment of the stimulus event according to the payoff rules, those same rules should guide the design of solutions aimed at ameliorating the undesirable condition represented in the problem statement. Solutions are also affected by authority rules; whatever solutions are proposed, they must utilize only permitted actions. In other

words, are the means justified? Technology and resources, as exogenous elements of the action situation, are not themselves affected by authority or any other rules but the ways in which technology and resources may be employed in the pursuit of desired outcomes are determined by authority rules. As for the impact of participants, information and language and vocabulary, the discussion above with respect to problems applies in parallel fashion to solutions.

Each of the middle phases of the policy life cycle -- attention, analysis-argument, and decision-action -- has an output associated with it. Out of the attention phase come preliminary problem statements and out of the analysis-argument phase come fully developed, objectified problems and solutions. The outputs of the decision-action phase are interventions (or decisions not to intervene) aimed at affecting undesirable initial conditions (or, aimed at leaving initial conditions undisturbed). The final phase of the policy life cycle is represented by the outcome resulting from the interventions or (non-interventions) of the preceding phase. When I discuss the impact of institutional changes on the performance of the policy making system in terms of its capacity, flexibility, effectiveness, legitimacy and accountability it will be useful to refer to “decisions and actions” and “outcomes” as variables.

The set of *decisions and actions* taken are a function of the set of problems, the set of solutions, the set of participants, timing rules and aggregation rules. Given the discussion above, I do not feel there is a need to say much more about problems, solutions and participants. Clearly, the statements of problems and solutions are key

inputs into the decision making process and decisions will be directed at finding solutions to the problems. Similarly, the comments made earlier about the influence of the personal characteristics of participants -- those behaviours and attitudes that are determined independently of any institutional rules -- apply equally to decision making. However, a few words about the influence of timing and aggregation rules are in order. Timing rules determine when issues come up for decision. Because of the flow of problems, solutions and participants through the "garbage can" each point in time is associated with a particular configuration of contents. The presumption of the garbage can model is that decisions will vary according to the point in time at which they are made. Aggregation rules specify a group decision function.⁵⁶ There is an analogy between aggregation rules that are used by groups of participants and the decision routines that each individual participant has internalized. An aggregation rule that states "Person A is entitled to decide the question" may occasion a much different result than a rule that states "The question will be decided upon the basis of one person, one vote." Thus, it is easy to see that decisions and actions are much dependent upon the aggregation rules in force.

⁵⁶ The fact that Ostrom names them aggregation rules may be a subtle reflection of her bias as a member of the public choice school. March and Olsen distinguish between aggregative and integrative institutions. Roughly speaking, the former presume that conflicts will be resolved competitively, perhaps leaving outright winners and losers, while the latter presume that consensus can be reached, with everyone winning and losing to some degree. To avoid any presumption about how groups might choose to resolve conflicts, one could refer instead to aggregation/integration rules; however, for the sake of simplicity I will not adopt this usage.

The set of *outcomes* is a function of the set of initial conditions and the set of decisions and actions taken.⁵⁷ The influence of the various kinds of institutional rules is entirely indirect, operating through decisions and actions, which, in turn, are functions of institutional rules and elements of the action situation. Some elements of the action situation are themselves dependent upon institutional rules.

With the discussion of all the intermediate variables out of the way, I now turn to the main variables of interest -- the performance characteristics of the policy making system: capacity, flexibility, effectiveness, legitimacy and accountability.

The *capacity* of the policy making system is a function of the set of problems, the set of solutions, the set of participants, the set of available information, the aggregation rules and the timing rules. For "capacity" and all other performance variables, much of the influence of institutional rules is indirect, embedded in the elements of the action situation that affect the variable. The number of problems and proposed solutions that the policy making system has to process -- the size of the agenda -- and their nature will be a major determinant of the system's ability to handle the workload. A system that is overloaded will be severely tested, while a more moderately tasked system ought to be able to cope handily. Moreover, the loading of the system is not just a matter of numbers of issues; some problems may be easy to solve or to reach consensus upon while others may be intractable and divisive. The quantity and quality of participants that are

⁵⁷ While it is not germane to this study, I acknowledge that the vagaries of implementation will have a huge influence on whether the decisions and actions taken

available to treat problems will affect the capacity of the policy making system. The greater the amount of relevant knowledge and skill that participants, individually and collectively, bring to bear on the task of policy making, the more capable the policy making system will be. However, the more people involved in the policy making process the more complex it will be. The dynamics will be harder to control and the process will take longer to work through. The extent to which participants possess the political and interpersonal skills needed to make the process function in an optimal manner will affect the efficiency and, therefore, the capacity of the system. Aggregation rules determine how participants will decide on policy questions. Decision procedures specified by aggregation rules may be either elegant and efficient or cumbersome and inefficient. The capacity of the policy making system may be greatly impaired if aggregation rules operate to create gridlock. There will be close interaction between timing rules and aggregation rules, in that the former will dictate when decisions will be worked through while the latter will specify how they are to be worked through. Timing rules will, therefore, affect the speed of the policy making process. Because information is a critical input to policy making, its quality and availability to participants affects the ability of the policy making process to treat issues in a timely manner. Decision makers need to take advantage of available information. The sooner that complete information is brought to bear on an issue the quicker it can be resolved.

The *flexibility* of the policy making system is a function of the set of participants, the set of available information, the permissible language and vocabulary, the set of

ultimately produce the intended effects.

problems and the set of solutions. With more people of different types participating in it, a policy making system ought to be more flexible. Competing views on the nature of problems and the appropriateness of solutions would be aired, and the dynamic of conflict would, if properly managed, ensure that the eventual decision would reflect something of a consensus among participants. No one, unrepresentative view could carry the day unchallenged. Having a heterogeneous collection of participants, however, is not sufficient to ensure flexibility in the system. The quality of their participation must be high, and this will depend, in large part, on their access to information and on their ability to understand and use the language and vocabulary characteristic of the policy field of interest. A highly technical policy field might be ostensibly open to many participants but, in fact, be influenced only by a handful of experts having a grasp of specialized jargon. Because a flexible policy making system is inclusive of and responsive to many different interests, one would expect the nature and sources of issues placed upon the policy agenda to reflect this quality. The agenda, therefore, can serve as a proxy for the system. The agenda, in this case, being the collection of problems and solutions on which the system focuses its attention at any point in time.

The *effectiveness* of the policy making system is a function of the set of outcomes it produces and the payoff rules. The direct measurement of effectiveness requires the examination of the outcome of a policy intervention and its comparison to the objective of the intervention. In the most general sense, this means comparing the actual distribution of costs and benefits with the desired distribution of costs and benefits. Since this is the domain of payoff rules, we see that they are fundamental to the establishment

of the benchmark against which an outcome is to be judged. One could say that payoff rules define what policy effectiveness means. Payoff rules deal explicitly with the quintessential political question of who gets what. Benefits run the gamut of political gains/goals: transfer payments, patronage, services, rights, and so on. As a practical matter, accurate and timely observation of outcomes may not be feasible. Here, the evaluation task is constrained by the state of technical knowledge (as was the decision making task constrained by the state of technical knowledge present in the action situation). As an alternative to observation of outcomes, one may be faced with making inferences about likely outcomes based on observation of inputs to the policy making process. An input of particular interest will be the quantity and variety of expertise that is brought to bear during the policy making process. Persons possessed of sound technical expertise should be able to make the best use of the resources, technology and know-how present in the action situation in order to change the problematic initial conditions in the desired fashion. Another critical input is information. The amount and nature of information available in large part determines whether policy alternatives are accurately evaluated so that the technically best alternative is identified. With limited or poor information the technical superiority of one alternative may not be revealed.

The *legitimacy* of the policy making system is a function of the set of participants, the aggregation rules, scope rules, authority rules, and payoff rules. The legitimacy of decisions and outcomes produced by the policy making system will depend on the representativeness of the participant group in relation to the characteristics of the population that will be affected. For example, an outcome that results from a minority

group imposing its will on the majority group may be viewed as illegitimate by the majority. Similarly, the outcome of a majority group imposing its will on a minority may be viewed as illegitimate by the minority. Related to this is that participants who are selected to represent an interest group must be accepted as rightful and worthy leaders by those whom they are understood to represent if any decision and subsequent outcome with which the participants are associated are to be viewed as legitimate. Aggregation rules also affect legitimacy. Imagine a country having universal suffrage but where members of one ethnic community were given two votes and members of another only one. Anyone committed to the principle of equality would not view the voting procedure nor the resulting decisions as being legitimate. Even the best possible aggregation rules would likely produce winners and losers in a given policy debate. In theory, therefore, it would be preferable to work with integration rules -- rules aimed at achieving consensus. This result would maximize legitimacy, but probably cannot ever be a practical alternative. There is a question of organizational legitimacy linked to scope rules. The population at large may not view an organization's involvement in a particular issue area as legitimate even though the organization itself considers it within its scope.

Jurisdictional disputes between the federal and provincial governments in Canada sometimes involve linkages between scope rules and legitimacy. The legitimacy of policy outcomes depends in part on whether or not it is perceived that legitimate means are used in their production. Thus, to the extent that authority rules specify acceptable means, the failure to observe the rules would render illegitimate the resulting decisions and outcomes. One can now see parallels to what was said earlier about the adoption of institutional structures and practices as a way to secure legitimacy for an organization.

Legitimacy in a political context is secured by showing that decisions accomplish appropriate objectives or by showing that they are made in appropriate ways. Political actors demonstrate that they are good decision makers by ensuring that qualities that are valued are symbolized in the decisions made. A "good" decision making process, therefore, involves consultation with relevant people, consideration of alternatives, and gathering information, and results in definite but prudent action.

The *accountability* of the policy making system is a function of the set of available information, the permissible language and vocabulary, position rules and authority rules. The notion of accountability is virtually synonymous with the notion of an "agent" supplying information to a "principal" about some responsibility that the agent discharges on the principal's behalf. The purpose is to enable the principal to control the actions of the agent. Thompson describes three ways in which accountability is exercised -- retrospection, generalization and mediation.⁵⁸ In the context of which Thompson writes, the "principal" is represented by the citizenry but there may also be a "quasi-principal" represented by legislators; the "agent" is represented by the bureaucracy. Retrospection involves the citizenry reviewing past decisions/actions of the bureaucracy. Generalization involves the citizenry/legislators debating and then setting out in advance guidelines for the decisions/actions of the bureaucracy. Mediation involves the legislators (or, usually, a committee thereof) exercising oversight of decisions/actions of the bureaucracy as they are being contemplated. The more relevant,

⁵⁸ Dennis F. Thompson, *Political Ethics and Public Office* (Cambridge, Mass.: Harvard University Press, 1987), pp. 22-33.

understandable (using permissible language and vocabulary) information supplied by the agent, the better for the principal. In the context of policy making, as Thompson's discussion illustrates, there are many levels of accountability as many participants are simultaneously principal and agent. For example, in Canada, a bureaucrat is accountable to the minister, who is accountable to Parliament, which is accountable to the citizenry. The minister is both principal (to the bureaucrat) and agent (to Parliament). The roles of the principal and agent -- in particular, the obligations and limitations imposed upon the agent -- are described by the position and authority rules, taken together. Accountability information must be relevant to these obligations. Accountability can be for both actions and outcomes; an agent may be expected to perform certain acts and to achieve certain ends.

9. Conclusion

This chapter has laid out the theoretical framework that is used to guide the empirical portion of the study which follows. There are two major subdivisions of the framework, corresponding to two major empirical investigations to be performed. The first deals with the nature and purpose of institutions and the factors that account for or influence institutional design, reproduction and change. The second deals with the impacts of institutional changes affecting a policy making process.

Institutions are coordinating mechanisms that can be represented as systems of eight categories of rules. Institutions are designed, reproduced or changed in response to

sociological or economic factors. Sociological factors have to do with the quest for social fitness; economic factors have to do with the minimization of transaction costs.

Institutions and institutional changes have an impact on various qualities of the policy making process and its outcomes. In order to understand these impacts, I first considered the life cycle of a policy issue over time. The most important point arising from this view is that an issue is traced from events or conditions appearing in "objective" reality through "socially-constructed" reality and back again. I then considered the concept of the action situation, which focuses on a moment in time and identifies the mix of factors, some objective and some socially constructed, that come into play in making a decision.

With these intermediate results in hand, I then placed a boundary around my search for impacts of institutional changes. Two areas were identified: (1) the impact of institutional changes on the strategies employed by participants in the policy making process, and (2) the impact of institutional changes on five performance characteristics of the policy making system. Some very general hypotheses were enumerated.

The stage is now nearly set for me to examine and evaluate, in subsequent chapters, a number of institutional changes that have occurred in the Canadian tax policy making process. However, before getting to that I wish to take one more preparatory step. The next chapter undertakes a different kind of literature review. It describes the tax policy making process as it existed in Canada up to about 1980. This provides a

useful benchmark against which to identify institutional changes that have happened since.

Chapter Three: The Literature on Tax Policy Making in Canada

The literature dealing with early tax reform and with the normal revenue budget process draws a picture of the institutions and practices of tax policy making circa 1980, which represents a jumping off point for a number of institutional changes. This literature also presents a discussion of what amounted to certain experiments in tax policy making that were influential in the design of subsequent proposals for reforms to the tax policy making process. The literature dealing with suggestions for reform of the revenue budget process details certain "moves" in a game in which tax professionals and the tax community each seek to put in place advantageous institutional innovations. The literature dealing with a positive theory of the evolution of the tax structure contains some discussion of current institutions which, although peripheral in that context, is important in the context of this thesis.

The 1971 tax reform exercise is interesting because of a couple of important "firsts" that were associated with it. For one, it began with the work of the Carter Commission, which was unprecedented in the amount of resources that it had at its disposal and in the size of the research effort that ensued. For another, the Commission's Report was followed up with the issuance of a government white paper and an elaborate program of public consultations on it. Both the report of the Royal Commission and the White Paper, in turn, sparked enormous controversy. The bold vision of tax reform offered by Carter was successively watered down, first in the White Paper and then further in the legislation, so that what emerged as the new taxation regime was modest in

comparison. These factors prompted the academic community to study closely this episode in Canada's taxation history.

MacDonald¹ used the pluralist conception of various interests competing within a policy field as the theoretical framework for his research. He sought to explain why the widespread public participation in the tax policy making process that characterized the work of the Carter Commission and the consultations on the White Paper failed to produce an outcome in which the benefits deriving from tax reform were themselves widespread. He did this by focusing on how the "comprehensive income" concept, the centrepiece of the Carter reform proposals, was received by policy makers.

At the time the Carter Commission was struck in September 1962,² whether and at what rates income was taxed depended upon its source: income earned by a person from employment was taxed according to one rate schedule, income earned by a small incorporated business was taxed according to another rate schedule, and income earned by anyone from capital (for example, capital gains realized on the sale of company shares) was not taxed at all. Therefore, the effective tax rate faced by any person depended upon how he or she earned his or her income. Of course, more rich people than poor people realize capital gains. Thus the system was biased to favour the rich. The Carter Commission's proposals called for the comprehensive definition of income,

¹ Leslie T. MacDonald, *Taxing Comprehensive Income: Power and Participation in Canadian Politics*, unpublished Ph.D. dissertation, Carleton University, 1985, pp. 13-16; 32.

meaning that all income would be treated the same for tax purposes regardless of its source. This would have significantly raised the tax burden of the rich relative to that of the poor and of middle-income people.

The reforms actually implemented were a far cry from those proposed by Carter. MacDonald concludes that while the process of public consultation involved many voices, the ones that were heeded belonged to the privileged sectors of Canadian society. Bucovetsky's³ examination of the mining industry's performance during the tax reform debate produced conclusions that, while not identical, are fully consistent with those of MacDonald. Rather than concluding in terms of the advantages associated with wealth and privilege, Bucovetsky focuses on the advantages related to the mineral industry's own organizational capability and its close ties to powerful provincial governments. Obviously, however, the two pairs of factors are not unrelated.

In the years prior to the tax reform of 1971, the extractive industries in Canada (as in other countries, such as the United States) had been the beneficiaries of some significant preferential tax provisions. As a result, businesses in these industries were more lightly taxed than businesses in industries that were not so favoured. The Carter Commission recommended that preferences to the extractive industries be reduced, but not eliminated. By arguing for reduction, it prompted special interest groups and certain

² Linda McQuaig, *Behind Closed Doors: How The Rich Won Control of Canada's Tax System....And Ended Up Richer* (Markham: Penguin Books, 1987), p. 139.

provincial governments to unleash fierce attacks against the proposals. During the public consultation that followed release of the Commission Report and, after that, the White Paper, the extractive industries surpassed all other interested parties in terms of organization. However, Bucovetsky attributes the ultimate capitulation of the federal Finance Minister to the influence of the provinces. The possibility that tax changes could threaten the viability of one-industry towns in any given province causes the government of that province to react with vigour.

A somewhat different slant on the 1971 tax reform experience was taken by Doerr,⁴ who viewed the White Paper on Tax Reform as an experiment having a three-fold purpose: (1) to improve the quality of government policies and programs; (2) to improve Parliament's ability to scrutinize the executive; and (3) to allow for public involvement and influence in governmental affairs. For the most part, Doerr viewed the experiment as a success. Doerr maintains that by encouraging interest groups and provinces to contribute information, many errors and pitfalls were avoided. The process also provided an opportunity to sound out public opinion on the acceptability of the proposals. Parliamentary committees were made more effective by assigning them responsibility to examine government proposals and to develop alternative proposals. Doerr did not regard the public consultation portion of the experiment as a great success. True, the public's access to information was greatly improved, but only highly organized groups

³ M. W. Bucovetsky, "The Mining Industry and the Great Tax Reform Debate," in *Pressure Group Behaviour in Canadian Politics*, ed. Paul A. Pross (Toronto: McGraw-Hill, 1975), pp. 94-96; 100-101; 105.

were able to contribute to the tax reform debate in a meaningful fashion. In reality, tax reform was carried out by a relatively small group of political elites. Doerr saw the solution to the problem of lack of public participation as the creation of institutional arrangements that could amplify the public's voice. This notion, though not Doerr's specific examples, of the importance of institutions and the potential impact of institutional changes is significant for this thesis.

The seminal work on the revenue budget process was done by Good,⁵ who explained the process in terms of the relationship between the "tax community" and "attentive actors." Good defines the tax community to include the Finance Minister, senior Finance Department officials and the staff of the Department's Tax Policy Branch. Attentive actors consist of an unconnected collection of governmental (both federal and provincial) and nongovernmental components of the environment, each having a very particular interest in taxation.

Good puts forward what amounts to a contingency theory in which the tax community considers tax proposals along two principal dimensions and chooses its strategy for dealing with attentive actors accordingly. The first dimension concerns the degree of certainty that the tax community feels regarding its prediction of how attentive actors will react to a given proposal. The second dimension concerns the "embarrassment

⁴ A. D. Doerr, "The Role of White Papers," in *The Structure of Policy-Making in Canada*, eds. G. Bruce Doern and Peter Aucoin (Toronto: Macmillan, 1971), pp. 195-197.

potential" of a proposal. A proposal having high embarrassment potential is one for which an adverse reception by attentive actors could force its withdrawal. The usual, and desired, state is for the tax community to put forward proposals having low embarrassment potential and about which it is quite certain of the type of reaction they will spark. In this case, the tax community follows an avoidance strategy. More will be said about this shortly. The nontypical, and less desirable, situation occurs when the tax community perceives that a proposal may have high embarrassment potential and/or the tax community is uncertain about how a proposal will be received. In such situations the tax community discards the avoidance strategy in favour of a strategy that, at a minimum, involves consultation with attentive actors and may even involve negotiation. Good cites the 1971 tax reform as one such situation, thanks to the high embarrassment potential.

Much of Good's study is devoted to the elaboration of the avoidance strategy and the anticipatory tactics that it entails. The first of the anticipatory tactics is incremental calculation. By concentrating on small changes from the existing situation the tax community is better able to forecast the consequences of the changes and to anticipate the reactions of attentive actors. The second tactic is to concentrate on the political assessment of proposals. This means making feasibility the prime criterion against which to judge any proposal. It also means having a tendency to adopt a pessimistic view of likely outcomes so that the tax community will always err on the side of caution. The final tactic is to rely on a culture of mutual trust within the tax community. According to

⁵ David A. Good, *The Politics of Anticipation: Making Canadian Federal Tax Policy* (Ottawa: Carleton University School of Public Administration, 1980), especially

Good, within the tax community no single actor dominates; it is hard to discern the contributions of individual members; and, all members conform to the norms of the Tax Policy Branch. Differences of opinion are "absorbed" as each member learns to do his or her part and to rely on colleagues to do their parts.

Good's work, with its emphasis on the private nature of tax policy making, is an important point of reference for this study. The tax community's tendency to employ an avoidance strategy was a consequence of the institutional structures for consultation available to it at the time. Since then, the tax community has worked in concert with tax professionals (see below) to create institutions that greatly facilitate consultation. For the tax community, this lowers the cost of acquiring information. By being able to afford more information, the tax community can better design its policy proposals to minimize the political costs associated with them.

About the same time that Good was carrying out his ambitious research project, Hartle was performing a more modest study.⁶ In the end, Hartle incorporated much of Good's work into his own. However, Hartle did use one device that differentiates his study from Good's. He arranged for a number of former tax policy "insiders" -- Ministers and bureaucrats -- to review a draft of the study and then in the final version Hartle included verbatim the reviewers' comments. Some of the reviewers were quite critical of

Chapters 1, 2 and 5.

⁶ Douglas G. Hartle, *The Revenue Budget Process of the Government of Canada: Description, Appraisal, and Proposals*, Canadian Tax Paper No. 67 (Toronto: Canadian Tax Foundation, 1982), passim; p. 41.

Good's conclusion (as recounted by Hartle) that the tax community was cautious and prone to stifle debate and disagreement. Indeed, the events of 1981 give credence to their doubts about the cautiousness of the tax community.

Although not given advance billing as a tax reform budget, the nature and magnitude of proposed changes to the tax system announced by Finance Minister Allan MacEachen in November 1981 amounted to the most significant tax reform since 1971 and horrified numerous special interests. Many observers were quick to point out that the problem -- that would permit such an atrocious Budget to be produced -- was the highly-flawed process by which revenue budgets were prepared. As a corollary, over the next few years there appeared suggestions for amending the process.

Two Ministers of Finance, Allan MacEachen and Michael Wilson, put forward discussion papers on reform of the budget process and, in response, the Canadian Tax Foundation twice (1982 and 1986) formed Committees to provide comments and suggestions. The 1982 Committee's⁷ main finding was that there was not enough public discussion of tax proposals. It argued that more public consultation would both improve the quality of proposals - especially as regards technical issues - and increase the likelihood that the measures finally enacted would be accepted by taxpayers. It cautioned that care should be taken to obtain the views not just of special interests that were well

⁷ Canadian Tax Foundation, Committee on the Budget Process, "On Opening Up the Budget Process: A Report to the Honourable Allan J. MacEachen, Minister of Finance, from a Committee Formed Under the Auspices of the Canadian Tax Foundation," *Canadian Tax Journal*, March-April 1982, p. 169.

organized and endowed with resources but also from those who might not normally get involved in public debates.

Creating an environment more conducive to public consultation meant mounting an attack on the tradition of budget secrecy. It was acknowledged that there was a legitimate role for the doctrine of budget secrecy but that it was then being applied too broadly and in regard to matters where secrecy really was unnecessary and counterproductive. The doctrine of budget secrecy should be applied only with respect to changes that are to take effect immediately upon being announced. With respect to other matters, the government should make much greater use of green papers and other consultative documents and should request written submissions and hold hearings on them. The Canadian Tax Foundation Committee also advocated creation of permanent consultative bodies such a Finance Advisory Committee or a Tax Reform Commission.

The 1986 Canadian Tax Foundation Committee on the Budget Process reported some progress in improving the budget process.⁸ The government was praised for regularly publishing draft legislation with explanatory notes in order to invite comment. However, the Committee saw further room for improvement. It advocated adoption of a regular annual budget timetable, imposition of a deadline for enactment of tax legislation after a budget proposal had been made, and the separation of technical changes from policy changes, with the former being dealt with in a separate bill introduced at some

⁸ Canadian Tax Foundation, Committee on the Budget Process, "The Canadian Budget Process," *Canadian Tax Journal*, September-October 1986, pp. 990-998; 1009-1011.

point in the year other than when the Budget was to be brought down. The Committee also endorsed certain proposals that had been made for reform of House of Commons procedure. In particular, it favoured moving consideration of tax legislation out of the Committee of the Whole House and into a Standing Committee.

Many, but not all, of the recommendations of the two Canadian Tax Foundation Committees have been implemented. Comparing the contemporary situation to that which prevailed at the time of the Carter Royal Commission, one prominent academic has noted improvement in the tax policy making process.⁹

Gillespie, in a series of contributions, elaborates what he calls a positive theory of tax structure.¹⁰ In this framework there is a government that provides goods, services and transfer payments to its citizens. From these expenditures the government derives political benefits in the form of electoral victory. Expenditures are financed by way of taxes imposed on various sources. There are political costs associated with the imposition of taxes and the government tries to maximize political benefits while minimizing political costs. Assuming that each source of tax revenue is subject to a

⁹ Brian J. Arnold, "The Process of Tax Policy Formulation in Australia, Canada and New Zealand," *Australian Tax Forum*, No. 7, 1990, p. 386, footnote 10.

¹⁰ W. Irwin Gillespie, "Tax Reform: The Battlefield, The Strategies, The Spoils," *Canadian Public Administration*, Vol. 26, No. 2 (Summer 1983), pp. 184-186; W. Irwin Gillespie, "The 1981 Federal Budget: Muddling Through or Purposeful Tax Reform?," *Canadian Tax Journal*, Vol. 31, No. 3 (November-December 1983), pp. 976-977; W. Irwin Gillespie, "The Department of Finance and PEMS: Increased Influence or Reduced Monopoly Power?," in *How Ottawa Spends 1984: The New Agenda*, ed. Allan M. Maslove (Agincourt: Methuen, 1984), pp. 201-203; W. Irwin Gillespie, *Tax, Borrow and*

unique political cost function, the government will choose the tax structure that equalizes marginal political costs for each source. Changes to the political cost functions and/or changes to the government's spending levels mean that the government will need to search out a new political equilibrium. Thus, over time there emerges an observable pattern of tax structure changes that are amenable to empirical investigation. Gillespie's major work in this area performs such an empirical investigation for over one hundred years of Canada's tax history.¹¹

For the present study, there are two aspects of Gillespie's discussion of the determination of political cost functions that are of particular interest. He presents a number of propositions concerning the way in which constitutional agreements (an institutional arrangement of paramount importance) affect political cost functions. This leads one to expect that the model could be extended to take account of other institutional arrangements and their effects on political cost functions and, ultimately, on tax structure. Gillespie also discusses alternative tax reform strategies - a consultative model and a budget model. This distinction is reminiscent of Good's consultative strategy and avoidance strategy, although the analogy is not perfect. Gillespie's consultative model contains several features that represent institutional mechanisms for communication of proposals and provision of feedback. Thus there is a further suggestion that governments might indirectly affect the political cost functions they face by attending to the design of institutions. Moreover, a researcher could observe institutional changes and attempt to

Spend: Financing Federal Spending in Canada, 1867-1990 (Ottawa: Carleton University Press, 1991), pp. 17-20.

trace their outcomes in terms of changes to the tax structure or, alternatively, in terms of citizens' acceptance of particular features of the tax structure.

One can take various facts and inferences from this literature and organize them according to the eight categories of rules identified in Chapter 2 to produce a sketch of the institutions affecting tax policy making in Canada at the beginning of the 1980s. Later chapters will identify and explain changes to these rules.

The literature dealing with the Carter Commission suggests that tax system at the end of the 1960s was characterized by a narrow base, embodying many preferences. The literature dealing with the MacEachen budget of 1981 reveals that even after tax reform in 1971 much of this character remained. MacEachen brought down what was in effect a tax reform budget that attacked many preferences and was met with harsh criticism -- he had violated the prevailing scope rules, which condoned the use of the tax system for the conferment of preferences to special interests. In this instance, payoff rules are corollary to the scope rules. The literature on the Carter Commission portrays a tax system biased towards easing the tax burden of the rich. A similar inference can be made from the reaction to the MacEachen budget by those whose enjoyment of preferences were threatened by the tax reform measures that it contained.

The discussion in Good's study of the "tax community" and "attentive actors" -- each of which terms he explains in detail -- provides some insight into the position rules

¹¹ Gillespie, *Tax, Borrow and Spend*.

in existence around 1980. However, neither his work or the other work noted above deals with boundary rules -- that is, how positions come to be filled or vacated. Good tells us something about aggregation rules insofar as he isolates tax policy decision making within the tax community.

With respect to authority rules, Good is again the source of information on actions that the tax community and attentive actors can and do take. In addition, the literature on reform of the revenue budget process provides insight into Parliament's role in the early 1980s: taxation bills were considered in Committee of the Whole and House of Commons standing committees had no routine role to play. Literature on the 1971 tax reform process provides information on the experiment involving the conduct of public consultations with the aid of a parliamentary task force.

Information rules are central to Good's exposition of the private nature of tax policy making and of the resulting need for anticipatory tactics. According to Good, consultation was a relatively rare occurrence. The literature on reform of the revenue budget process identified the perceived need to adhere to strict rules of budget secrecy as being the root cause of the reluctance to engage in consultation.

Regarding timing rules, one can infer from the recommendations of the Canadian Tax Foundation committee that budget timing was irregular. Also, tax measures were generally, if not invariably, tabled in association with a budget.

While not an exhaustive treatment of the status of the institutions affecting tax policy making around 1980, this sketch does highlight a few key points. It will be a useful point of reference to bear in mind as I trace, in the next few chapters, major changes to the institutions since that time.

Chapter Four: Changes to the Scope and Payoff Rules

1. Introduction

This chapter deals with the nature and causes of changes to the scope and payoff rules applicable to the tax policy making process. Elinor Ostrom defines scope rules as rules that “specify the set of outcomes that may be affected and the external inducements and/or costs assigned to each of these outcomes.”¹ In the context of this study, this means the rules that determine what are the permissible uses of the tax system -- the kinds of policy objectives that may be pursued -- and the permissible design features of tax measures (including administrative measures). In other words, rules about what may be done and how it may be done through the tax system.

“Payoff rules prescribe how benefits and costs are to be distributed to participants in positions.”² In the context of taxation, payoff rules and scope rules are linked. To the extent that participants in the tax policy making process are themselves taxpayers or act as representatives of taxpayers, the outcomes with which scope rules deal entail payoffs for the participants themselves. Imagine a hypothetical, and most unlikely, situation where the scope rules change to prohibit any tax assistance to industry. The loss of that assistance would entail a change in the payoff rules -- a benefit will have been eliminated for a class of participants. Or, imagine another most unlikely situation in which the scope rules change to prohibit wealth redistribution through the tax system and that the change

¹ Elinor Ostrom, “An Agenda for the Study of Institutions,” *Public Choice*, 48 (1986), p. 19.

was manifested in the elimination of progressive tax rates -- rates that increase as income increases. That change would entail a benefit for high income individuals and, directly or indirectly, a cost for low income individuals.

It is not true that all payoffs to participants are related to scope rules. This is because individual participants obtain some personal benefits that are unrelated to policy outcomes. Examples include the salary that Tax Policy Branch officials and staff hired by interest groups earn and the personal satisfaction they and volunteer participants get from doing work that they enjoy and which contributes to the public good. However, the rules to which these payoffs are subject are outside the rules that govern the tax policy making process, *per se*.

Bearing in mind the link between scope and payoff rules, in this chapter I will, for the most part, refer only to scope rules. However, payoff rules will always be in the background.

One might conclude that there are no scope rules at play in tax policy -- that anything goes. "The tax system is a whore" was the response by one of the persons interviewed to a question aimed at eliciting information about what are permissible and what are not permissible uses of the tax system as a public policy instrument.³ While the concept of scope rules applied to the tax system is not limited to rules about the use of tax

² Ostrom, "An Agenda for the Study of Institutions," p. 19.

³ Interview No. 7.

expenditures, the topic of tax expenditures is nevertheless one that is particularly easy to discuss in terms of scope rules.

A cursory examination of the government's published tax expenditures account reveals both the substantial number and diversity of policy measures currently being implemented through the personal, corporate and commodity tax systems (collectively, "the tax system"). The incentives and redistributive measures that remain in the system are the legacy of decades of policy intervention through the tax system. However, a number of the people interviewed maintained that the scope rules have changed;⁴ the argument goes that -- for the time being, at least -- it is virtually unthinkable that further such interventions of any significant magnitude could occur.

Although the legitimacy of using tax expenditures for new policy interventions has diminished, they remain as potential instruments. However, the rules about when tax expenditures can be successfully used are better articulated. In addition, rules for the design of tax expenditures have evolved to guard against the recurrence of problems associated with past uses of tax expenditures.

Reflecting the fact that the Canadian tax system is constantly changing to keep pace with the changing domestic and international economic systems in which it is embedded, rules have evolved to deal with the implementation of tax changes. Essentially, these rules have to do with providing for appropriate transition arrangements to deal with the reality that at any point in time taxpayers will have entered into

commitments based on the tax regime in force and that the economic well being of the parties to such commitments could be adversely affected by changes to the tax regime.

A growing area of concern has to do with the costs imposed upon taxpayers and others in connection with the performance of duties assigned to them by the tax system. Tax policy makers now face rules that require them to consider the compliance costs associated with new measures under consideration.

The introduction of the *Canadian Charter of Rights and Freedoms* constituted a fundamental change to the institutional context in which the tax system and the tax policy making system are embedded. Changes aimed at bringing the tax system into compliance with *Charter* requirements were brought about through a combination of bureaucratic and judicial action. Charter-based court challenges to the tax provisions have been successful with respect to guarantees of security against unreasonable search and seizure but have been unsuccessful with respect to rights regarding freedom of conscience and religion and equality. The Thibaudeau case is a noteworthy illustration of how an unsuccessful Charter-based court challenge played a key role in bringing about legislative change through political action. This case, which will be dealt with in more detail later on, involved a single mother who challenged the rules governing the income tax treatment of child support payments.

⁴ Interview Nos. 2, 3, 4, 9, 12, 16, 19, 23, 28, and 30.

2. Limitation on the Future Use of Tax Expenditures

The term “tax expenditures” refers to measures such as tax exemptions, deductions, tax credits and deferrals used to provide relief from the payment of taxes that are introduced into the tax system by the government in its pursuit of policy objectives. These measures are called tax expenditures because they are a substitute for government assistance provided by way of direct expenditures.⁵

Stanley S. Surrey is the man generally acknowledged to have recognized and named the tax expenditure concept, although what he dubbed “tax expenditures” were a well-entrenched feature of tax systems.⁶ Surrey, at the time the Assistant Secretary for Tax Policy with the U.S. Treasury Department, first spoke publicly of the concept in 1967.⁷ However, it was after he had left the government for a post with the Harvard Law School⁸ that he wrote the highly influential *Pathways to Tax Reform*. Surrey saw as the task of tax reform the restoration of fairness to the federal income tax system by removing the ability of well-off individuals and large corporations to escape their tax burden. A catalogue of tax expenditures would be an invaluable tool for use in pursuit of tax reform.⁹

⁵ *Tax Expenditures*, (Ottawa: Canada, Department of Finance, December 1994), p. 3.

⁶ See, for example, Roger S. Smith, *Tax Expenditures: An Examination of Tax Incentives and Tax Preferences in the Canadian Federal Income Tax System*, Canadian Tax Paper No. 61 (Toronto: Canadian Tax Foundation, 1979), p. 1.

⁷ Stanley S. Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures* (Cambridge, Mass.: Harvard University Press, 1973), p. vii.

⁸ Surrey, *Pathways to Tax Reform*, p. vii.

⁹ Surrey, *Pathways to Tax Reform*, p. viii.

In Canada, academics and others demonstrated their interest in the concept early on.¹⁰ In 1976, the National Council of Welfare published a short report highlighting a handful of tax expenditure provisions which it dubbed “the hidden welfare system.”¹¹ The subject of Canadian tax expenditures was given an extensive treatment by Roger S. Smith in 1979.¹² Also in 1979, the Department of Finance made a major contribution by publishing the government’s first *Tax Expenditure Account*.¹³ An update of the *Account* was published the following year.¹⁴

According to one former Department of Finance official interviewed, the act of preparing the *Account* was revealing even to those in the Department’s Tax Policy Branch.¹⁵ They had not been aware of all the preferences that were listed in the *Account*, and, up to that point, they had not fully identified all the preferences that were in the tax system. Furthermore, having the *Account* before them, Branch officials quite naturally began to question why the various preferences were needed in the first place, even though there was no appetite at the time for modifying or removing some of them.

¹⁰ Many examples of early Canadian work on tax expenditures are cited in Smith, *Tax Expenditures*.

¹¹ *The Hidden Welfare System: A Report by the National Council of Welfare on the Personal Income Tax System in Canada* (Ottawa: National Council of Welfare, November 1976).

¹² Smith, *Tax Expenditures*.

¹³ *Government of Canada Tax Expenditure Account: A Conceptual Analysis and Account of Tax Preferences in the Federal Income and Commodity Tax Systems* (Ottawa: Canada, Department of Finance, December 1979).

¹⁴ *Government of Canada Tax Expenditure Account: The Account of Tax Preferences in the Federal Income and Commodity Tax Systems 1976-1980* (Ottawa: Canada, Department of Finance, December 1980).

¹⁵ Interview No. 26.

Eight years earlier, in 1971, the federal government had completed the first of what Gillespie identified in 1991 as the five major tax reforms of the previous twenty-five years. Of particular note was the broadening of the income tax base achieved by the partial inclusion of capital gains in taxable income.¹⁶ Base broadening achieved through elimination of tax expenditures was not yet in vogue. Quite the opposite -- Smith identifies forty-five tax expenditures introduced during the years 1974 to 1978.¹⁷

People interviewed for this study offered different explanations for this propensity to use the tax system to deliver programs.¹⁸ One held that it was done by the Liberal government in an attempt to win back the support of the business community which it had earlier alienated.¹⁹ Another suggested that the business community regards spending programs as illegitimate while support offered through the tax system is welcomed.²⁰ As regards support to business itself, one might speculate that firms would prefer this vehicle because it is likely to require less day to day interaction with government officials in order to receive the benefits.²¹ Still another person interviewed attributed it to a desire by the Deputy Minister of Finance to augment his personal power by bringing more and

¹⁶ W. Irwin Gillespie, *Tax, Borrow and Spend: Financing Federal Spending in Canada, 1867-1990* (Ottawa: Carleton University Press, 1991), p. 182.

¹⁷ Smith, *Tax Expenditures*, pp. 13-15.

¹⁸ Interview Nos. 2, 4, 5, 6, 9, 10, 12, 13, 16, 18, 25, 26, and 30.

¹⁹ Interview No. 19. See also James Gillies, *Where Business Fails: Business Government Relations at the Federal Level in Canada* (Montreal: Institute for Research on Public Policy, 1981), p. 1: "As Canada entered the last two decades of the twentieth century, the interrelationship between business...and the federal government was, at best, strained."

²⁰ Interview No. 30.

²¹ This view can be inferred from comments such as the following from Gillies, *Where Business Fails*, p. ix: "In the spring of 1980, whether they liked it or not, and most did not, chief executive officers (CEOs) of major Canadian corporations...were spending more and more of their time managing relationships with government..."

more policy fields under the umbrella of the tax system, over which he had primary control.²²

About the same time as the tax expenditure account was published the government adopted a system for integrating tax expenditures into the policy making process for Cabinet committees. Difficulties in doing the necessary tax expenditure accounting and a lack of consistency regarding what tax expenditures did and did not get charged to expenditure envelopes were principal reasons why this policy making innovation was short lived. Nevertheless, according to a former Department of Finance official, the system did for a time have a dampening effect on demands by program ministers for new tax expenditures, due to the fact that one of their main attractions -- their apparent costlessness -- had been removed.²³

In 1974, the federal government posted its last budget surplus (\$186 million, on a National Accounts basis)²⁴ before encountering a string of budget deficits that has continued to the present day. A number of the people interviewed for this study cited concern over the cumulative effect of this series of deficits as the number one factor determining the government's fiscal stance, including the government's approach to tax policy.²⁵ When the time came for Finance Minister Allan MacEachen to prepare his

²² Interview No. 26.

²³ Satya Poddar, "Integration of Tax Expenditures Into the Expenditure Management System: The Canadian Experience," in *Tax Expenditures and Government Policy*, ed. Neil Bruce (Kingston: John Deutsch Institute for the Study of Economic Policy, 1988), p. 263.

²⁴ *The National Finances, 1980-81*, (Toronto: Canadian Tax Foundation, 1981), p. 54, Table 3-11.

²⁵ Interview Nos. 17, 19, 22, 23, 25, and 26.

1981 budget, the annual deficit for the year ended 31 March 1981 had reached \$7.3 billion dollars,²⁶ on a National Accounts basis.

At the same time, the United States passed the *Economic Recovery Tax Act, 1981*, which, among other things, was to reduce marginal income tax rates by 23 percent over 3 years, including a cut in the top marginal rate to 50 percent from 70 percent.²⁷ This action by the United States occasioned an abrupt shift in focus by the Department of Finance which, until then, had been working on a tax-based incomes policy²⁸ aimed at the problem of wage-push inflation. The newly arrived Assistant Deputy Minister in charge of the Tax Policy Branch, Glen Jenkins, was instrumental in mounting an effort to bring down the Canadian top marginal income tax rate to 50 percent in order to maintain tax competitiveness with the United States. He was convinced that pursuit of a tax-based incomes policy at that time was wrong-headed. Given the now persistent budgetary deficit, a marginal income tax rate reduction had to be financed through base-broadening measures in the form of cutbacks to tax expenditures. The time had now come to make

²⁶ *The National Finances, 1994*, (Toronto: Canadian Tax Foundation, 1994), p. 3:16, Table 3.15.

²⁷ Cedric Sandford, *Successful Tax Reform: Lessons from and Analysis of Tax Reform in Six Countries* (Bath: Fiscal Publications, 1993), p. 108.

²⁸ A tax-based incomes policy is an anti-inflation policy that uses the tax system to provide incentives for wage and price restraint. Inflation is viewed as a kind of externality, and the objective of such a policy is to cause business decision makers to internalize the societal costs associated with excessive inflation. A tax surcharge or subsidy associated with less or more wage and price restraint serves as a penalty or reward that approximates the external effects of a business' actions. For example, a firm that awards pay increases exceeding some standard percentage determined by the government would have a few percentage points tacked on to its corporate income tax rate as a penalty. A firm would therefore have an incentive to keep wage increases below the standard percentage in order to avoid paying extra income tax. See Arthur M. Okun, *Prices and Quantities: A Macroeconomic Analysis* (Washington: The Brookings Institution, 1981), pp. 348-353.

use of the work done previously on identifying and measuring tax expenditures and of the critical reexamination of tax incentives spawned by production of the *Tax Expenditure Account*. Assisting the Department of Finance in putting together the 1981 budget was Neil Brooks, who five years earlier had worked as a project consultant to the National Council of Welfare when it produced its landmark study of tax expenditures.²⁹

MacEachen's November 1981 budget contained proposals to reduce marginal personal income tax rates -- focusing mainly on the top two income tax brackets and achieving Jenkins' target of a 50 percent maximum marginal rate -- and to eliminate or reduce many personal and corporate income tax expenditures. The total revenue gain of \$3.4 billion from the cutbacks on tax expenditures would provide financing for the personal income tax rate reductions to the tune of \$1.3 billion, leaving a net gain in tax revenue of \$2.1 billion that would allow the government to reduce its borrowing requirements.³⁰ Almost immediately, due to an extremely adverse reaction by business groups, tax practitioners and others, the budget was labeled a disaster.³¹ The next chapter will argue that this reaction was instrumental in bringing about changes to institutional processes related to tax policy making; however, for the time being, I shall view the significance of this budget in terms of its signaling a fundamental change to the scope rules associated with tax policy making. Despite the fact that the base-broadening measures (aimed at facilitating the reduction in marginal tax rates) in the MacEachen

²⁹ *The Hidden Welfare System*

³⁰ Gillespie, *Tax, Borrow and Spend*, p. 197; Allan M. Maslove, *Tax Reform in Canada: The Process and Impact* (Halifax: Institute for Research on Public Policy, 1989), p. 10; J. Harvey Perry, *A Fiscal History of Canada - The Postwar Years*, Canadian Tax Paper No. 85 (Toronto: Canadian Tax Foundation, 1989), p. 90.

budget were somewhat watered down by the time the budget was enacted in March 1983, the government did succeed in maintaining the general direction of the 1981 proposals.³²

The growing antipathy towards tax expenditures was given further impetus from the circumstances surrounding the rise and fall of the Scientific Research Tax Credit, or SRTC. The SRTC was first announced in the Lalonde budget of April 1983 and was passed into law in January 1984. The SRTC permitted corporations to pass on the tax credit to shareholders who had provided funds for research and development at a rate of 50 percent of the funds provided. The legislation was written in a way that allowed transactions known as “quick flips” to take place, the effect of which was the sale of the tax credits to investors having no interest in whether or not any research and development was actually done.³³ The take up of this tax expenditure program was phenomenal and reports were rampant of dubious deals cooked up solely to take advantage of the tax

³¹ Linda McQuaig, *Behind Closed Doors: How The Rich Won Control of Canada's Tax System...And Ended Up Richer* (Markham: Penguin Books, 1987), p. 223.

³² Gillespie, *Tax, Borrow and Spend*, p. 199; Perry, *A Fiscal History of Canada*, p. 314.

³³ McQuaig, *Behind Closed Doors*, p. 248, provides this example of a quick flip:

“A company came up with a plan to carry out, let's say, \$10 million worth of research. Under the SRTC program, that would entitle the company to a tax credit equal to 50 percent of the amount to be spent on research; in this case \$5 million.

“Under normal circumstances, a tax credit of \$5 million would be used to reduce the company's taxes by \$5 million. But the whole purpose of the SRTC was to allow companies that paid no taxes to be able to take advantage of this tax break. Therefore the R&D company was allowed to sell its tax credit to an investor who could use it to reduce his own taxes.

“...an investor or groups of investors would hand over a cheque to the research company for \$10 million. This, in theory, represented an investment of \$10 million in the research company...

“...the investor would get in return papers entitling him to a tax credit worth \$5 million and a refund cheque for \$5 million, *plus a bonus...* of about \$500,000...That way, he put down \$10 million and received, in essence, \$10.5

loophole that the SRTC had created. So much tax revenue was being lost that the government had to place a moratorium on quick flips in October 1984, just 10 months after the measure was enacted, and ultimately announced the demise of the program in the May 1985 budget. However, even the moratorium did not solve the problem, with the result that more tax revenue was lost before the program was terminated effective December 31, 1985. A total of \$2.8 billion worth of tax credits were sold.³⁴

The Auditor General of Canada took note of the unfolding SRTC disaster and reported it in his 1984 report to the House of Commons.³⁵ This, in turn, prompted the House of Commons Standing Committee on Public Accounts to hold four hearings on the subject. The Committee's report labeled the SRTC "a costly boondoggle, a tax expenditure that in effect became a tax loophole." Nevertheless the Committee stressed the point that the program did support some legitimate research and development and did give rise to some new products and new technologies. While not condemning the use of tax expenditures, it made a number of recommendations which, if implemented, would place a much greater duty of care on any government that chose to introduce new tax expenditures. (The Committee did recommend against the use of prefunding-type tax expenditures, in which the taxpayer receives the benefits before having incurred any expenses.) It wanted tax expenditure programs to be tightly controlled, to be subject to program evaluation, and it wanted the Minister of Finance to "table an annual report

million back...The investor wasn't an investor at all. He was simply a purchaser of tax credits." (Italics in original.)

³⁴ *Report of the Auditor General of Canada to the House of Commons for the Fiscal Year Ended 31 March 1984* (Ottawa: Supply and Services Canada, 1984), paragraphs 3.34 to 3.49; McQuaig, *Behind Closed Doors*, pp. 242-274; Perry, *A Fiscal History of Canada*, p. 102.

stating the objectives, known information on progress towards these objectives, and estimated costs of every major tax expenditure program.”³⁶

It is somewhat ironic that the same May 1985 budget that announced the end of the SRTC also announced the introduction of the \$500,000 lifetime capital gains exemption, which would narrow the tax base. This unexpected measure had the effect of virtually undoing one of the main accomplishments of the 1971 tax reform -- the inclusion in taxable income of a portion of capital gains.³⁷ The measure was soundly criticized by one of Canada’s most distinguished professional tax advisors, William R. Lawlor.³⁸ Lawlor cites studies done by the U.S. Treasury Department and the Canadian Department of Finance that raise doubts about the ability of reductions of tax rates on capital gains to have a significant impact on things such as risk-taking and savings. In Lawlor’s view, the scope of the exemption was too broad, encompassing such assets as jewellery, speculative land, U.S. condominiums, antiques, gold bullion and deep discount bonds. He also criticized it for creating an incentive for owners of corporations to try to withdraw corporate surplus as a tax-free capital gain rather than as a taxable dividend (“surplus stripping”). In this connection, Lawlor foresaw the opening up of loopholes in the tax system as taxpayers and their advisors invented structures for transactions that would allow them to accomplish their tax avoidance goals.

³⁵ *Report of the Auditor General* (1984), paragraphs 3.34 to 3.49.

³⁶ *Fourteenth Report of the Standing Committee on Public Accounts*, (Ottawa: House of Commons, June 26, 1986), paragraph 32. Reproduced in Office of the Auditor General, *Report of the Auditor General of Canada to the House of Commons* (Ottawa: Supply and Services Canada, 1986).

³⁷ Perry, *A Fiscal History of Canada*, pp. 315, 340.

This measure, too, was relatively short lived. Finance Minister Michael Wilson's June 18, 1987 *White Paper* on tax reform announced that the exemption was to be capped at \$100,000, except as it applied to farmers and small businesses.³⁹ Finance Minister Paul Martin's February 22, 1994 budget heralded the elimination of the exemption, again excepting as it applied to farmers and small businesses.⁴⁰ The cost in terms of lost revenue for the \$100,000 lifetime capital gains exemption was substantial. The government estimated that it was worth \$665 million in 1991 and \$735 million in 1992.⁴¹ Mintz and Wilson estimated the revenue cost to the government of the lifetime capital gains exemption over the period 1985-1991. Using three different methodologies they came up with estimates ranging from \$1.7 billion to \$9.3 billion. Their preferred estimate was \$4.5 billion.⁴²

Summarizing the findings of a symposium on the lifetime capital gains exemption, Mintz and Richardson concluded that the exemption was not an effective means of encouraging investment and risk taking. On the other hand, the exemption carried with it significant revenue costs and adverse distributive impacts.⁴³

³⁸ William R. Lawlor, "Surplus Stripping and Other Planning Opportunities with the New \$500,000 Capital Gains Exemption," *Canadian Tax Journal*, Vol. 34, No. 1 (January-February 1986.), pp. 58-60.

³⁹ *The National Finances, 1987-88*, (Toronto: Canadian Tax Foundation, 1988), p. 6:9.

⁴⁰ *The National Finances, 1994*, (Toronto: Canadian Tax Foundation, 1994), p. 6:8.

⁴¹ *Tax Expenditures* (Ottawa: Canada, Department of Finance, December 1994), p. 21.

⁴² Jack Mintz and Thomas A. Wilson, "Realization and Revenue Effects of Lifetime Capital Gains Exemptions," *Canadian Public Policy*, Vol. 21, Supplement (November 1995), pp. S179, S189. See also reference to this article in Jack Mintz, and Stephen R. Richardson, "The Lifetime Capital Gains Exemption: An Evaluation," *Canadian Public Policy*, Vol. 21, Supplement (November 1995), p. S9.

⁴³ Mintz and Richardson, "The Lifetime Capital Gains Exemption," p. S11.

In 1985, the federal government once again published information on the cost of tax expenditures.⁴⁴ This document became the subject of ten hearings by the House of Commons Standing Committee on Finance, Trade and Economic Affairs (known as the Blenkarn Committee, after its chairman) from April 8 to May 22, 1986. In all, thirteen witnesses were called. Officials of the Department of Finance appeared three times; officials of the Department of National Revenue appeared twice; representatives of leading legal and accounting firms and the Canadian Institute of Chartered Accountants appeared at four hearings; and, one hearing dealt with representatives of the Life Underwriters Association of Canada.⁴⁵ The Committee's purpose in examining the *Account* was to find tax expenditures that could be cut back.

The Committee found that tax expenditures did not present easy game. The question of what constitutes a tax expenditure and what is part of the benchmark system against which tax expenditures are measured is complex and subtle.⁴⁶ In addition, some tax expenditures represent fundamental, long-standing pillars of government policy. A

⁴⁴ *Account of the Cost of Selective Tax Measures* (Ottawa: Canada, Department of Finance, August 1985).

⁴⁵ House of Commons, Standing Committee on Finance, Trade and Economic Affairs, *Minutes of Proceedings and Evidence*, 1986 - April 8, 10, 15, 17, 22 and May 6, 13, 15, 20, 22.

⁴⁶ See, for example, David E. Wildasin, "Tax Expenditures: The Personal Standard," in *Tax Expenditures and Government Policy*, ed. Neil Bruce (Kingston: John Deutsch Institute for the Study of Economic Policy, 1988), p. 136. The concept of tax expenditures is a concept of deviations from a norm. The actual tax structure is compared against the normative structure and deviations are labeled tax expenditures. Defining the normative structure is a matter for serious debate and yet is critical in determining tax expenditures. The set of tax expenditures that would arise from the comparison of an actual tax structure to a comprehensive income-based norm would be different from the set that would arise from a comparison to a consumption-based norm.

case in point is the role of registered retirement savings plans in the government's policy towards ensuring that Canadians enjoy adequate levels of retirement income. The upshot was that the Committee did not recommend changes to or elimination of any specific tax expenditures. However, it did make recommendations that reflected the Committee's unease with the use of this policy instrument. The general theme of the report emanating from these hearings was that of tax simplification, and included among its fourteen recommendations were the following:

- "That the tax system should be used to promote equity or growth only if no other method is simpler or less costly"
- "That the Government review the current package of exemptions, deductions and special tax measures to see whether the benefits from these can be provided in a simpler manner, by some method outside of the tax system, or by adjusting tax rates or general exemptions."⁴⁷

Also in 1986, the Auditor General once again picked up the theme of tax expenditures.⁴⁸ He followed up his brief 1984 note on the SRTC with a full chapter in his 1986 report in which tax expenditures were portrayed as high-risk program delivery options. One source of risk is that the take up of tax expenditure programs cannot be controlled. A program is there for anyone to use and its cost may turn out to be much

⁴⁷ House of Commons, Standing Committee on Finance, Trade and Economic Affairs, *Minutes of Proceedings and Evidence*, June 16, 1986.

⁴⁸ *Report of the Auditor General of Canada to the House of Commons for the Fiscal Year*

higher than expected if it proves to be popular -- this was part of the problem with the SRTC. Risk is exacerbated if the program is meant to provide an incentive to undertake a particular type of activity and it is possible for individuals and/or corporations to obtain benefits in respect of activities that would have been undertaken even without the benefit. Tax revenue foregone on such infra-marginal activities produces no marginal benefits.

The *Income Tax Act* is a statute of broad, general application. Therefore, any attempt to use it to deliver programs aimed at a relatively narrow target population requires complex eligibility rules, and even these may not succeed in directing the financial assistance where it is intended to go. The problem of support to infra-marginal activities is an example of this, but the Auditor General was equally, if not more, concerned with the problem of taxpayer-induced avoidance mechanisms. This refers to the creative use by taxpayers and their professional advisors of financial instruments or other legal arrangements to maneuver the taxpayer into a position wherein the taxpayer can take advantage of certain tax expenditure programs. The quick flip used to transfer benefits under the SRTC is an example of such an arrangement. Again, tax revenue is foregone without any activity of the type the government wishes to support having been undertaken.

Finance Minister Michael Wilson ushered in a major tax reform program that unfolded over the years 1985 to 1991. Several facets and reform strategies were evident in this program, including the continued assault on tax expenditures. Regarding personal income tax, the February 1986 budget announced the withdrawal of the Registered Home

Ownership Savings Plan. The June 1987 White Paper signaled the end of the \$500 employment expense deduction, the \$1,000 interest and dividend deduction, and deductions for investments in multiple-unit residential buildings. In addition, the generous capital cost allowance rates applicable to Canadian films were to be scaled back. On the corporate income tax side, certain capital cost allowance rates were reduced, the earned depletion deduction applicable to certain resource industries was to be phased out, and further restrictions were to be placed on the use of investment tax credits (which had also been reduced in the February 1986 budget).⁴⁹

If we are to understand the occurrence of changes to the scope rules applicable to Canadian tax policy making it is important to consider the international context. Tax reform was an international movement during the 1980s. Developed and developing countries alike undertook sweeping changes to their taxation systems, and several of the broad outlines of these changes were similar across the spectrum of countries. Sandford identified six common characteristics: (1) reduction in personal income tax rates; (2) reduction in the number of tax brackets; (3) base broadening -- largely through the reduction or removal of tax expenditures; (4) change in the tax mix -- partly financing reductions in personal income taxes with increases in other taxes; (5) reduction in corporate income tax rates, also allied to base broadening; and, (6) tightening up tax administration.⁵⁰

⁴⁹ Perry, *A Fiscal History of Canada*, pp. 340-348; Sandford (1993:139-142).

⁵⁰ Sandford, *Successful Tax Reform*, pp. 10-15.

3. Improving the Design of Tax Expenditures

The preceding section has focused on the reduction or elimination of tax expenditures. However, even when the concept was in its infancy critics of tax expenditures recognized that many, if not most, of the then extant tax expenditures would or should be retained but argued that their design ought to be improved.⁵¹ The 1980s in Canada saw the adoption of new principles of tax expenditure design. First, was the preference for tax credits over tax deductions; second, was the principle of refundability.

Traditionally, assistance delivered through the income tax system came in the form of a deduction that would reduce taxable income -- the base to which the tax rate was applied. To the extent that taxable income was otherwise at a level that resulted in a positive tax assessment, application of a deduction caused a reduction in the amount of tax payable. This system also has the characteristic that the higher the taxpayer's marginal tax rate, the higher is the cash value of a deduction of a given amount. That is, a \$100 tax deduction is worth \$50 to someone in a 50 percent tax bracket while the same \$100 tax deduction is worth \$35 to someone in a 35 percent tax bracket. Critics feel that this device favours higher income taxpayers and violates equity principles.

Alternatively, tax assistance could be provided in the form of a tax credit that is applied directly against tax otherwise payable rather than against taxable income. In this case, a \$35 tax credit would be worth exactly the same amount to someone in a 50 percent tax bracket and to someone in a 35 percent tax bracket. Proponents of the use of

tax credits regard this as a better result, from an equity point of view. The June 1987 *White Paper* announced that a whole series of personal deductions were to be converted to tax credits.

The other design principle to gain acceptance was that of refundability. One of the characteristics of both tax deductions and tax credits is that they have cash value only to a taxpayer who otherwise has tax payable. So, for example, someone might be entitled to a deduction for dependent children but might have such low income that they are already paying no tax; the tax deduction is worthless to him/her. To resolve this problem, the government could turn the deduction into a refundable tax credit. “Refundability” means that if the subtraction of the amount of the tax credit from the amount of tax otherwise payable results in a negative number, a cash payment will be made equal to the absolute value of that negative number. The first use of a refundable tax credit in Canada came with the introduction of the Refundable Child Tax Credit in 1978. It replaced a non-refundable tax credit of \$50 per child that had been granted the year before.⁵²

The refundability feature need not be applied only to social benefit type tax expenditures. One of the complaints about assistance to corporations is that it is often the cash-strapped, non-taxable corporations that would benefit most from assistance but they cannot benefit because they have no taxable income or no tax payable against which to apply an ordinary deduction or tax credit. A refundable tax credit has the potential to put

⁵¹ *The Hidden Welfare System*, p. 35.

cash into the hands of those corporations that need it most. The SRTC was designed with a refundability feature for this reason. However, despite the merits of refundability, in that case it contributed to the flawed nature of the program that made it such a disaster.

While the use of refundable tax credits in the Canadian tax system is now well established, it is not widespread, no doubt in recognition of the risks that they entail. However, some refundable tax credits, such as the Goods and Services Tax Credit (GSTC) are vital elements of current tax policy. More will be said about the GSTC in the next chapter.

4. Income Redistribution

Returning to the link between changes to scope rules and changes to payoff rules within the tax policy making process, some recent articles that look at the effects of Canadian tax reforms are illuminating.

Neil Brooks explains Canadian tax reform in terms of a shift in the prevailing ideology from liberalism to neoconservatism. The base-broadening, rate-lowering reforms were justified as part of a strategy to reduce the influence of government on business decisions and to allow the market to operate with fewer impediments. While the base-broadening efforts generally operated to the detriment of high income earners, who were the primary beneficiaries of tax expenditures, the lower rates -- in particular, the

⁵² Brigitte Kitchen, "A Canadian Compromise: The Refundable Child Tax Credit," *Canadian Taxation, A Journal of Tax Policy*, Vol. 1, No. 3 (Fall 1979), p. 44-45.

reduction in the top marginal rates -- were offered in compensation. What we can infer from Brooks' argument is that while scope rules had changed to cause the elimination of many tax expenditures, payoff rules governing the overall distribution of the tax burden had not. Therefore, tax rates had to be adjusted in order to offset the effects of changes to scope rules that, in themselves, would violate the payoff rules. Brooks argues that some tax expenditures -- relating to child care expenses, investments in flow-through shares, exempt capital gains, and registered pension plan contributions -- were not eliminated because the loss in benefits from doing so would have fallen primarily on the well-to-do.⁵³

An economist, Patrick Grady, performed a quantitative analysis of the tax changes introduced by the Mulroney Conservatives over the period 1984 to 1992. Using the Statistics Canada SPSPD/M⁵⁴ software and data base, he looked at the tax changes from perspective of their effect on the progressivity of the tax system. Grady summarized his findings, which were based on calculations of the change in taxes paid by income class, as follows:

“...the tax changes are very progressive in the aggregate for families earning less than \$35,000 per year, become roughly proportional...for families earning between \$40,000 and \$75,000, and then become regressive...for families earning more than \$150,000...The regressivity at the highest income levels reflects the

⁵³ Neil Brooks, “The Changing Structure of the Canadian Tax System: Accommodating the Rich,” *Osgoode Hall Law Journal*, Vol. 31, No. 1 (1993), pp. 143-149; 155-157.

⁵⁴ “SPSPD/M” stands for “social policy simulation database and model.”

reduction in the top marginal income tax rates and the \$100,000 lifetime capital gains exemption...”⁵⁵

Howard, Ruggeri, and Van Wart looked at roughly the same period as Grady, but focused their analysis on changes in marginal tax rates. Taking the marginal tax rates for a composite of payroll, income and sales taxes, they found that between 1986 and 1993 there was a fairly complex pattern of marginal rate increases and decreases across income classes. Generally, however, there was a reduction in marginal rates for individuals with less than about \$6,500 in annual income, an increase in marginal rates for individuals having annual income in the range from about \$6,500 to about \$55,100, and a decrease in marginal rates for individuals having an annual income higher than about \$55,100. The highest marginal rate increase -- 15.3 percentage points -- occurred at around \$30,000 in annual income and the largest marginal rate decrease -- 5.61 percentage points -- occurred at annual income levels in excess of about \$89,000.⁵⁶

The preceding discussion deals with the effects of taxation on the economic welfare of individuals. However, as Brooks notes, an explicit objective of Canadian tax reform was to narrow the range of variation among marginal tax rates applicable to particular industries.⁵⁷ The rationale behind this objective was the desire to reduce the distorting effects of taxation on business investment decisions. In theory, the competitiveness and, therefore, the attractiveness of high-tax industries was being

⁵⁵ Patrick Grady, “Conservative Federal Tax Increases,” *Canadian Business Economics*, Vol. 1, No. 1 (1992), pp. 19-20.

⁵⁶ R. Howard, G. C. Ruggeri, and D. Van Wart, “Federal Tax Changes and Marginal Tax Rates, 1986 and 1993,” *Canadian Tax Journal*, Vol. 43, No. 4 (1995), p. 921, Table 4.

impaired and low-tax industries were attracting more investment than would be justified by their underlying economic realities. Average federal corporate taxes as a percentage of financial statement income across nine major economic sectors ranged from a low of 14.5 percent for financial institutions, insurance and real estate to a high of 24.5 percent for the wholesale trade. The overall average across all sectors was 18.7 percent.⁵⁸

5. Transition Provisions

One of the things that was found to be offensive about the 1981 MacEachen budget was what one of the people interviewed for this study described as its retroactivity.⁵⁹ The budget was put together in considerable haste due to the shift in budget strategy, in late Spring, towards deficit fighting and away from inflation fighting. By the time the base-broadening moves were identified, there was little time left to attend to the painstaking work of identifying potential implementation problems and accommodating these during the technical drafting of the notice of ways and means motion.

Many taxpayers found themselves in the unhappy position of having entered into commitments based on a certain expectation of how the tax regime would operate only to find that the ground had shifted without any provision having been made for relief of those who would be adversely affected. The 1971 tax reform had allowed for transition

⁵⁷ Brooks, "The Changing Structure of the Canadian Tax System," p. 175-176.

⁵⁸ *Income Tax Reform* (Ottawa: Canada, Department of Finance, June 18, 1987), p. 16, Chart 2.5.

⁵⁹ Interview No. 23.

provisions and “grandfathering” and there was an implicit understanding that the scope rules for tax policy making forbade punitive outcomes of the sort threatened by the 1981 budget, had it been fully implemented.

Accepting that transition smooting was one of the relevant scope rules in existence at the time, then the rules have not really changed since then. However, the deviation from an established institutional norm prompted a swift sanction in the form of harsh public opinion.⁶⁰ This provided strong reinforcement of the rule that “no transactions for which firm commitments have been made, and that are legal under the existing legislation, should be made illegal after the fact by legislation that has a retroactive effect”⁶¹ and, it will be argued in the next chapter, set in motion changes in other rules aimed at ensuring that this scope rule would always be respected.

The scope rules concerning transition provisions may even go further. To take one recent example, when the government decided to bring the lifetime capital gains exemption to an end (except as it applied to farmers and small businesses) it provided a transition period to ensure that anyone who had so far failed to take advantage of the exemption would be given one last chance to do so. Thus, remaining eligible gains as at 22 February 1994 could still be sheltered up to 31 December 1994.

⁶⁰ Andrew Schotter, *The Economic Theory of Social Institutions* (Cambridge: Cambridge University Press, 1981), p. 11, refers to the self-policing nature of some social institutions.

⁶¹ *Report of the Auditor General* (1986), paragraph 4.23.

6. Compliance Costs

The most obvious kinds of outcomes affected by tax policies are the level and distribution of the tax burden and the level and distribution of benefits available under tax expenditure programs. In addition, the impacts of the incidence of these burdens and benefits on economic efficiency come easily to mind as another type of outcome. More recently, the burden of so-called compliance costs have come to be recognized as another kind of outcome.

The requirement to pay taxes in today's world carries with it certain administrative responsibilities for taxpayers and others. For example, businesses may need to keep certain records in order to be able to determine their tax liabilities or to satisfy the taxation authority as to the accuracy and appropriateness of information contained in tax returns. There is a cost associated with preparing these records and this cost is one example of a compliance cost. The more onerous the demands of the taxation authority, the greater the compliance costs that must be borne by taxpayers and others.⁶²

More and more there is an expectation that tax policy makers will design tax legislation with a view to minimizing the burden of compliance costs that is imposed. A

⁶² Another way to explain the concept of "compliance costs" is to distinguish them from "administrative costs." The difference has nothing to do with the substantive nature of the costs or the activities that give rise to them. The difference is entirely a matter of who incurs the cost. Compliance costs are borne by taxpayers and others (not government) while administrative costs are borne by government. One can imagine circumstances in which a given activity (say, keeping a particular record) could be performed either by taxpayers or by the government (Revenue Canada). If the activity is performed by

Department of Finance official interviewed for this study cited the example of a review currently under way to look at structural issues related to the imposition of certain excise taxes.⁶³ In large measure, the legislative amendments that will arise from this review will be aimed at creating a statute that is easier for businesses in the affected industries to comply with, given the changes to business practices that have happened since the *Excise Act* was first passed a century ago.

Perhaps no other change to the tax system in Canadian history has put the spotlight on the issue of compliance costs as has the introduction of the Goods and Services Tax (GST) in 1991. Nearly 2,000,000 businesses were going to become agents for the collection of the tax for the federal government and would have to file tax returns in order to remit the tax they had collected and claim input tax credits. The attendant costs of this new activity (all but 80,000 of these businesses would have had no similar responsibilities under the former manufacturer's sales tax) were expected to be significant. To alleviate the burden on small businesses, the federal government offered \$1,000 grants to be applied to costs incurred in preparation for the GST (for example, purchase of new cash registers).⁶⁴

In order to better understand the nature and magnitude of GST compliance costs, the Department of Finance commissioned a study by Plamondon & Associates Inc.. The Plamondon study criticizes the methodology used by the Canadian Federation of

taxpayers, the cost is considered a compliance cost; if the activity is performed by Revenue Canada, the cost is considered an administrative cost.

⁶³ Interview No. 12.

⁶⁴ *Report of the Auditor General of Canada to the House of Commons for the Fiscal Year*

Independent Business to arrive at its estimate that compliance costs amounted to 40 percent of GST remittances. The Plamondon study found that compliance costs ranged from 3.74 percent of remittances for businesses with annual revenues over \$1,000,000 to 17.62 percent of remittances for businesses with annual revenues less than \$100,000. All businesses in the Plamondon sample were considered to be small.⁶⁵

Concern over compliance costs was evident in the debate about finding a replacement for the GST.⁶⁶ Reduced compliance costs for businesses was listed among the key benefits of a single harmonized tax system in the technical paper which accompanied the announcement of the creation of a harmonized sales tax between the federal government and three Atlantic provinces.⁶⁷

7. The *Canadian Charter of Rights and Freedoms*

The *Canadian Charter of Rights and Freedoms*, forming as it does a part of the constitutional law of the country, occupies a place at the summit of the institutional framework governing the tax system. The *Charter* is thus a key contextual element that partly determines the scope rules that apply to tax policy. The advent of the *Charter*, from the point of view of the tax policy making system, is an exogenous event that occasions changes within the system by virtue of the *Charter*'s constitutional status. The

Ended 31 March 1992 (Ottawa: Supply and Services Canada, 1992), paragraph 20.88.

⁶⁵ Plamondon & Associates Inc., *GST Compliance Costs for Small Business in Canada: A Study for the Department of Finance Tax Policy* (Ottawa, 1993), pp. 3, 112.

⁶⁶ See, for example, "Replacing the GST: Options for Canada," *Ninth Report of the Standing Committee on Finance* (Ottawa: House of Commons, June 16, 1994), pp. 16-17.

⁶⁷ *Harmonized Sales Tax Technical Paper* (Ottawa: Canada, Department of Finance,

media for these changes include the courts, the government bureaucracy and the legislature.

Statutes such as the *Income Tax Act*, the *Excise Tax Act*, and the *Excise Act* form the foundation for the institutional framework governing the operation of the tax system. These statutes are supplemented by the common law as it applies to taxation matters, administrative policies, and so on, to complete the institutional framework. Together, this institutional framework comprises the aggregation, authority, boundary, information, payoff, position, timing, and scope rules applicable to the tax system. Rules falling into any of these categories are potentially the output of the tax policy making system. In other words, there are two levels of institutional framework: one governing the tax system and one governing the tax policy making system. The point of emphasizing this distinction is simply to clarify that an output of the tax policy making system (and, therefore, subject to that system's scope rules) may be, for example, an authority rule to be applied to the operation of the tax system.

When it comes to considering the impact of the *Charter* on the output (a scope element) of the tax policy making system, one has to consider the impact on the kinds of authority rules (what actions are/are not permissible) that the tax policy system creates for application in the tax system. In fact, this was the area in which the impact of the *Charter* was first felt.

In the course of administering the *Income Tax Act* the government may require certain information that is in the possession of a taxpayer. From time to time, a taxpayer may not be forthcoming with such information and the government has to resort to the methods of search of the taxpayer's premises and seizure of records in order to obtain the sought after information. The government's powers of search and seizure in relation to income tax matters are set out in the *Income Tax Act*.

After the *Charter* came into force, the search and seizure provisions of the *Income Tax Act* that existed at the time were challenged and struck down. At about the same time, the Supreme Court of Canada rendered a decision in a similar case involving the *Combines Investigation Act*. The Supreme Court's decision included an enumeration of minimum standards that such legislation must meet for it to satisfy the requirements of Section 8 of the *Charter*, which gives everyone the right to be secure against unreasonable search or seizure. New provisions were added to the *Income Tax Act* to replace those that had been struck down. The new provisions were based upon the criteria set out by the Supreme Court. However, these also came under challenge in the courts and, like their predecessors, were struck down.⁶⁸

Even without the intervention of the courts, the Department of Finance was cognizant of the need to update legislation that pre-dated the *Charter* to bring that legislation into line with the values embodied in the *Charter*. One official interviewed

⁶⁸ Allison Scott Butler, "Charter Challenges to Income Tax Provisions," in *Report of Proceedings of the Forty-Sixth Tax Conference*, (Toronto: Canadian Tax Foundation, 1995), pp. 29:2-3; *Minister of National Revenue, et al. v. Kruger Inc., et al.*, (84 DTC

for this study cited an example concerning the *Excise Act*.⁶⁹ That legislation provided for something called writs of assistance, which were like search warrants. Using a writ of assistance, a Royal Canadian Mounted Police officer could enter any premises where there was a suspicion that alcohol or tobacco products were being illegally produced or stored. Because these writs did not have to be justified before a judge, they offended the *Charter*. The *Excise Act* was amended to repeal the right of Royal Canadian Mounted Police Officers to carry writs of assistance.

While these examples deal with particular authority rules (that is, those pertaining to search and seizure) within the institutional framework of the tax system, their resolution also establishes a scope rule at the level of the tax policy making system. Should it happen that tax policy makers in the future contemplate making changes to the search and procedure provisions they must recognize that their scope for action is circumscribed by the *Charter* and the jurisprudence related to it.

Next, we deal with a case in which the *Charter* played an important role in bringing about a change to a scope rule contained in the tax system despite the fact that the rule in question, prior to the change, did not contravene the *Charter*, according to the Supreme Court. This is the highly publicized case of Suzanne Thibaudeau.

Ms. Thibaudeau is a divorced mother who received child support payments from her former husband. The *Income Tax Act* required a person in Ms. Thibaudeau's position

6478); *Lawson A. W. Hunter, et al. v. Southam Inc.*, (84 DTC 6467); *Berl Baron and Howard Baron, C.A. v. Her Majesty the Queen, et al.*, (91 DTC 5055).

to include the child support payments in that person's taxable income; the person making the payments was entitled to claim them as a deduction from income. This system was predicated on the assumption that it is the higher income person who makes child support payments to the lower income person. Given the progressive income tax rate structure, this should produce the result that the higher income person gets the deduction and the lower income person pays the income tax -- but at a lower rate than would have been the case had the higher income person had to pay it. In theory, this should minimize the tax burden over all and, therefore, maximize the amount of money, net of tax, available for support of the children.

Ms. Thibaudeau claimed that the requirement that she include child support payments in her income violated her right to equality under section 15 of the *Charter*. She won her case at the Federal Court of Appeal, but the Supreme Court of Canada overturned that decision (with the Supreme Court judges split 5 to 2 on gender lines). The majority accepted the merit of the rationale for the inclusion-deduction system and did not view the taxation of the child support payments as placing a burden on the recipient of a type that would offend section 15 of the *Charter*.⁷⁰ Although she lost the case, Ms. Thibaudeau's battle galvanized support for the notion that the income tax rules, while constitutional, were unfair. In time, the federal government felt compelled to get rid of the inclusion-deduction system that had stood for over 50 years.⁷¹

⁶⁹ Interview No. 12.

⁷⁰ Joseph Frankovic, "Thibaudeau Case Overturned by Supreme Court," *Tax Topics*, June 8, 1995 (CCH Canadian Limited).

⁷¹ "Tax on Child Support to Die," *Globe and Mail*, March 5, 1996.

Many other court cases have attempted to challenge aspects of the *Income Tax Act* on Charter-based grounds. Section 15 of the *Charter*, dealing with equality rights, has been a popular basis for such challenges, however, as with the Thibaudeau case, none have succeeded in having any provision of the *Income Tax Act* struck down. I will briefly mention two of the better-known examples.

Elizabeth Symes unsuccessfully argued that the prohibition against claiming child care expenses as a business deduction offended section 15 because this prohibition, although seemingly gender-neutral, in fact discriminated against women, who would be more likely to incur expenses of this nature.⁷² Elaine Schachtschneider unsuccessfully argued that her inability to claim the “equivalent-to-married” non-refundable tax credit in respect of her child (Ms. Schachtschneider lived with her spouse but did not support him) offended section 15 because an unmarried woman living with her common law spouse in similar circumstances would be able to claim the tax credit and that this difference amounted to discrimination on the basis of marital status.⁷³

According to a former Department of Finance official, it is probable that the advent of the *Charter* led to the government’s decision to redefine the notion of a “spouse” for income tax purposes.⁷⁴ In fact, it proved to be difficult to find a definition that would work from a technical standpoint yet satisfy the requirements of the *Charter*.

⁷² Butler, “Charter Challenges to Income Tax Provisions,” pp. 29:10-11; *Elizabeth C. Symes v. Her Majesty the Queen, et al.*, (94 DTC 6001).

⁷³ Butler, “Charter Challenges to Income Tax Provisions,” p. 29:16; *Elaine Schachtschneider v. Her Majesty the Queen*, (93 DTC 5298).

⁷⁴ Interview No. 10.

Even so, this official indicated that the issue has not yet been resolved in respect of same sex couples.

A social policy consultant interviewed for this study offered the view that it ought not to be surprising that the *Income Tax Act* is resistant to equality-based challenges. The notion of vertical equity -- treating taxpayers in different circumstances differently -- is fundamental to the theory of taxation. In his words, "The tax system is all about drawing distinctions."⁷⁵

Finally, section 2 of the *Charter*, dealing in part with freedom of conscience and religion has been invoked as an argument against the payment of taxes. As one example, Jerilynn Prior, a Quaker and a pacifist, objected to paying taxes on the grounds that the money would be used to support the military. This case and others like it have been unsuccessful.⁷⁶

8. Comparison of Empirical Findings to Theory

This chapter has identified three significant changes to scope and payoff rules: (1) limitations on the design and use of tax expenditures; (2) limitations on the imposition of compliance costs on taxpayers and others; and, (3) requirements for the observation of Charter rights and freedoms. The chapter also speaks of reinforcing the rule requiring the use of transitional arrangements when introducing tax policy changes.

⁷⁵ Interview No. 7.

The changes and the emphasis on the rule concerning transitional arrangements can be explained by sociological (isomorphism) and/or economic (transaction cost minimization) factors.

A number of the people interviewed for this study are of the opinion that we will never again see tax expenditures the likes of the Scientific Research Tax Credit and the Lifetime Capital Gains Exemption.⁷⁷ One person regarded 1984, the year the SRTC moratorium was announced, as the watershed year for tax expenditures.⁷⁸ The falling from favour of tax expenditures can be seen as an example of mimetic isomorphism in action.⁷⁹ As more and more countries undertake tax reform, pressure grows on those remaining to do the same. As particular features of tax reform gain acknowledged approval, the likelihood is greater that late-reforming countries will adopt generally accepted strategies. Such pressures are harder to resist the more there are stakeholders in the environment, such as major multinational corporations and international institutions, that implicitly or explicitly endorse the strategies and on which a late-reforming country is somehow dependent for support.

Sandford gives six ostensible reasons why tax reform appeared when it did as a world wide phenomenon and why it displayed particular characteristics. These are: (1)

⁷⁶ Butler, "Charter Challenges to Income Tax Provisions," p. 29:17; *Jerilynn Prior v. Her Majesty the Queen*, (88 DTC 6207).

⁷⁷ Interview Nos. 2, 3, 4, 9, 12, 16, 19, 23, 28, and 30.

⁷⁸ Interview No. 23.

⁷⁹ Paul J. DiMaggio and Walter W. Powell, "The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields," in *The New Institutionalism in Organizational Analysis*, eds. Walter W. Powell and Paul J. DiMaggio (Chicago: University of Chicago Press, 1991), p. 67.

extreme discontent with the existing system; (2) widespread belief that taxes were failing to achieve their social and economic objectives; (3) concern that high marginal tax rates were causing economic distortions; (4) the economic environment facing all countries was changing; (5) international influences helped to spread the tax reform movement; and, (6) a general change in economic philosophy.⁸⁰

A common feature of world wide tax reform was the broadening of tax bases, in large part through the elimination of tax expenditures, and the lowering of tax rates. This was the pattern followed by the United States in 1986 and Canada had little choice but to follow suit -- an example of how international influences helped to spread the tax reform movement. In this instance, isomorphism was facilitated by the close economic ties between Canada and the United States such that Canada had to maintain competitive marginal tax rates in order to avoid the flight of labour and capital to its large, powerful neighbour.

One can also look at the same phenomenon from the perspective of transaction cost economics. Sandford's reference to economic philosophy brings to mind North's thoughts on the influence of ideology on institutional change. North argued that institutional innovation occurs when justified on cost-benefit terms.⁸¹ Further, the costs of maintaining existing arrangements are inversely related to the perceived legitimacy of

⁸⁰ Sandford, *Successful Tax Reform*, pp. 16-20.

⁸¹ Lance E. Davis and Douglass C. North, *Institutional Change and American Economic Growth*, (New York: Cambridge University Press, 1971), p. 10.

those arrangements.⁸² Therefore, when ideological shifts reduce the perceived legitimacy of institutional arrangements the cost of maintaining them rises and the opportunity for institutional change increases.

A number of the people interviewed for the study noted an ideological shift affecting the scope rules applicable to tax policy making.⁸³ Efficiency, fairness and equity across industrial sectors have become dominant values. This points in the direction of a neutral tax system that does not distort business decisions, a direction that is contrary to that embodied in tax expenditures that are intended to affect business decisions. The trend towards more limited acceptance of new tax expenditures and towards the removal of many existing ones is consistent with the dominant economic ideology of the day. The interventions by the Blenkarn Committee and the Auditor General are expressions of this ideology and help to promote it.

Moreover, the SRTC fiasco went a long way towards souring tax policy makers on the notion of tax expenditures. The reaction of politicians to these experiences, it is argued, has led to the institutionalization of scope rules that severely inhibit the future use of such measures. The stories of the Scientific Research Tax Credit and the Lifetime Capital Gains Exemption illustrate most vividly the potential for tax expenditures to become very costly in terms of foregone tax revenue and even to induce tax avoidance behaviour. In the language of transaction cost theory, this is an example of opportunism on the part of taxpayers that imposes a cost on the government. The limitations on the

⁸² Douglass C. North, *Structure and Change in Economic History* (New York: W. W. Norton & Company, 1981), p. 53.

design and use of tax expenditures are institutional responses aimed at economizing on these costs.

As an aside, this response illustrates March and Olsen's observation that rules reflect historical experience in a way that makes the rules accessible to individuals who have not themselves lived through the experience.⁸⁴ At the very least, any new economic-incentive-type tax expenditures are likely to be much less generous and subject to much tighter controls than were either of these measures.

However, it must be acknowledged that tax expenditures may experience a revival. As the deficit is brought under control and as interest groups continue to press for support of their special interests, tax policy makers' resistance to new tax expenditures may wane. What is more, changes to the Canadian federal bargain have reduced the federal government's ability to use its spending power. As a consequence, the tax system will become a more attractive instrument of federal government policy.

The school of thought represented by North and Williamson maintains that institutions develop as means to economize on transaction costs. All possible institutional arrangements have transaction costs associated with them, which implies that choice involves a comparison of alternative institutional arrangements to determine

⁸³ Interview Nos. 2, 3, 4, 23, 28, and 30.

⁸⁴ James G. March and Johan P. Olsen, *Rediscovering Institutions: The Organizational Basis of Politics*, (New York: The Free Press, 1989), p. 37.

which one is least costly.⁸⁵ In the context of the institutional arrangement known as the tax system, a subset of the associated transaction costs have been identified within the public finance literature as “compliance costs.” With the existence and magnitude of compliance costs now more generally understood, there is pressure upon tax policy makers to consciously design tax provisions in order to minimize those costs. This compliance cost minimization rule belongs to the class of scope rules, since it deals with an outcome of the tax system -- the resources consumed in operating the tax system. The operation of the compliance cost minimization rule has been particularly evident in the controversy over the implementation of the GST. The review of the *Excise Act* currently under way is an example of deliberate institutional adaptation that is motivated in large measure by a desire to reduce compliance costs.

Transaction cost minimization theory may also explain the tendency -- which runs counter to the general trend in reduction of tax expenditures -- for the use of the tax system to deliver social benefits, such as the child tax benefit and the GST Credit. Canada has a very high proportion of its citizens who file income tax returns, which means that the tax system forms a valuable data base that can be used for program delivery purposes. By piggybacking social programs on the income tax system, the government is able to economize on costs associated with what would otherwise be the creation and maintenance of a data base of the clientele.

⁸⁵ Oliver E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, 1985), pp. 17, 21-22.

In the case of the SRTC, one observes the government's reaction to opportunistic behaviour by taxpayers. In the case of the 1981 MacEachen Budget, one observes taxpayers' reaction to what many regarded as opportunistic behaviour by government. Assumptions about the fiscal regime upon which financial decisions had been made were turned upside down. The government violated an institutional rule requiring that adequate transitional measures be designed to protect taxpayers who had made commitments based on the former fiscal regime and in so doing had imposed significant transaction costs on taxpayers. Taxpayers' emphatic reaction to the government's actions served to reinforce the observance of this rule in the future.

The changes to the search and seizure provisions of the *Income Tax Act* and the *Excise Act* are the outcome of the process of coercive isomorphism identified by DiMaggio and Powell.⁸⁶ The status of the *Canadian Charter of Rights and Freedoms* demands that tax policy makers align the statutes governing the tax system to the *Charter*. The courts have been key players in bringing about this alignment by striking down legislation that offends section 8 of the *Charter*.

However, regarding arguments in respect of *Charter* rights to freedom of conscience and religion and to equality, the courts have not been proactive in bringing about change to taxation statutes. This can be explained by Posner's observation that the legal process tends to subordinate distributive considerations.⁸⁷ The cases involving sections 2 and 15 have dealt with the actual imposition of the tax burden, with obvious

⁸⁶ DiMaggio and Powell, "The Iron Cage Revisited," p. 67.

distributional implications, while the cases involving section 8 merely dealt with obtaining access to taxpayers' records. Posner points out that legislatures are much better placed to make distributional judgements. For their part, judges apply statutes in accordance with the original "deal" between the legislature that enacted the statutes and the beneficiaries of the legislation.⁸⁸

⁸⁷ Richard A. Posner, *Economic Analysis of Law*, Fourth Edition (Boston: Little, Brown and Company, 1992), p. 520.

⁸⁸ Posner, *Economic Analysis of Law*, pp. 524, 534.

Chapter Five: Changes to the Authority, Information and Timing Rules

1. Introduction

In Chapter 4 we dealt with scope rules, which brought us into contact with substantive tax policy. In this chapter we deal with authority, information and timing rules, which are oriented more towards the process of tax policy making. Recalling Elinor Ostrom's definitions, authority rules specify the set of actions assigned to a position at a particular node, and information rules authorize the channels of communication among participants in positions and specify the language and form in which communications take place.¹ The notion of timing rules is implied by Schotter, who speaks of the sequence of moves or turns applicable to players in a game.² Although conceptually distinct, the changes to the rules to be considered in this chapter are closely bound together.

The title of Linda McQuaig's popular account of the tax policy making process as it was up until the mid-1980s, *Behind Closed Doors*, suggests a process that was very dark and secretive. In contrast, a few years later Irwin Gillespie spoke of the government's use of a consultative strategy in tax policy making. Since then, the extent to which a consultative strategy is used has increased. This chapter traces the nature and

¹ Elinor Ostrom, "An Agenda for the Study of Institutions," *Public Choice*, 48 (1986), p. 19.

² Andrew Schotter, *The Economic Theory of Social Institutions* (Cambridge: Cambridge University Press, 1981), p. 110.

causes of changes to the institutional rules that facilitated or accompanied the development of the present approach to tax policy making.

It is argued that the negative reaction to the MacEachen budget of 1981 acted as a catalyst that converted latent discontent with the process of federal budget making into a resolve to update the traditional notion of budget secrecy. This was manifested in more frequent and open exchanges of views between interest group representatives and the Minister of Finance and his officials. A short while later, demands by Members of Parliament for a more meaningful role in policy making helped create a more activist House of Commons Standing Committee on Finance. This development was greatly aided by the presence of an ambitious and effective leader of the Committee in the crucial formative years of operation under the new paradigm.

Other important changes involved placing budget making on a far more regular and predictable time table and the separation, to a large extent, of so-called “technical” changes to tax legislation from “budgetary” changes. Technical changes could then proceed through the legislative process independently of budgetary changes and would not be encumbered by the tradition of budget secrecy.

Finally, the increased availability of information relevant to tax policy making and of analytical tools gave participants outside the Department of Finance greater capacity to evaluate current tax policies and to mount persuasive arguments in favour of proposals that they put forward.

2. Advocacy for Reform of the Budget Process

To put the changes to the authority, information and timing rules into proper perspective, it is necessary to review the history of a movement to reform the budget process. As early as 1964 criticism of the budget process was being voiced.³ However, it was in 1977 that a crucial milestone was reached when the Canadian Tax Foundation weighed in with a report to Finance Minister Jean Chrétien by a committee formed to examine the tax legislative process.⁴

The Committee distilled its detailed criticisms into two summary points:

“(1) there is no formal and public way in which persons outside government may engage in a debate concerning the policies that ought to be considered by the Minister in preparing his budget; and (2) because the clause-by-clause consideration of a tax bill is conducted in a committee of the whole House, there is usually no effective way in which informed members of the tax community outside of government can examine the proposed amendments and suggest corrections before they become law.”⁵

The Committee went on to suggest numerous possible reforms: some it endorsed as proposals and others it presented as options to its main proposals which nevertheless merited consideration. Some of the more influential suggestions included opening up proposed tax policy, fiscal policy and “structural” changes to public debate via a parliamentary subcommittee; giving the Minister of Finance greater freedom to retain private consultants to comment on policy options; publication of draft legislation;

³ Canadian Tax Foundation, Tax Legislative Process Committee, “The Tax Legislative Process,” *Canadian Tax Journal*, March-April 1978, pp. 160-161.

⁴ CTF Tax Legislative Process Committee, “The Tax Legislative Process,” p. 157.

publication of explanatory memoranda to accompany bills containing amendments to the *Income Tax Act*; and, separating proposed policy and structural changes into separate bills so that they might be processed through Parliament differently.⁶ Mickey Cohen, the Assistant Deputy Minister in charge of Tax Policy Branch, was quite supportive of the ideas raised by the Committee.⁷

It would be about four years before another work with the scope and high profile of this one would appear. In March 1982, another Canadian Tax Foundation committee presented another report to the Minister of Finance, Allan MacEachen.⁸ The event that triggered the renewed interest in the topic of the budget process was the budget of November 12, 1981. Before considering the content of the Committee's report, we will briefly discuss the budget that prompted it.

As noted in chapter 3, the 1981 MacEachen budget put forward a major program of tax reform. The general thrust of the budget -- base broadening and rate lowering -- was a hallmark of later tax reform in Canada and of tax reforms around the world. Despite this, at the time the budget was presented the reaction that it received was nothing short of vitriolic. How could reforms of this magnitude be presented virtually

⁵ CTF Tax Legislative Process Committee, "The Tax Legislative Process," p. 164.

⁶ CTF Tax Legislative Process Committee, "The Tax Legislative Process," pp. 159-160, 176.

⁷ Marshall A. Cohen and Donald R. Huggett, "The Budget Process and Income Tax Changes," in *Report of Proceedings of the Twenty-Ninth Tax Conference*, (Toronto: Canadian Tax Foundation, 1978), p. 7.

⁸ Canadian Tax Foundation, Committee on the Budget Process, "On Opening Up the Budget Process: A Report to the Honourable Allan J. MacEachen, Minister of Finance, from a Committee Formed Under the Auspices of the Canadian Tax Foundation," *Canadian Tax Journal*, March-April 1982, p. 161.

“out of the blue”? Critics immediately focused on shortcomings in the budget process itself.

Various persons interviewed for this study offered the following perspectives on the process followed in preparing the 1981 budget.⁹ The budget was put together, for the most part, by a handful of people, two of whom had little prior experience in budget preparation. Because the budget strategy -- to secure a gain of about \$2 billion in tax revenue by closing loopholes -- was decided only in mid-spring, there was only about a two month window during which to perform the necessary analysis of potential revenue saving measures. This, in turn, meant that there was little time for legislative drafting and preparing for public reaction to the budget. Consultative efforts, while not completely absent, were not what they should have been, given the magnitude of the changes being contemplated. The notice of ways and means that accompanied the budget was very general. Some of the rules employed in implementing the tax changes were quite arbitrary and insufficient attention was given to grandfathering provisions to ease the transition from the old regime to the proposed new regime.

The process followed in preparing the 1981 budget was not typical, yet it was taken to exemplify the malaise caused by strict application of the doctrine of budget secrecy. The Canadian Tax Foundation annual conference was held shortly after the budget was brought down and Finance officials attending the event were able to experience the displeasure of tax practitioners first hand. The press and opposition politicians joined tax practitioners in denouncing the lack of pre-budget consultation.

The budget was soundly criticized in the House, and by Christmas the government had to back down on perhaps as many as 15 proposals. Ultimately, however, much of the budget did survive. Gillespie has suggested that the process followed by MacEachen was intended to spark consultation after the budget was presented.¹⁰ However, another commentator says "The fact that Allan MacEachen has many changes in his 1981 Budget is viewed not as a virtue but as an admission of incompetence."¹¹ In any event, thanks to the MacEachen budget, the reform of the budget process was put back on the public agenda.

In large measure, the report of the 1982 CTF committee echoed the views expressed by the 1977 CTF committee. However, the 1982 report did raise some new points and at times gave greater emphasis to points that had been raised in the earlier report. In years to come, certain of the 1982 committee's concerns and recommendations would be reflected in changes to the process, including: a need for greater communication and coordination of fiscal policies between the federal and provincial governments; a proposal for the use of ad hoc consultative committees to advise the Department of Finance on technical tax questions; and, a proposal that all major tax changes be preceded by Green or White Papers.¹²

⁹ Interview Nos. 6, 10, 19, 23, and 26.

¹⁰ W. Irwin Gillespie, *Tax, Borrow and Spend: Financing Federal Spending in Canada, 1867-1990* (Ottawa: Carleton University Press, 1991), pp. 197-201.

¹¹ Arthur Drache, "Improving the Budget Process," *Policy Options*, September-October 1982, p. 15.

The Minister of Finance, at whose invitation the CTF committee had prepared its report,¹³ responded with a Green Paper on the budget process.¹⁴ Not surprisingly, the Green Paper covered much the same ground that the two CTF committee reports had covered, but it was unique in that it gave prominence to the issue of budget timing.¹⁵ Its recognition of the merit of having a predictable annual budget period would prove to be portentous.

At this point in the debate over reform of the revenue budget process the basic terrain had been pretty much mapped out. Further contributions by authors such as Hartle, Drache and Young kept the debate alive and helped deepen the understanding of the issues.¹⁶ Then, in November 1984, Minister of Finance Michael Wilson announced that reform of the budgetary process was to form part of the government's agenda for economic renewal.¹⁷ The Conference Board of Canada responded with a study that identified twenty-one recommendations that had emanated from earlier works on the subject of budget process reform and, with the help of a sample of thirty experts,

¹² CTF Committee on the Budget Process, "On Opening Up the Budget Process," pp. 166-167.

¹³ Thomas E. McDonnell, "Toward Getting It Right: Reflections on 50 Years of the Tax Legislative Process in Canada," *Canadian Tax Journal*, Vol. 43, No. 5 (1995), p. 1140.

¹⁴ Canada, Department of Finance, *The Budget Process: A Paper on Budget Secrecy and Proposals for Broader Consultation*, reproduced in the *Canadian Tax Journal*, Vol. 30, No. 2 (March-April 1982) pp. 171-178.

¹⁵ Canada, Department of Finance, *The Budget Process*, pp. 175-176.

¹⁶ Douglas G. Hartle, *The Revenue Budget Process of the Government of Canada: Description, Appraisal, and Proposals*, Canadian Tax Paper No. 67 (Toronto: Canadian Tax Foundation, 1982); "Improving the Budget Process"; Robert A. Young, "Business and Budgeting: Recent Proposals for Reforming the Revenue Budgetary Process," *Canadian Public Policy*, Vol. 9, No. 3 (1983), pp. 347-361.

¹⁷ Recounted in *The Canadian Budgetary Process: Proposals for Improvement*, Budget Papers (Canada, Department of Finance, May 1985). Reproduced in the *Canadian Tax Journal*, September-October 1986. At p. 1015.

analyzed each one in detail. The number one conclusion of this study was that Canada needed a predictable annual budget timetable.¹⁸

In May 1985, the Minister of Finance tabled detailed proposals for reform of the budgetary process.¹⁹ The document acknowledged the changes that had been made to the process to date as a result of recommendations contained in the various works discussed above; it also affirmed a number of pending recommendations that were gaining general acceptance. Because some significant proposals had to do with the parliamentary process, the House of Commons Standing Committee on Procedure and Organization held hearings and issued a report on the proposals.²⁰ The Canadian Tax Foundation struck a committee to examine the Minister's proposals and published its response in 1986.²¹

The purpose of this short review has been to demonstrate the intellectual antecedents of many of the changes to the budget process that will be discussed in the remainder of this chapter. It has also been to identify the contribution of important players in the debate over reform of the budget process, in particular the contribution of the exchange of views between the Minister/Department of Finance and the Canadian

¹⁸ Evert A. Lindquist, *Consultation and Budget Secrecy: Reforming the Process of Creating Revenue Budgets in the Canadian Federal Government*, Study No. 86 (Ottawa: Conference Board of Canada, 1985), pp. x-xi.

¹⁹ Canada, Department of Finance, *The Canadian Budgetary Process: Proposals for Improvement*.

²⁰ *First Report of the Standing Committee on Procedure and Organization on The Canadian Budgetary Process: Proposals for Improvement* (Ottawa: House of Commons, June 26, 1985). Reproduced in the *Canadian Tax Journal*, Vol. 34, No. 5 (September-October 1986), pp. 1045-1070.

Tax Foundation. While these were not discussed, it is important to mention that at various times and in various of the works cited other suggestions for changes to the budget process been made but these have not been implemented. The reader must not be misled into believing that the march towards reform has been marked by consensus and comprehensive implementation of suggestions for improvement.

3. Consultation Involving the Minister of Finance

For years prior to the MacEachen budget of 1981 the Department of Finance had engaged in pre-budget consultations. Typically these were informal. Various groups would make private representations to the Minister and his officials, who would listen to the pleadings without tipping their hands as to what budget options they might be considering. Some of this occurred even before the 1981 budget. What the various interest groups found unsatisfactory was that it was not possible for them to know, prior to budget night, whether or not their arguments were finding a receptive audience. Moreover, if it happened that the government was contemplating an issue that an interest group had failed to anticipate, the interest group's views would not be brought forward. Interest groups could not react to the government's agenda because they were never sure what was on it.

From time to time the government introduced Green Papers to solicit comment on policy options that it was contemplating or it put together review committees to advise

²¹ Canadian Tax Foundation, Committee on the Budget Process, "The Canadian Budget Process," *Canadian Tax Journal*, September-October 1986, pp. 989-1094.

the Minister and departmental officials, but these were rather exceptional. In any event, the reaction and advice obtained through these vehicles tended to be considered within the Department of Finance and was not aired in a public forum. Reaction to budget proposals came after the budget had been announced publicly.

After taking a considerable amount of heat over the MacEachen budget, the Minister of Finance moved to introduce a more formal consultation process. In 1982, the Department of Finance set up a consultations group, lodged within the offices of the Senior Assistant Deputy Minister, whose job it was to formally establish year-round linkages with a small number of influential communities, such as business, labour, social and voluntary groups.

The following year, Consultations and Communications Branch was created. Headed by an official at the Director General level, the Branch represented an elevation of the role of consultations within the Department. The Branch provided full strategic communication planning and consultations services. Henceforth, budget policy development was accompanied by communications planning, in order to assess policy elements for communications risks. The Branch identified groups with whom consultations should take place and undertook public opinion research, if necessary. By the mid- to late 1980s, polling and focus group research was viewed as an almost essential adjunct to major policy initiatives.

The success of an experiment involving consultations between the Department and interest groups (see below) led Finance officials to believe that the notion of consultation (as opposed to pleading) might be usefully applied to encounters between the Minister and interest groups. Finance Minister Michael Wilson was receptive to the idea. Supported by the consultations unit within Consultations and Communications Branch, the Minister adopted the practice of meeting one-on-one with local groups -- perhaps a labour group or a manufacturers' association -- as he traveled around the country. Wilson would have 40 to 50 such meetings in a year.

However, in time the usefulness of this kind of exercise to the Minister came to be questioned. In part, it was a question of the Minister's personal style; in part, it was a question of the considerable amount of Ministerial time that it consumed. When Don Mazankowski became Finance Minister a different approach was adopted. Groups tended to come to the Minister with representations reflecting their narrow interests. As the need for government spending cuts loomed larger, Finance wished to lift the dialogue above special pleadings and instead focus it on broader issues that would shape the overall philosophy and strategy of the budget. The concept of multilateral consultations emerged: getting together different groups having different perspectives to debate issues with the Minister present.

Finance Minister Mazankowski would attend three to five sessions a year, in Ottawa and in other parts of the country. At first, 8 to 10 groups would meet with the Minister. But as the practice caught on, more and more groups became interested in

joining in; meetings grew to include as many as 20 groups. At times the meetings neared the breaking point in terms of the number of groups that could be involved and the number of people that could be gathered in a single room. In total, perhaps as many as 100 groups were heard from in this way each year, double the number that were heard from in one-on-one meetings in Michael Wilson's day.

The interpersonal dynamics of these sessions were completely different from those that obtained in one-on-one meetings. Meetings were two to four hours in length. Groups would generally be given only a short time to make an opening address. Although the intent was to get them to focus on the big picture, often they continued to talk about their particular concerns. This allowed the Minister to play them off one against the other. Little sympathy was accorded to groups that asked the government to do impossible things.

The next major innovations in the consultations process came when Paul Martin took over as Finance Minister. While he did hold one-on-one meetings and some multilateral meetings with interest groups, he wished to break through the interest group mold. Prior to Martin's first budget the Department of Finance entered into contracts with four private sector institutes (Atlantic Provinces Economic Council, Institute for Research on Public Policy, Public Policy Forum, and Canada West Foundation) to stage conferences, consisting of plenary sessions and workshops, in four major cities across Canada. About 100 people were invited to each conference as individuals, although the behaviour of some indicated that they were representing interest groups. The Minister

made some remarks, but essentially acted as an observer. The Department made a formal effort to collect the advice offered during these conferences. A booklet published with the 1994 budget reported some of this advice together with the government's responses to it.²²

The run-up to the 1994 budget contained other innovations. One involved the distribution of a workbook aimed at soliciting suggestions from members of the general public on how to address the budgetary challenges facing the government. This exercise was not successful. Few workbooks were returned and, of those, many were incomplete. The verdict on the experiment is that the document was too intimidating and difficult for most people. There was also a televised discussion between 38 leading economists and the Minister of Finance and the Secretary of State for Finance. Another innovation was a special debate in parliament where members could propose ideas for the budget. As usual, the Minister received a large number of written submissions and letters.²³

In preparation for the 1995 Budget, a major consultative role was assigned to the House of Commons Standing Committee on Finance. This role will be discussed in some detail below. Meanwhile, the Minister continued to hold one-on-one meetings with interest groups, although the number of meetings was reduced considerably, to the range of 20 to 25 meetings.

²² *Response to Pre-Budget Consultations: Facing Choices Together* (Ottawa: Canada, Department of Finance, February 1994).

4. Consultation Involving the House of Commons Standing Committee on Finance

As noted above, as early as 1978 the Canadian Tax Foundation was advocating an increased role for parliamentary committees in the tax policy making process. This call was repeated by the Foundation and others in the years that followed. At the time such recommendations were made, parliamentary procedure called for tax legislation to be referred to a committee of the whole House after second reading.²⁴ This procedure was felt to be unsatisfactory because of limitations on the ability to make motions for amendment of the legislation and because no witnesses could be called.²⁵ The CTF committee had the experience of the 1971 tax reform to draw upon in comparison. The 1969 White Paper on Tax Reform had been referred to both the House of Commons Standing Committee on Finance, Trade and Economic Affairs and the Senate Standing Committee on Banking, Trade and Commerce. The Commons committee received 524 briefs and 1093 letters and other submissions. It heard 820 individuals present 211 briefs during 146 meetings. Two subcommittees heard 68 briefs during 31 meetings. The Senate committee heard 118 of the 345 briefs it received. While not an unqualified

²³ *Facing Choices Together*, p. 3.

²⁴ Procedural changes adopted in 1968 had shifted clause-by-clause consideration of most bills to standing committees from the committee of the whole House. This move could be criticized on at least two grounds: (1) It threatened to take away from all members the opportunity to participate in the preparation of bills. (2) Members of standing committees would not be able to argue their cases for amendments of a bill before the whole House. See John B. Stewart, *The Canadian House of Commons: Procedure and Reform* (Montreal: McGill-Queen's University Press, 1977). Apparently, arguments such as these were effective in preserving, for a time, the former procedural rules in respect of taxation bills.

²⁵ CTF Tax Legislative Process Committee, "The Tax Legislative Process," p. 163.

success, according to one commentator, the experiment was judged to have advanced the quality of the debate over the White Paper proposals.²⁶

In addition, there was in the early 1980s a more general interest in parliamentary reform which, while not focused on tax policy making, had implications for the tax policy making process.²⁷ In particular, House of Commons standing committees gained the ability to select their own topics for study and were given more financial resources and research capability.²⁸

When the Mulroney government took power in 1984, Don Blenkarn was given the chairmanship of the House of Commons Standing Committee on Finance, Trade and Economic Affairs. (The Committee has subsequently been renamed twice, first as the Standing Committee on Finance and Economic Affairs and then as the Standing Committee on Finance. We refer to all versions of the Committee as either the Standing Committee on Finance or the Finance Committee.) Under Blenkarn's exceptional leadership the Finance Committee attained a high profile and level of performance the likes of which was seldom seen in Canada. Some of the Committee's most impressive

²⁶ A. D. Doerr, "The Role of White Papers," in *The Structure of Policy-Making in Canada*, eds. G. Bruce Doern and Peter Aucoin (Toronto: Macmillan, 1971), pp. 196,199.

²⁷ C. E. S. Franks, *The Parliament of Canada*, (Toronto: University of Toronto Press, 1987), pp. 178-185.

²⁸ Robert J. O'Brien, "The Finance Committee Carves Out a Role...and Bloodies some Three-Piece Suits in the Process," *Parliamentary Government*, Vol. 8, No. 1 (1988), p. 4; Magnus Gunther, "Reform of the Committee System," in *House of Commons Reform*, eds. Magnus Gunther and Conrad Winn (Ottawa: Parliamentary Internship Program, 1991), pp. 215-220; Jonathan Malloy, "Reconciling Expectations and Reality in House of Commons Committees: The Case of the 1989 GST Inquiry," *Canadian Public Administration*, Vol. 39, No. 3 (Fall 1996), pp. 319-320.

accomplishments were in the field of taxation, largely occasioned by Finance Minister Michael Wilson's tax reform initiatives.²⁹ Relatively few of the tax-related studies performed by the Blenkarn Committee were chosen by the Committee itself.

A few simple statistics³⁰ illustrate the dramatic difference in the emphasis given to taxation and budgetary matters during the 32nd Parliament, during which the Liberals formed the government, and the 33rd Parliament, during which the Progressive Conservatives formed the government (see Table 1). During the 32nd Parliament the Standing Committee on Finance met on 197 days. Of these, 46 days (23 percent) were devoted to taxation and budgetary matters. In contrast, the Standing Committee on Finance during the 33rd Parliament dealt with taxation and budgetary matters on 152 out of 288 meeting days (53 percent).

²⁹ See, for example, O'Brien, "The Finance Committee Carves Out a Role," and Malloy, "Reconciling Expectations and Reality in House of Commons Committees."

³⁰ The statistics consist of counts of total and tax-related meeting days of parliamentary committees and counts of organizations and persons who appeared as witnesses. I personally performed these counts using minutes of proceedings and evidence as my source. For ease of data collection I chose to count "meeting days" rather than "meetings." On some days, several meetings might be held, and some meetings may cover more than one topic. Given the purpose of my analysis -- to monitor gross trends in the amount of attention paid to tax policy matters -- I felt that the use of "meeting days" provided a fine enough measure of activity.

Table 1

House of Commons Standing Committee on Finance
Summary of Meetings
32nd to 35th Parliaments

Years	Parliament	Session	Total			Percentage			Number of Organizations Heard	Number of Witnesses Heard
			Meeting Days	Tax Meeting Days	of Tax Meeting Days	Meeting Days	of Tax Meeting Days			
1980-83	32	1	176	37	21%	63	181			
1983-84	32	2	21	9	43%	9	28			
			197	46	23%	72	209			
1984-86	33	1	120	36	30%	46	114			
1986-88	33	2	168	116	69%	281	753			
			288	152	53%	327	867			
1989-91	34	1								
	34	2	137	76	55%	353	850			
1991-93	34	3	76	16	21%	47	93			
			213	92	43%	400	943			
1994-95	35	1	132	119	90%	1025	1855			
1996-97	35	2	48	34	71%	430	564			
			180	153	85%	1455	2419			

Source: Author

Senate Committee on Banking, Trade and Commerce
Summary of Meetings
32nd to 35th Parliaments

Table 2

Years	Parliament	Session	Total			Percentage		Number of Organizations Heard	Number of Witnesses Heard
			Meeting Days	Tax Meeting Days	of Tax Meeting Days				
1980-83	32	1	118	47	40%		62	165	
1983-84	32	2	14	6	43%		8	14	
			132	53	40%		70	179	
1984-86	33	1	50	4	8%		9	18	
1986-88	33	2	88	26	30%		49	149	
			138	30	22%		58	167	
1989-91	34	1							
	34	2	75	54	72%		327	831	
1991-93	34	3	46	10	22%		16	39	
			121	64	53%		343	870	
1994-95	35	1	58	16	28%		31	61	
1996-97	35	2	15	2	13%		4	14	
			73	18	25%		35	75	

Source: Author

There was also a remarkable difference in the operating style of the respective committees, as reflected in the emphasis given to hearing from witnesses in those meetings devoted to taxation and budgetary matters. During the 32nd Parliament the Committee heard from 209 witnesses, including witnesses from 72 organizations. During the 33rd Parliament, the Committee heard from 867 witnesses, including witnesses from 327 organizations.

The performance of the Standing Committee on Finance in the 34th Parliament, featuring the second Mulroney government, was fairly similar to the performance of the Committee in the 33rd Parliament. The percentage of meeting days devoted to taxation and budgetary matters declined to 43 percent (92 days out of 213 days); however, the number of witnesses and the number of organizations heard from in these meetings increased to 943 and 400, respectively.

The content dealt with by the three incarnations of the Committee went through a major transformation at the same time that the changes in operating style were going on. In the 32nd Parliament, the Committee met for 34 days to deal with legislation, 8 days to deal with Revenue Canada's Estimates and 4 days to deal with policy studies. In the 33rd Parliament, the Committee met for just 24 days to deal with legislation and 6 days to deal with Estimates. However, it devoted 119 days to policy studies of one kind and another. Even though it was during this Parliament that Finance Minister Michael Wilson tabled his White Paper on tax reform, over half of these meeting days occurred before the White Paper appeared. Also, during the 2nd session, the Committee met for 3 days to consider

the country's economic outlook, a precursor to the present day pre-budget consultations. The 34th Parliament saw the Committee once again placing greater emphasis on the review of legislation, meeting for 35 days. Yet the Committee still devoted 36 days to policy studies and increased to 13 days the time it spent on the economic outlook. This was supplemented with 3 days spent on the 1991 Budget. The review of Revenue Canada's Estimates occupied the Committee for 5 days.

The preceding statistical overview indicates how the beginning phase of the changes to the authority rules affecting the Standing Committee on Finance was manifested in the Committee's work. The legitimacy of these changes was enhanced by the acknowledgment of the output produced by the Committee. The examples of the Committee's involvement in income tax reform and sales tax reform illustrate the point. However, before dealing with these, brief mention should be made of some of the Committee's other tax policy work: in 1985 the Committee looked into the subject of taxation as it related to the agricultural industry; in early 1986 the Committee studied the government's tax expenditure account, heard witnesses, and issued a report on tax simplification; and, in 1988 the Committee looked into the government's proposed interim measures to deal with revenue losses from the manufacturer's sales tax (pending its replacement by the GST).

In October 1986, Finance Minister Wilson issued a document setting out certain principles that were to guide the impending tax reform exercise. The tax reform

proposals were then outlined briefly in the Minister's February 1987 budget.³¹ From the end of October 1986 to the early part of April 1987, the Finance Committee under Chairman Don Blenkarn held 26 days of meetings under the rubric of "tax issues." In all, 80 witnesses including representatives of 34 organizations presented their views. These hearings complemented other consultative efforts conducted by the Minister and his officials prior to the issuance of the June 1987 White Paper on tax reform.

After the White Paper was tabled, the Committee held a further 41 days of hearings culminating in a report presented on November 16, 1987.³² This time the committee heard from 347 witnesses including representatives of 129 organizations. When, on December 16, 1987, the government introduced a notice of ways and means motion to implement tax reform, it contained changes from the White Paper that arose mainly from the work of the Committee.

While its work in relation to income tax reform was important, it was the Blenkarn Committee's role in the implementation of the Goods and Services Tax that is its most noteworthy accomplishment. The Committee first turned its attention toward sales tax reform in a series of meetings over 9 days during the period January to March 1988. At this point the Committee mainly worked with its research staff, for the most part consultants, to obtain an orientation to the subject matter. Its deliberations included

³¹ Allan M. Maslove, *Tax Reform in Canada: The Process and Impact* (Halifax: Institute for Research on Public Policy, 1989), pp. 27-28.

³² J. Harvey Perry, *A Fiscal History of Canada - The Postwar Years*, Canadian Tax Paper No. 85 (Toronto: Canadian Tax Foundation, 1989), p. 363.

a trip to New Zealand to study that country's GST. The Committee issued a report at the conclusion of its study.³³

Following an election in November 1988 and a budget in April 1989, the government issued a technical paper on the GST in August 1989.³⁴ The Blenkarn Committee responded with 34 days of meetings during which it heard from 608 witnesses including representatives of 264 organizations. In addition, the Committee received over 1,100 briefs and other representations.³⁵ Through this mass of input Blenkarn became convinced that the GST at a rate of 9 percent, as proposed by the government, was politically unacceptable. The Committee's report, issued in November 1989, proposed that the rate of tax be reduced to 7 percent.³⁶ The report suggested other changes aimed at making up the revenue shortfall that would result from the rate reduction.³⁷

In December 1989, the government issued a new technical paper which adopted the Finance Committee's key recommendation for a 7 percent rate of tax.³⁸ When Bill C-62 to implement the GST was given second reading the Committee met for 22 days to consider it but heard from only about one-fifth the number of organizations and witnesses as before. During this phase, the limelight fell upon the Senate, where the Liberal majority left over from previous governments resolved to defeat the Bill. The Mulroney

³³ Neil Brooks, *The Canadian Goods and Services Tax: History, Policy, and Politics* (Sydney: Australian Tax Research Foundation, 1992), pp. 30-31.

³⁴ Brooks, *The Canadian Goods and Services Tax*, p. 31.

³⁵ "Report on the Technical Paper on the Goods and Services Tax," *Second Report of the Standing Committee on Finance* (Ottawa: House of Commons, November 21, 1989). House of Commons (1989:xiv).

³⁶ "Report on the Technical Paper on the Goods and Services Tax," p. 3.

³⁷ Brooks, *The Canadian Goods and Services Tax*, pp. 34-35.

government resorted to a never-before-used constitutional provision in order to appoint eight additional senators and ensure passage of the Bill.

Implementing the GST was the last major tax initiative of the Mulroney government and so reviewing that policy and legislation was also the last major tax-related effort by the Finance Committee. However, it did mount its largest pre-budget examination of the Canadian economy. This consisted of 8 days of meetings but involved only a modest number of witnesses (15) and organizations (12).

The Finance Committee's capability and credibility as regards matters of taxation having been established under Blenkarn, it continued to play an important role under the Chrétien government. However, the role did change somewhat by virtue of the fact that the major tax reform was mostly complete. "Mostly" because the Liberals had promised during the election campaign to "replace the GST with a system that generates equivalent revenues, is fairer to consumers and to small business, minimizes disruption to small business, and promotes federal-provincial fiscal cooperation and harmonization."³⁹ The Finance Committee was given the job of reporting on all options for alternatives to the then-current GST, which it did in June 1994. The Committee received 714 submissions, and heard from 489 witnesses in the course of 38 days of hearings. This work occupied the Committee for over four months.

³⁸ Brooks, *The Canadian Goods and Services Tax*, p. 37.

³⁹ *Creating Opportunity: The Liberal Plan for Canada* (Ottawa: Liberal Party of Canada, 1993), p. 22.

The Finance Committee, under the chairmanship of Jim Peterson, proposed that the GST be replaced with a national value added tax that would integrate federal and provincial sales tax systems.⁴⁰ This was, to some extent, the resurrection of an idea for a national sales tax which the Mulroney government had abandoned in 1989 after negotiations with the provinces had reached an impasse.⁴¹ Peterson's Committee acknowledged that not all provinces may wish to join in the national VAT initially, but hoped that eventually they would come to see its merits. It also recommended that a regime of tax-included pricing be adopted.⁴² "Sticker shock," the realization by consumers of the additional tax cost of their purchases was a universally acknowledged irritant associated with the GST.

In broad outline, the course of action recommended by the Peterson Committee was at first being followed by Finance Minister Paul Martin as he worked to implement the "Harmonized Sales Tax" with the provinces of New Brunswick, Nova Scotia, and Newfoundland. These provinces were to basically adopt the GST and bury the tax in the price of goods and services, with separate disclosure of the tax component. However, due to political pressure at the provincial level, the tax will not now be buried. The federal government hopes that other provinces might one day join in the harmonization scheme. Quebec had previously adopted a GST-like value added tax to lead the way.

⁴⁰ "Replacing the GST: Options for Canada," *Ninth Report of the Standing Committee on Finance* (Ottawa: House of Commons, June 16, 1994), p. 41.

⁴¹ Brooks, *The Canadian Goods and Services Tax*, p. 31.

⁴² "Replacing the GST: Options for Canada," pp. 41-43.

The Liberal campaign platform also contained a promise to involve Members of Parliament in “an effective pre-budget consultation process.”⁴³ The vehicle for implementing this commitment was the Finance Committee.

The Finance Committee of the 35th Parliament met for the first time in February 1994, less than three weeks before Finance Minister Paul Martin brought down his first budget. In view of the timing and the fact that the Committee had been given the major assignment of reviewing alternatives to the GST, it played no role in pre-budget consultations.

With its work on finding an alternative to the GST complete, the Committee took on the task assigned to it by standing order 83.1 to “consider and make reports upon proposals regarding the budgetary policy of the government.”⁴⁴ The chairman characterized the Committee’s work as providing for “unprecedented public involvement in the federal government’s pre-budget process.”⁴⁵ Indeed, the numbers of participants were impressive. The Committee met for 24 days from September through December 1994 on budgetary policy. It received 118 written submissions and heard the testimony of 650 intervenors.⁴⁶ Over 320 organizations appeared before the Committee. A particularly intensive period of work was the five days from October 31 to November 4.

⁴³ *Creating Opportunity*, p. 92.

⁴⁴ *Standing Orders of the House of Commons* (Ottawa: House of Commons, December 1995), p. 51, S.O. 83.1. This standing order was among a package of amendments to the Standing Orders that were moved, debated and adopted on 7 February 1994.

⁴⁵ “Confronting Canada’s Deficit Crisis: Building Our Next Budget through Consultation,” *Tenth Report of the Standing Committee on Finance* (Ottawa: House of Commons, December 5, 1994), p. xi.

⁴⁶ “Confronting Canada’s Deficit Crisis,” p. xi.

The Committee split into two parts, with one part traveling west and the other traveling east. Moving from city to city, on a given day each part might hold two or three meetings. In this way, on one day the Committee heard from 85 witnesses in Montreal and Hamilton.

The theme of the Committee's report was battling the deficit crisis, and made recommendations both for reduction of expenditures and, to a lesser extent, increasing tax revenue. As revenue raising measures, the Committee favoured increasing gasoline excise taxes, increasing taxes on corporations (especially large corporations), and instituting a tax on lottery winnings.⁴⁷ The February 27, 1995 Budget announced a 12.5 percent increase to the Large Corporations Tax, a one percentage point increase to the corporate surtax, a temporary tax on the capital of large deposit-taking institutions, and a 1.5 cents per litre increase in federal gasoline excise taxes.⁴⁸

In the Committee's 1996 report the chairman declared that "the process is now firmly established as a permanent feature of citizen participation in budget-making." The Committee heard from 480 witnesses and received 58 submissions.⁴⁹ Almost 360 organizations were represented at the hearings. This time, the Committee held 18 days of hearings from September to December 1995, with another intense period of activity from mid-November to mid-December during which the Committee once again criss-crossed

⁴⁷ "Confronting Canada's Deficit Crisis," p. 42.

⁴⁸ *Budget Speech* (Ottawa: Canada, Department of Finance, February 27, 1995), p. 24.

⁴⁹ "The Next Steps to Fiscal Health After a Year of Historic Progress: Building the 1996 Budget Through Consultation," *Twenty-fourth Report of the Standing Committee on Finance* (Ottawa: House of Commons, January 17, 1996), p. xiii.

the country. At least as regards its recommendations for the tax system, the Committee's report went unheeded in the March 6, 1996 budget.

The consultations leading up to the 1997 budget revealed a bit of a drop-off in the rate of participation, though participation was still significant. The number of meeting days declined to 15, the number of witnesses heard from declined to under 380, and the number of organizations represented fell to under 320.

In addition to its major work on the study of GST alternatives and its three years of pre-budget consultations, the Finance Committee has worked on other tax related projects, including the review of tax Bills. In late 1994 and early 1995 it undertook a study of the taxation of family trusts. It revisited this topic in 1996 after a report by the Auditor General drew attention to the issue. Also in 1996, the Committee looked into the subject of business taxation, following the lead of the Minister of Finance who, in his 1996 budget, announced the formation of a Task Force to examine this matter.

It is interesting to contrast the experience of the Senate Committee on Banking, Trade and Commerce over the 32nd to 35th Parliaments with that of the House of Commons Standing Committee on Finance. Unlike the House Committee, the Senate Committee did not experience any formal amendment to its mandate or operating rules.

A summary of Senate Committee meetings appears in Table 2. In the 32nd Parliament, the Senate Committee devoted more meeting days and a larger percentage of

meeting days to tax matters than did the House Committee (53 days versus 46 days and 40 percent versus 23 percent, respectively). The relative positions of the two committees reversed during the 33rd Parliament. Then, during the 34th Parliament, thanks to the Senate Committee's acute interest in the GST legislation, its meeting days devoted to tax matters reached its highest point, as did its percentage of tax meeting days, number of organizations heard (on tax matters) and number of witnesses heard (on tax matters). However, in the 35th Parliament, the Senate Committee did its least amount of tax work, meeting on tax for only 18 days, hearing from just 35 organizations and 75 witnesses. This contrasts sharply with the House Committee, which during the same Parliament reached a high point in terms of tax-related meeting days, percentage of tax meeting days, number of organizations heard and number of witnesses heard.

To recap, the increased involvement of the Finance Committee in the study of tax policy and, more generally, budgetary policy has been one of the most striking changes to occur in the last decade and a half. This is largely due to institutional changes to the authority rules governing the tax policy-making/budget-making process.

5. Closer Relations Between Interest Groups and Department of Finance Officials

In 1982, Mickey Cohen, who after spending a period of time in the energy portfolio had returned to Finance as Deputy Minister, started an initiative to develop better informal ties between senior departmental officials and the business community. The difference between these relations and those which had traditionally taken place was

that they were not Minister-focused and were not confined to the pre-budget period. The initiative began with dinner meetings between Assistant Deputy Ministers and members of local branches of the Canadian Chamber of Commerce (CCC). Eventually, the dinners were supplemented with day-long meetings between tax professionals and Tax Policy Branch officers. Earlier, contacts between the two groups had been formally organized around a joint submission by the Canadian Bar Association and the Canadian Institute of Chartered Accountants.⁵⁰ The success of the CCC-led encounters was noticed by the Canadian Council on Social Development, which asked that the meetings be extended to include encounters between officials and local groups having an interest in social policy. This style of consultation went on for about two years, during which time meetings were held in about ten cities.

In addition, over the next few years the personnel resources of Tax Policy Branch was expanded three-fold, giving Finance much greater technical/analytic capability. This contributed to a new style of consultation in which the Department developed detailed technical papers with options and analysis for presentation to the public. Some of the topics covered in this way included a minimum tax for high income individuals, indexed security investment plans, employee profit sharing and registered retirement savings plans. The purpose of such consultations was to get feedback on the social and economic impacts of the options presented and to improve on the design of these options.

⁵⁰ David A. Good, *The Politics of Anticipation: Making Canadian Federal Tax Policy* (Ottawa: Carleton University School of Public Administration, 1980), pp. 93-94.

As Finance officials and interest group members became more comfortable working with each other, Finance officials began to feel more free to ask industry groups for information and to engage them in joint problem solving. A successful (at least from Finance's point of view) instance of this involved relations with the Canadian Bankers' Association (CBA).⁵¹ At one time it was generally acknowledged that the banking industry in Canada was paying less tax than one might have expected given its size and profitability. Finance officials did not have a full appreciation of the reasons behind this phenomenon. The Department consulted the CBA in private then produced a draft policy which then prompted further consultations. The final outcome was a regime of bank taxation that was administratively feasible and which placed a fair (according to Finance) burden on the industry.

Finance also worked closely with social policy groups. A good example involves the design of the Goods and Services Tax Credit (GSTC). When the GST was being contemplated groups concerned with poverty issues worried about the impact of the tax on prices and on the ability of poor people to cope with any increase in the cost of living. To address this concern, the Minister of Finance enlisted the aid of the National Anti-Poverty Organization (NAPO) to design a refundable tax credit that would help alleviate the regressivity associated with the new tax. The key feature of the GSTC, from NAPO's point of view is that it is paid quarterly in advance. This way, the intent is that the money

⁵¹ I do not wish to overstate the extent to which closer relations between interest groups and Finance officials has led to the solution of policy problems. There remain examples where the approach has not yielded results -- the taxation of insurance companies is one such area.

from the credit will be in the hands of poor people before they incur the GST on their purchases.

It was also suggested by one of the people interviewed for this study that the Seniors Benefit announced in the 1996 Budget was the work of Ken Battle of the Caledon Institute for Social Policy; however, this has not been confirmed.⁵²

6. The Separation of Budgetary and Technical Issues

To the average person, tax policy making is something that happens once a year at the time the Minister of Finance brings down his budget. However, to the relatively small community of tax professionals inside and outside government and a few assorted others, tax policy making is a continuous process. Much of this effort is directed not at major, high-profile new initiatives but at myriad fine-tuning adjustments aimed at making the tax system work better, or work as it was intended to work. Issues that fall into the latter category are known as “technical issues” to distinguish them from “budgetary issues.” At one time, the two kinds of issues tended to flow through the tax policy making system together, both targeted for announcement in connection with the delivery of a Budget by the Minister of Finance. But in the last 15 years or so two separate streams have appeared.

The furor surrounding the 1981 MacEachen budget provided an important impetus to the separation of technical and budgetary issues. The technical flaws

associated with certain of the budgetary proposals were spotlighted as examples of what could happen if adequate technical expertise was not brought to bear in the formulation of tax legislation. The Department of Finance did not possess enough people having both highly developed technical knowledge and knowledge of business practices to be able to tackle all the technical issues that it had to deal with in the time available.

If a way could be found to bring private sector expertise to bear on the resolution of technical issues this might ameliorate the situation. But standing in the way of this goal was the doctrine of budget secrecy, which apparently dictated that only the Minister of Finance and his officials could have access to information about what may be contained in an upcoming budget. The solution that was worked out was to classify tax policy issues into those for which maintenance of absolute secrecy was necessary and those for which it was not. Two streams would be developed -- one to deal with each type of issue. Each of the streams would follow its own timetable.

Chapter 4 talked about the concern over complexity of tax legislation and compliance costs, which are partly a function of complexity. As big a potential problem as out-of-pocket compliance costs is, uncertainty and perceived inequity in the distribution of the tax burden can be even more troublesome to taxpayers, at times. The tax consequences of a very large, sophisticated transaction can mark the difference between whether or not the transaction makes economic sense. The more that the tax system is subject to change and the more uncertain is the application of the tax laws to

⁵² Interview No. 25.

particular transactions, possibly due to ambiguity in the drafting of the legislation, the greater the risk associated with doing business.

A key mechanism for ensuring that tax legislation does not contain egregious technical flaws is the publication of draft legislation for comment by interested parties. For about a decade Finance has followed this practice prior to the tabling of tax bills in Parliament. This implements one of the proposals made by the 1977 CTF committee.

One very important source of feedback on draft legislation is the Joint Committee on Taxation, which is made up of taxation specialists who are members of the Canadian Bar Association and the Canadian Institute of Chartered Accountants. The Tax Executives Institute and individuals are other important sources of feedback. Revenue Canada is also instrumental in ensuring the technical quality of legislation; its officials work along side Finance officials in drafting legislation. Of particular concern to Revenue Canada is the administrative feasibility of proposed measures -- the burden they will place on taxpayers and the amount of service that Revenue Canada will have to provide to implement the measures. Members of the Joint Committee volunteer their time to pour over the details of draft legislation and ask themselves to envisage how the proposed provisions would apply to real life situations. Inevitably, this process turns up a number of ambiguities and logical lapses that are brought to the attention of staff from the Legislation Division of Finance's Tax Policy Branch. The experts from inside and outside Legislation Division discuss the problems and possible solutions. As a result of this exchange, Finance is able to re-draft the legislation before it goes to Parliament for

first reading. Members of the Joint Committee do not themselves get involved in redrafting the provisions.

In order to assist this process, draft legislation is routinely accompanied by explanatory notes. This practice, too, responds to a recommendation by the 1977 CTF committee. The purpose of the notes is to help those reviewing the legislation to understand the policy purpose behind the legislation. Armed with this information, reviewers such as the members of the CBA-CICA Joint Committee can think about whether the draft proposals will achieve their objectives. If it appears that they will not, Finance can be alerted to this fact.

7. An Annualized Budget Process

I noted earlier that a study commissioned by the Conference Board of Canada concluded that the single biggest problem with the budget process was the lack of a regular annual timetable for budget preparation. A review of the history of budget timing from 1867 to 1982 helps us to understand the source of this concern. It is especially revealing to contrast the first 90 years of budgets with the 25 year period ending with the 1981 MacEachen budget.

In the first 90 years of confederation, governments brought down a total of 93 budgets. In only 5 of these years were two budgets presented in the same calendar year. As for timing, 39 out of 93 budgets (42 percent) appeared during the first three months of

the year, 46 budgets (50 percent) appeared during the second three months of the year, 3 budgets (3 percent) appeared during the third quarter, and 5 budgets (5 percent) appeared during the last quarter of the year.

The next 25 years were much different. In 9 of the years there were two budgets brought down, bringing the total for the period to 34 budgets. Of these, just 7 budgets (21 percent) appeared in the first quarter, 14 budgets (42 percent) appeared in the second quarter, and 13 budgets (39 percent) appeared in the fourth quarter of the year. There were no budgets brought down during the third quarter.⁵³

The 1982 Green Paper on the Budget Process had raised the issue of budget timing.⁵⁴ It cited criticisms that the unpredictability of budget timing was an impediment to organizations who wished to make pre-budget representations because it meant that they would not have a great deal of lead time with which to prepare their points. The Green Paper suggested that having a regular autumn budget would make sense in terms of the effective date of tax changes applicable to individuals and because it would provide valuable information to the provinces in advance of their own budget preparations, which often took place in late winter or early spring. However, the government's 1985 Discussion Paper on the budget process found reasons to support a mid-January to mid-February budget date:⁵⁵

⁵³ The counts contained in this and the preceding paragraph were based on data contained in Gillespie, *Tax, Borrow and Spend*, Appendix E, for the years 1867 to 1990 and on data compiled by the author by reference to Budget Speeches for the years 1991 to 1997.

⁵⁴ Canada, Department of Finance, *The Budget Process*, pp. 175-176.

- It would provide more time for pre-budget consultations;
- It would still be early enough to feed into provincial budget deliberations;
- It would tie in with Parliament's consideration of the Main Estimates and borrowing authority legislation; and,
- It would allow the government to use more up-to-date information in the preparation of its budget forecasts.

Both the House of Commons Standing Committee on Procedure and Organization and the 1986 CTF Committee on the Budget Process endorsed the budget timing proposal made in the Discussion Paper.⁵⁶

Looking at the timing of budgets brought down since 1981 we see that the government has made considerable progress in achieving the goal set out in the Discussion Paper. None of the years since 1981 have contained two budgets. Nine out of the 16 budgets (56 percent) were presented during the month of February and one was presented in the first week of March. The remaining 6 budgets were all brought down within the second quarter of the year, 4 of these in the month of April.⁵⁷ Clearly, the budget timing rule has changed.

There is no question that the need to coordinate federal and provincial budgets was a key factor forcing the adoption of a more predictable budget process. For the

⁵⁵ Canada, Department of Finance, *The Canadian Budgetary Process*, pp. 1017-1023.

⁵⁶ House of Commons (1985:1052-1054); CTF Committee on the Budget Process, "The Canadian Budget Process," pp. 994-995.

1994-95 fiscal year, the expenditures of the federal and provincial-territorial governments were virtually equal, in the range of \$175 billion.⁵⁸ In addition, one person interviewed for this study suggested that as Canada's deficit problems persisted the international financial community looked for a more regular budget process as a sign that the federal government was managing its finances deliberately and was not simply being bounced around helplessly by economic forces.⁵⁹

8. Increased Information Resources

Underlying much of the discussion in this chapter and the preceding one is a recognition that more information is being supplied to participants in the tax policy making process. The information rules have changed. In this section we will make that recognition more explicit.

When the government first undertook to provide estimates of tax expenditures in 1979 it was not meant as a signal that such information would be supplied on a regular basis. Although the 1979 tax expenditure estimates were updated in 1980, there was a five year gap before the next version of the tax expenditure account was published in 1985. At this point in time the Auditor General, backed by the Public Accounts Committee, sounded the call for regular production of tax expenditure information. Although it took the Department of Finance some years to respond, one person

⁵⁷ See footnote 53 for sources.

⁵⁸ *Finances of the Nation, 1995*, (Toronto: Canadian Tax Foundation, 1995), pp. 17:6, 17:9.

⁵⁹ Interview No. 25.

interviewed for this study felt that this intervention by the Auditor General was influential.⁶⁰

In December 1992, the Department of Finance published a report on personal income tax expenditures.⁶¹ The information release accompanying this publication indicated the government's commitment to publish comprehensive tax expenditure reports "on a regular basis, once the necessary data on sales and corporate taxes become available."⁶² In December 1993, the Department of Finance published a report on personal and corporate tax expenditures and, in December 1994, published a report that also included tax expenditures related to the GST.⁶³ The latter report explained that the delay in putting together a comprehensive account of tax expenditures was needed to reflect the substantial changes brought about by tax reform and to permit collection of data relevant to the new tax regime.⁶⁴ It also stated that the purpose of the report was:

"to serve as a source of information for parliamentarians, government officials and others who wish to analyze Canada's federal income tax system and the Goods and Services Tax (GST). It is also an important input into the process of evaluating the operation of these tax systems."⁶⁵

⁶⁰ Interview No. 19.

⁶¹ *Government of Canada Personal Income Tax Expenditures* (Ottawa: Canada, Department of Finance, December 1992).

⁶² Information Release No. 92-102 (Ottawa: Canada, Department of Finance, December 23, 1992).

⁶³ *Government of Canada Personal and Corporate Income Tax Expenditures* (Ottawa: Canada, Department of Finance, December 1993); *Tax Expenditures* (Ottawa: Canada, Department of Finance, December 1994).

⁶⁴ *Tax Expenditures* (1994), pp. 2-3.

⁶⁵ *Tax Expenditures* (1994), p. 1.

A different kind of information resource whose appearance marks an important change to the process of tax policy making is the Social Policy Simulation Database/Model (SPSD/M). Developed by Statistics Canada with the help of other federal government departments and the Institute for Research in Public Policy, SPSPD/M is a tool for analysts and researchers to use in evaluating the effects of proposed changes to the Canadian tax/transfer system.⁶⁶ The significance of this tool is that for those outside the Department of Finance who wish to make tax policy proposals it overcomes their former difficulties in showing the effects and implementation costs of proposals.⁶⁷

9. Comparison of Empirical Findings to Theory

This chapter has identified changes to the authority, information and timing rules that are manifest in the following five ways: (1) increased use of formal mechanisms of consultation over taxation and budgetary matters, involving the Minister of Finance and Parliament; (2) increased use of informal mechanisms of consultation over taxation and budgetary matters, involving Department of Finance bureaucrats; (3) the separation of budgetary and technical issues in the legislative process; (4) the observation of a more rigorous annual timetable for budget preparation and presentation; and, (5) increased public availability of information relevant to tax policy analysis and accountability. Once more, the notions of transaction cost minimization and isomorphism can be used to explain the changes.

⁶⁶ "Portable SPSPD/M: Introduction and Overview," (Statistics Canada, 1987, Mimeo).

⁶⁷ "Statscan Tax Model Available for Public Use," *Canadian Taxpayer*, January 5, 1988.

The underlying dynamic of the institutional changes affecting the revenue budget process is consistent with the transaction cost minimizing behaviour posited by North.⁶⁸ Both taxpayers and professional advisors, on the one hand, and the Minister of Finance and his officials, on the other hand, had experienced the transaction costs associated with budget making. For taxpayers and professional advisors the costs had to do with uncertainties created by their exclusion from the budget making and legislative drafting processes. For the Minister and his officials, the costs were political -- adverse reaction to and loss of legitimacy for his proposals.⁶⁹

With respect to the pattern of events described in this chapter, observations about institutional change made by March and Olsen provide a nice complement to transaction cost minimization theory.⁷⁰ Changes to the revenue budget process reflect the influence of years of work by academics and professional tax advisors in highlighting problems in the process as it was and in suggesting options for changes to the process. Changes to the doctrine of budget secrecy were achieved by finding the ambiguity and flexibility in the doctrine and then reinterpreting it in a way that facilitated a partial opening up of the budget process. The final impetus for change was provided by the shock associated with the reaction to the 1981 MacEachen budget. Thanks to the persistent efforts of critics of the budget process to keep the issue of reform relatively current, when a window of

⁶⁸ Lance E. Davis and Douglass C. North, *Institutional Change and American Economic Growth*, (New York: Cambridge University Press, 1971), p. 11.

⁶⁹ Good, *The Politics of Anticipation*, pp. 99-100; Gillespie, *Tax, Borrow and Spend*, pp. 17-32; 198-199.

⁷⁰ James G. March and Johan P. Olsen, *Rediscovering Institutions: The Organizational Basis of Politics*, (New York: The Free Press, 1989), p. 58.

policy opportunity opened a set of proposed solutions having a high degree of legitimacy were readily at hand and were adopted.⁷¹ Recall that North emphasizes the deliberate, purposeful nature of institutional change.

Turning to isomorphism as an explanation for the five institutional changes listed above, one aspect of the theory concerning the spread of institutional forms recognizes the role of professional bodies, such as engineers or accountants. In part, the quality of professionals' work is controlled through the application of standard practices to the tasks they undertake. Professionals are well trained in their craft and are expected to follow the dictates of their professional practices in carrying out their duties regardless of whom they are employed by. In this way, professionals introduce their common practice into the organizations for which they work.

In the case of the tax policy making process, I argue that professionals have played a significant part in bringing about institutional changes, although the mechanism of influence is not the one described above. Professional tax advisors were forceful advocates of changes to authority, information and timing rules applicable to the technical amendments process. These changes did not amount to the spread of standardized professional rules, for there were no standardized rules. It was more a case of wishing to invent a set of rules and to have them adopted. In this endeavor the professional tax advisors' views were most influential because of the stature they enjoyed and because of the stature of the Canadian Tax Foundation, with which many -- if not most -- prominent professional tax advisors are associated.

⁷¹ March and Olsen, *Rediscovering Institutions*, pp. 86-87.

Pressures on the government to reform the revenue budget process were evident as early as the 1960s. The serious debate over the need to reform the process and the nature the reforms should take was initially conducted between the relatively small community of tax practitioners and Department of Finance officials. While Finance officials expressed sympathy for the practitioners' arguments, no significant change occurred in the process. The notoriety surrounding the MacEachen budget rekindled the debate and prompted the government to make some changes. This pattern of events supports one of Oliver's hypotheses, as discussed in chapter 1.⁷² Finance was able to resist pressures for change as long as the social legitimacy of reform proposals was low due to limited public concern over the need for reform. Once the issue captured the attention of the public, the social legitimacy of the proposals rose and Finance was obliged to make more serious gestures of acceptance.

Others of Oliver's hypotheses suggest that Finance's ability to resist the pressures for change emanating from tax practitioners may have been relatively low even before the 1981 budget was brought down.⁷³ The highly technical nature of tax legislation and the limited in-house resources of the Department meant that there was a high degree of dependence by Finance on technical input from practitioners in order to implement, via statute, the government's desired tax policy changes. Because of this dependence, a fairly high degree of interconnectedness had developed between Finance and its environment. Reinforcing this tendency, was the desire expressed by some Finance

⁷² Christine Oliver, "Strategic Responses to Institutional Processes," *Academy of Management Review*, Vol. 16, No. 1 (1991), pp. 160-161.

Ministers for a loosening of the constraints of secrecy. This compatibility of goals is also hypothesized by Oliver to increase the likelihood that pressures for institutional change will not be resisted.⁷⁴

One of the arguments used by advocates of reforms to the revenue budget process was the similarity of the measures they were proposing to practices already established in other jurisdictions. In this way they were attempting to influence Finance by demonstrating the voluntary diffusion of the practices being promoted. Oliver would predict that to the extent that this case can be made effectively, the lower would be Finance's resistance to the proposals.⁷⁵

⁷³ Oliver, "Strategic Responses to Institutional Processes," pp. 163-164, 170-172.

⁷⁴ Oliver, "Strategic Responses to Institutional Processes," pp. 164-166.

⁷⁵ Oliver, "Strategic Responses to Institutional Processes," pp. 167-170.

Chapter Six: Position, Boundary, and Aggregation Rules

1. Introduction

In Chapter 5, I examined the rules that govern what participants in the tax policy making process may do, when they may do it, and what information they may possess and communicate. The notion of “participant” was present in the discussion, but was not the focus of the discussion. In this chapter, by turning my attention to a third and final grouping of rules, I shine the spotlight more directly on the participants in the process. The rule grouping I am interested in consists of position rules that specify a set of positions and how many participants hold each position; boundary rules that specify how participants are chosen to hold these positions and how participants leave these positions; and, aggregation rules that specify the decision function used by participants. Because aggregation rules focus on participants as decision makers, we must complement our understanding of the rules with an understanding of the participants themselves since, as Elinor Ostrom tells us, a model of the decision maker is needed in order to construct a model of an action situation.¹

Unlike the two previous chapters, which relied on several different primary and secondary research sources, this chapter is predominantly based on a series of interviews with participants in the tax policy making process. A few of these have had a long

¹ Elinor Ostrom, “An Agenda for the Study of Institutions,” *Public Choice*, 48 (1986), pp. 17, 19.

involvement in tax policy making and were especially useful in providing information on the changes to the institutions affecting the process.²

The overall message of this chapter is that there have been no changes to position rules. Changes to boundary rules appear as consequential to the changes to the authority and information rules discussed in the last chapter. It is the latter rules which were more binding, and by loosening them, the changes to other rules follow naturally. The factors causing the changes are the same, though in one case the linkage is direct while in the other the linkage is indirect. This chapter also concludes that aggregation rules have not changed, in the sense that the Minister of Finance remains the ultimate decision maker, but that the Minister's decisions are likely influenced by the views of other participants who now enjoy greater access to the policy making process.

2. The Players and Their Positions

Good provides a listing of the players in the tax policy game as it was played around the end of the 1970s. In keeping with demands of the particular theory he was examining, Good divided the players into two broad groupings: the tax community and attentive actors. The former grouping included from the Department of Finance the Assistant Deputy Minister and tax policy officers within Tax Policy Branch, certain other Assistant Deputy Ministers and senior officials, and the Deputy Minister. The Minister of Finance was a key member. Other more peripheral members included the Prime Minister, an occasional cabinet minister, and the Finance Minister's parliamentary

² Interview Nos. 3, 4, 6, 10, 12, and 26.

secretary. The latter grouping included spending ministers and their departments, the Department of National Revenue and its minister, tax interest groups, tax professionals, Members of Parliament, and taxpayers.³ For the purposes of the present study, we do not need to maintain these two groupings and can focus on the details within the groupings. Thinking of each of the elements as a “position” as specified by the position rules, we will see that, globally, one might conclude that the set of positions has not changed markedly in the decade and a half since Good wrote. However, by looking at the finer detail, we obtain a richer appreciation of the kinds of players that are active in tax policy making.

The Minister of Finance occupies the apex of the tax policy making structure, although he is by no means primarily interested in taxation. His role is that of manager of the economy in general, and so is interested in economic growth, price stability and employment. Aside from tax policy, he pays close attention to fiscal and monetary policy, social policy and federal-provincial relations. In whatever aspect of public policy the Finance Minister chooses to intervene, one of his main vehicles for action is the budget.

Because the Minister is an elected official he is anxious to showcase his policy acumen in the budgets that he brings down. He wants to have budgets with impact. Each budget is crafted strategically to contain some noteworthy initiatives aimed at earning political credit for the Minister. It is desirable for the budget to contain some unifying

³ David A. Good, *The Politics of Anticipation: Making Canadian Federal Tax Policy* (Ottawa: Carleton University School of Public Administration, 1980), pp. 45-97.

theme around which to organize the many individual announcements that are made within it. At the same time, he has to deliver to the government the money it needs to function. This means that the Minister is continually engaged in a balancing act -- keeping the “numbers” and the “politics” in step with one another.

Supporting the Minister of Finance is the whole of the Department of Finance bureaucracy. The Department is the guardian of the tax system. Within the Tax Policy Branch, officials’ natural inclination is to prefer a “pure” tax system that generates the revenues needed by government in an economically efficient, neutral manner. Yet, they live with the day to day reality that the tax system is not and cannot be pure. Their duty is to implement, to the best of their abilities, the policy direction given to them by the Minister and they try to carry out this duty faithfully.

Although they contribute their best efforts, the relatively small band of officers is severely challenged by the variety and intricacies of industries and business practices. Members of interest groups that deal with Finance officers invariably see their role as one of educating them. They are at the same time frustrated by and sympathetic to reasons for the officers’ lack of in-depth knowledge in this or that subject matter of interest.

The capacity of Tax Policy Branch depends very much on the size of its staff complement at any point in time. Since 1980 the size of the branch has fluctuated in accordance with the priority of the tasks assigned to it. Probably no where is this illustrated more dramatically than in the change in the numbers of staff assigned to work

on consumption taxes. In 1980, there was a staff of about 4; as design and implementation of the Goods and Services Tax assumed prominence the staff complement increased by ten fold; it has now shrunk somewhat but remains at a strength of about 35 persons.

Aside from the Department of Finance, a number of other federal government departments are active in tax policy making. Revenue Canada is an important source of feedback on how the tax system is operating and its observations regarding implementation problems may spark the Department of Finance to amend tax policy and legislation. Revenue Canada may also offer comments on anticipated implementation problems in proposed policy and legislation. Revenue Canada is uniquely well situated to play this role because of the institutional separation of tax administration, the domain of Revenue Canada, from tax policy making, which is Finance's responsibility. Because of the need for Revenue Canada to understand the purpose behind the tax legislation it administers, there is also feedback flowing to it from Finance, as required, when Revenue Canada has to make a difficult administrative judgment call.

Departments such as Natural Resources Canada, Industry Canada, and Heritage Canada may contribute policy ideas and analytic capability to the tax policy making process. Natural Resources Canada has had a sizable tax policy unit since before the days of the National Energy Program. At times, departments such as these find themselves in the middle between an industry that desires some sort of tax change and the Department of Finance, which is in a position to support the change or to dismiss it.

When this happens, the department in the middle assumes the role of the “honest broker” -- encouraging the industry to put forward credible information that will support its case and helping the Department of Finance to gain an unbiased view of the situation so that it may make a decision that best serves the public interest. In the resource industries, where the provinces also have a strong interest in policy, the federal department can act as a three-way broker, as a repository for pooled information, and provider of analytic capability that serves everyone. This is particularly true where all parties have a common interest, such as preserving the international competitiveness of Canada’s federal and provincial tax and royalty regimes together.

Good maintained that business groups were the most important of the tax interest groups, and devoted almost no space to discussion of other interest groups.⁴ This view is arguable, but Good is able to state it because he chooses to not count tax professionals as an interest group. However, even accepting Good’s categorization and the assessment of groups’ relative importance that follows from it, it must be noted that interest groups are not a homogeneous lot. Even within the broad category of business interest groups there is variety. On one level are organizations such as the Business Council on National Issues and the Canadian Chamber of Commerce. The diversity of their constituencies makes it difficult for them to promote the interests of one industry or one company. They are more likely to approach tax issues from a macroeconomic perspective. Accordingly, they would likely feel it appropriate for their organizations to voice an opinion on a favoured approach to consumption taxation, but may feel it inappropriate to comment on

⁴ Good, *The Politics of Anticipation*, pp. 91-93.

a significant technical legislative change that affects a only a small minority of their membership.

On another level are organizations such as the Canadian Bankers Association, the Canadian Federation of Agriculture, or the Mining Association of Canada, whose constituencies are narrower and can afford to look at issues from a more microeconomic perspective. These groups can be counted on to examine the fine detail of technical legislative changes that may threaten their constituency with adverse impacts. But even within these smaller constituencies issues may arise on which members may wish to pursue different agendas. Thus, we can discern a third level at which individual corporations may enter into the tax policy making process on their own behalf. Because of the resources requirements for political interventions of this sort, we expect mainly the very large companies to take on such a role.

A similar pattern appears in the non-business sector. There are organizations such as the Canadian Labour Congress, the Consumers Association of Canada, and the National Anti-Poverty Organization which aim to represent fairly large constituencies. These are complemented by more narrowly focused organizations such as the Council of Canadians with Disabilities. Aside from the size of the constituencies served, one can also look at diversity within the non-business sector in terms of groups' policy focus -- for example, social policy versus health policy versus environmental policy.

As a general rule, organizations in the non-business sector are much more poorly resourced than their business sector counterparts when it comes to tax policy. While the Canadian Labour Congress has the benefit of some in-house research capability, a small organization like the Council of Canadians with Disabilities likely has to rely on help from a social policy consultant who may or may not have extensive experience with tax policy. For some organizations, shortage of resources is a major impediment to participation. One source expressed the fear that reduced funding may ultimately drive smaller non-governmental organizations out of the tax policy business.⁵ Only a handful of the largest non-governmental organizations will retain the capacity to remain as players.

A very important set of participants in the tax policy making process is the think tanks, which exist on both the left and right wings of the political spectrum. The list of such organizations is quite long, and includes familiar names like the C. D. Howe Institute, Caledon Institute for Social Policy, Canada West Foundation, Canadian Council on Social Development, Centre for the Study of Policy Alternatives, Conference Board of Canada, Fraser Institute, and Institute for Research on Public Policy. Often working in association with think tanks but also acting as participants in their capacity as individuals are academic experts from various disciplines. Think tanks may not put forward organizational positions on particular issues; they may simply provide a platform from which experts can express their personal opinions on public policy.

⁵ Interview No. 25.

Immensely important participants in tax policy making are tax professionals -- lawyers and accountants specializing in taxation who work for a single organization or who provide advice to a variety of client organizations and individuals. Members of the former group may belong to the Tax Executives Institute. Some of the elite members of the latter group participate in the Canadian Institute of Chartered Accountants-Canadian Bar Association Joint Committee on Taxation. Also, each of the CICA and the CBA have their own taxation committees. The Canadian Tax Foundation is the focal point of a nation-wide network of tax professionals from industry and private practice. It is fairly common to find members of the tax professional category who are active in the tax policy making process via industry associations, general business associations, and think tanks.

What distinguishes this group from all others is its depth of expertise in taxation. The incredible complexity of the tax system is a significant barrier to would-be participants in the tax policy making process. Tax professionals are in a class by themselves when it comes to having mastery of the subject matter, and that makes them highly sought-after participants. In the last chapter, I talked about the fairly recent Department of Finance practice of publishing draft legislation and explanatory notes. It is probably safe to say that the main audience for these documents is the community of tax professionals. These men and women can examine proposed legislation in minute detail, imagining how it would apply in this situation and that, and alert the officers of Tax Policy Branch's Legislation Division of potential pitfalls.⁶ Not every tax

⁶ The focus of tax professionals is almost exclusively on "technical" rather than "policy" issues. They help to ensure that legislation will successfully implement the government's policy intent without producing any damaging side effects. Tax professionals generally avoid promoting policy interests or criticizing the government's intent.

professional performs this function, but those that do tend to come from an elite group of the very best practitioners. It is through such activities that outstanding professionals stay up to date and at the top of their field. The enjoyment of practicing their craft at the major league level and having contact with the source of the law is a significant motivating factor.

The preceding paragraph focuses on tax professionals' role as "part of the solution." Equally, if not more, significant is their role as "part of the problem." Taxation is one of the most lucrative specializations within the professions of accounting and law. These exceptionally bright people make their living helping their clients minimize the tax they pay. It is this group that combs the tax statutes for loopholes through which individuals and corporations can escape taxation. Much of the effort expended by the Department of Finance, assisted by Revenue Canada and by tax professionals possessed of a regard for the public interest, is directed at closing loopholes as they are discovered.

Good saw Members of Parliament's interest in taxation as being largely limited to representing the views of their constituents -- "average taxpayers."⁷ However, I demonstrated in the last chapter that changes to the rules governing House of Commons standing committees have given Members of Parliament serving on the Finance Committee a much different and much heavier focus on taxation than was the case at the time of Good's writing. The work of this committee shows that members' interests are not strictly parochial. The committee, in its consultative mode, functions as an extension

of the Minister of Finance, gathering information that he can factor in to his decision making. This can occur because, despite the fact that all recognized parties are represented on the committee, the chairman has tremendous influence and stays in close contact with the Minister.

It would be misleading to suggest that the Chairman of the Finance Committee is purely a puppet of the Finance Minister. However, whatever latitude is accorded the Chairman by the government is purchased with the understanding that when the government needs passage of a bill, the Chairman will deliver it. And even though, on paper, the Committee can examine topics of its own choosing, a prudent Chairman will informally seek the green light from the Minister of Finance for any work that is not dictated by the government's agenda.

In fact, when faced with the task of examining and reporting on a tax bill, the Committee will probably find itself mired in bewildering detail. The Chairman has to exercise considerable skill in having the members apply themselves to the task. The Finance officials who appear before the Committee to explain the bill are faced with a group having a very tenuous grasp on what the proposed legislation is all about. In part, the practice of giving public exposure to draft legislation is an acknowledgment that the tax system has achieved a level of complexity such that the House of Commons and Senate committees charged with reviewing tax legislation can no longer reasonably be expected to have the technical competence required for the job.

⁷ Good, *The Politics of Anticipation*, pp. 83-85.

In addition, other standing committees are occasionally focusing on tax policy as it affects their sectors of interest. So, for example, the Natural Resources Committee has looked at tax policy affecting the Canadian mining industry. One committee that has been quite active in its scrutiny of the tax system has been the Public Accounts Committee. This committee's interest comes as the result of an increased amount of attention given to the tax system by the Auditor General of Canada. The Auditor General's reports are permanently referred to the Public Accounts Committee, which regularly holds hearings into those segments of the report that interest it. Over the years, it has shown itself to be concerned with the government's management of tax expenditure programs and with the government's ability to close loopholes that permit erosion of the tax base.

The government party caucus is also said to have become more active in budget policy making, which to some extent involves tax policy making. From time to time different parties' caucuses have invited tax policy experts to brief them on some topic of interest. The government caucus is also a target for lobbying efforts by interest groups seeking changes to tax legislation, for example, the introduction of a new tax expenditure program. In recent years, the caucus is reputed to be much more thoroughly briefed on the proposed content of upcoming budgets.

Another category of participants to be mentioned is the provincial governments. Provinces closely monitor the impact of federal policies on them, and are more aggressive in protecting their interests. Provinces provide input into tax policy making through federal-provincial committees that operate at different levels. One committee

consists of Assistant Deputy Minister-level officials and another consists of Director-level officials. There are federal-provincial committees of tax administrators. We also see provincial Ministers and their officials appearing as witnesses before the House of Commons Finance Committee as it deliberates on tax issues or as it conducts its pre-budget consultations.

Finally, there are the taxpayers themselves. As Good reported, a major source of taxpayer input is through the letters that they write to the Minister.⁸ Today, that unsystematic source of input is supplemented by scientific polling and focus group research sponsored by the Department of Finance's Communications and Consultations Branch.

3. Determining Who Occupies Positions

With the possible exception of officers in the Department of Finance's Tax Policy Branch, none of the positions listed above exist for the sole purpose of tax policy making. This implies that the boundary rules governing the selection of individual or organizational occupants of the positions are largely exogenous to the system of players involved in tax policy making. Simply stated, organizations and groups originate for all kinds of reasons and one would expect that those whose sole or primary purpose is participation in tax policy making would be very rare indeed. Many groups have long histories and varied interests. Nevertheless, there are exceptional cases of individual

⁸ Good, *The Politics of Anticipation*, pp. 94-96.

participants within a position class having a strong tax policy focus: the “Don’t Tax Reading Coalition” could be one of these, judging from its name.

While the topic of group formation is outside the scope of this study, it is meaningful to talk about the manner in which participants (representing their positions) are granted entry into the system of tax policy makers from time to time. The major observation to make in this regard is that the system is now remarkably open. The statistics cited in the last chapter on the growth of participants in various consultation processes clearly show this. Today’s reality is a sharp contrast to that which existed when Good wrote these lines:

“Tax policy is a private affair. It is closed to outsiders, but open to insiders. Privacy at the centre is one of its most distinguishing features. The actions of central participants are not known by outsiders nor are they intended to be known. The tradition of budget secrecy supported by the Parliamentary traditions of cabinet solidarity and ministerial responsibility all work to reinforce the distinct separation of insiders from outsiders.”⁹

Despite the increased openness of the tax policy making system, there are a number of gateways to the system and some individuals or groups wishing to gain access may be shut out of some gateways some of the time.

One very important gateway regulates who may have access to the Minister of Finance. Members of interest groups interviewed for this study, perceiving that decision making power ultimately resides with the Minister, placed very high value on the ability

⁹ Good, *The Politics of Anticipation*, p. 45.

to talk to him.¹⁰ They believe that the Minister is always open to compelling arguments. While there are some individuals or organization who can expect to be granted access regardless of who is the incumbent Minister, there are those who may or may not enjoy access. Among the former group are leaders of influential national organizations such as the Canadian Manufacturers Association or the National Anti-Poverty Organization. These are formidable institutions in their own right and their widely accepted legitimacy assures that attention will be paid to them.

In part, legitimacy is a function of the number of individual members the organization represents. Canada's two major labour organizations, the Canadian Labour Congress and the Canadian Federation of Labour are cases in point. Similarly, the Canadian Chamber of Commerce and the Canadian Federation of Independent Business boast sizable numbers of member businesses. The Business Council on National Issues represents a relatively small number of members, but because these members include many of the very largest business organizations in the country it enjoys a privileged place among interest groups.

Other important factors include whether or not the organization has a high-profile leader and whether it has a track record of providing constructive input. Bob White of the Canadian Labour Congress and John Bulloch, formerly of the Canadian Federation of Independent Business, are examples of highly recognized individuals whose presence can help ensure that their organization can have a place in any policy debate in which it is

¹⁰ Interview Nos. 16 and 17.

interested. Thus, acceptance of an individual's or an organization's status by the media has the effect of opening the gateway.

However, even these organizations exercise their privilege of access sparingly, in recognition that the Minister has limited amounts of available time which should not be taken up with trivial matters. As a result, meetings with the Minister may only occur two or three times a year.

Contacts between the Minister and interest groups are often initiated by the Minister. If the policy change being contemplated affects particular industries, associations representing those industries will be sought out for consultation. Even though consultation with an association may be important when its industry is clearly affected, the same organization, if it belongs to declining industry, may be less sought after for comment on issues of more general interest. There is a pecking order among industry associations. On some issues, the Minister will wish to consult with both business and non-business groups so as not to appear to be favouring one side over the other.

The changes to the information rules, discussed in the last chapter, expanded the opportunities for consultation with the Minister of Finance. This entailed a concomitant change in the boundary rules to permit more participants through the gateway. How the gateway operates depends to some extent on the personal preferences of the Minister. I have already noted how Finance Minister Don Mazankowski found the demands on his

time by groups seeking consultation too great and so introduced the notion of round table meetings.

The topic to be discussed is a big factor in determining the level at which consultations will take place. If the topic is policy then it is the Minister who will be targeted. Many Finance bureaucrats are perceived as being highly conservative and therefore unlikely to act as champions for a new proposal. However, some consultation is necessarily off-loaded from the Minister's office to the bureaucrats because of the Minister's limited availability or because the Minister's interest has been piqued and he wishes his officials to investigate a proposal and provide him with advice.

At other times individuals and groups will contact Finance officials directly. This is more likely to be the case where the issue is technical and, therefore, would be unlikely to interest the Minister. Anyone who writes in will get a reply. For interesting proposals, officials may wish to speak to someone by telephone. Face-to-face meetings are granted sparingly, simply because officials, too, have limited time available. Senior officials at the Assistant Deputy Minister, Director and Chief levels act as gatekeepers. They have to judge whether the person interested in a meeting has good policy sense and a sound proposal that may interest the government, or whether the proposal is ill-considered and self-seeking.

Increasingly, Tax Policy Branch officials feel comfortable initiating contacts with people outside the Department. As successive Ministers of Finance have encouraged a

consultative mode of action, officials are willing to seek information and advice from people in affected industries, say, at an earlier point in the policy development process. Also, as draft legislation is put out, the names of Tax Policy Branch officials appear in accompanying press releases inviting potential commentators to make contact at the working level.

Some things that foster the feeling of openness between tax practitioners and Tax Policy Branch officials are the separate formal meetings that occur annually between officials and representatives of the Tax Executives Institute and the Canadian Institute of Chartered Accountants-Canadian Bar Association Joint Committee on Taxation. These conference-style meetings are fora for the participants to discuss work in progress -- such as outstanding draft legislation -- as well as to bring forward new proposals. Because there is a social side to the meetings they are valuable for loosening the boundaries around the Department of Finance.

A hot issue in years gone by that involved both information and boundary rules had to do with the ability of the Department of Finance to engage consultants to work on budget preparation. While the notion of employing consultants in this way was viewed as scandalous in Walter Gordon's day¹¹, it has now come to be regarded as a sensible

¹¹ Sutherland describes the Gordon episode as follows: "Gordon created a minor scandal in June 1963 in connection with his handling of the budget. While responding to criticism that he had favoured American financial interests by removing a tax on Canadian shares sold to non-residents, he left the impression that there were a couple of business 'special advisors' working in his department as consultants, and that these consultants had enjoyed privileged and illegitimate knowledge of the content of the budget before the sensitive tax decision. Gordon eventually apologized on 24 June for having created a 'misunderstanding.'" See S. L. Sutherland, "The Consequences of

response to the Department's need to obtain top quality technical expertise when drafting complex tax legislation.

A variation of this involves the federal government's executive interchange program, under which people from outside government occupy staff positions within the Department of Finance for a fixed period, such as one or two years.¹² Even positions as senior as the Assistant Deputy Minister in charge of Tax Policy Branch have been filled in this manner. One tax professional interviewed for this study cited the advent of this practice as one of the most significant institutional changes to have affected tax policy making in years.¹³ Not only is there the short term impact of giving the Department access to top notch experts, there is also the longer term impact of expanding and solidifying the communication links between departmental insiders and outsiders once these people leave their temporary posting and return to their regular employer.

With respect to the House of Commons Finance Committee, there exists a situation analogous to that involving the Minister of Finance. When the authority rules changed to permit the Committee to engage in more policy studies and pre-budget consultations there was a corresponding change in the boundary rules controlling access to the Committee. Here the general rule seems to be that individuals or groups may

Electoral Volatility: Inexperienced Ministers 1949-90," in *Representation, Integration and Political Parties in Canada*, ed. Herman Bakvis (Toronto: Dunburn Press, 1991), p. 322.

¹² Theoretically, the exchanges could go the other way, too, with government officials being seconded to positions outside the public service for fixed periods. In practice, however, this seems to occur rarely. Only one organization contacted for this study had experienced an interchange of this sort (Interview No. 31).

¹³ Interview No. 27.

submit written submissions and based on the perceived quality of the submission the group may be invited to make a presentation to the Committee in person. For potential participants who are well known and respected by the Committee an invitation may be dispatched whether or not a written submission is presented.

The partisan make up of the Committee has an effect on the boundary rules. For example, when the Committee is undertaking a policy study, the Chairman will allow all the parties represented on the Committee to nominate witnesses. In this way, there is some assurance that all points of view on the topic under study will be brought forward. There may be a preponderance of testimony that supports a particular position, but the written record will at least contain the contrary views even if they are not ultimately persuasive to the majority government members of the Committee.

The Chairman can also exercise influence on the Committee through the selection of consultants to advise it. While the Library of Parliament supplies one or more researchers to the Committee, the Chairman also controls a budget that allows for the hiring of contract researchers. Having the support of the majority of committee members means that the Chairman is assured of having the consultants he wants. The consultants exercise influence by briefing committee members, supplying them with analyses of briefs submitted, and assisting with the writing of the Committee's report. On occasion, the non-government members of the Committee may find resources outside the Committee's budget to hire consultants of its own to "shadow" the work done by the Chairman's hand-picked crew.

In the previous section I noted that the Prime Minister, other Cabinet ministers besides the Finance Minister, and caucus can be participants in the tax policy making process. The boundary rules for these participants form part of a separate institutional structure on which tax policy making is overlaid. For the purposes of this study, I have not looked into that structure in more than a casual way. However, I did learn that insofar as formal meetings take place between caucus and interest groups or individuals, the key seems to be that someone first captures the attention of an individual caucus member who then works within the caucus boundary rules to arrange a presentation.

While the venues for participation just mentioned do have restricted access, at least as regards face-to-face encounters, these and other venues have virtually unrestricted access via the medium of print. Policy think tanks, for example, may participate by publishing works containing avant garde analysis and proposals that may be picked up by advocacy groups who take on the role of policy entrepreneurs. One interest group representative interviewed for this study saw as part of his role to scan the literature and/or media reports turned out by think tanks, academics and interest groups in other countries for ideas that may be applicable to Canada.¹⁴

On a different plane, the Auditor General occasionally publishes reports drawing attention to problems in tax policy implementation that may be picked up by the Department of Finance or the Public Accounts Committee. Also, court decisions may come out that cause a stir in policy making circles. The series of Thibaudeau decisions

are notable examples. Like print, participation of these types is not subject to any gatekeeping by other participants within the tax policy making system. Unlike print, however, participation from these sources comes with a degree of legitimacy that means any interventions are almost assured of provoking an immediate action.

4. Aggregation Rules: Who Decides and How?

Given the variety in the organizations and roles represented by people interviewed for this study it was not surprising to find variation in their perceptions of who decides upon tax policy and of the bases on which decisions are made. However, there did seem to be a majority view, and this view differs a bit from the traditional view concerning the relative influence of different players in the process.

The traditional view has been that the Minister of Finance is the ultimate policy maker. In the very early stages of thinking about the next budget the Minister will engage the Prime Minister and selected Cabinet colleagues in private chats about general strategies. Then, about a week before the budget is brought down Cabinet is briefed on the budget but is not given any specifics. At about the same time the Prime Minister will see the details of the budget so that he might have a chance to suggest changes.¹⁵

Now, while the Finance Minister still occupies centre stage when budgets are brought down, he has been exposed to input from many more sources and will have had

¹⁴ Interview No. 16.

¹⁵ Good, *The Politics of Anticipation*, p. 123.

to weigh both the merits of the arguments and the political importance of the sources. He will be assisted in this endeavor by his personal staff and by a number of outsiders in whom he has confidence.

The heavy emphasis on a consultative process creates an expectation that the voices that are heard will have an influence on the policy directions chosen. One very important source is the polling and focus group research that gives feedback not only on the content of the proposed budget but also on the manner in which it is presented. The attentiveness of the Minister to public opinion can be troublesome for industry associations whose members come from industries that do not attract a lot of public sympathy, such as financial institutions, tobacco manufacturers, or distillers.

Indeed, the influence of the public environment on decisions has grown. A number of people interviewed for this study observed that recent decisions have not been “made” as much as they have been dictated by circumstances.¹⁶ The implication of this point of view is that aggregation rules and changes to them are of lesser significance than is the environment in determining tax policy. Specifically, these people say that recent tax policy has been determined by Canada’s severe financial need. Given that we found ourselves with our backs to the deficit wall, our tax policy choices come down to two: increasing tax rates or broadening the tax base. When the political mood and our proximity to the relatively low-tax United States are factored in, the first of these apparent options turns out to be illusory. The result is the cutting back of existing tax

¹⁶ Interview Nos. 19, 22, 23, 25, and 26.

expenditures and the virtual moratorium on new tax expenditures that was noted in chapter 4.

At no time was the influence of the environment more obvious than for the 1995 budget. Even though the rate-lowering, base-broadening trend had been in evidence since 1981, the world financial community watched closely for reassurance that Canada was serious about dealing with its deficit crisis. There was a very real threat that, had the budget not lived up to expectations, investors would begin selling off Canadian assets. One source offered the view that the changes in the policy-making environment (fiscal restraint) were far more influential than institutional changes in explaining the decisions made in recent years.¹⁷

The traditional view also holds that the bureaucrats within the Department of Finance wield a tremendous amount of influence over tax policy because of their technical expertise and the relative amateurism of their political masters. It is certainly true that no Minister of Finance would attempt to make tax policy without seeking the advice of officials. But how much influence they have will depend on whether the Minister respects them and has confidence in them.

When it comes to technical issues as opposed to budgetary issues, the attribution of significant influence to the bureaucracy appears to be especially accurate. Ministers of Finance are typically briefed by officials on those proposals for legislative change that are judged to be politically significant but as for more mundane proposals, these may be

presented to the Minister simply as matters that he need not worry about and he will approve them on the recommendation of his Deputy Minister. The judgment about which matters should be highlighted for the Minister and which can be rubber stamped belongs to senior officials, principally the Assistant Deputy Minister in charge of Tax Policy Branch and the Deputy Minister. An essential attribute for success in these positions is the ability to make sound judgments of this sort.

With respect to high profile and/or potentially sensitive issues, not only does the Minister of Finance not simply follow the advice of his officials, he is obliged to refer the decision to his Cabinet colleagues and the Prime Minister. Cabinet is far more involved and influential in budget making than it was in the 1970s. It may be true that the aspects of the budget with which they are most involved are not the tax changes. After all, the budget, thanks in part to the separation of technical tax changes into a separate process, is more significant as a vehicle for announcement of the government's initiatives across the full range of policy areas and less significant as the vehicle for making tax changes.

Caucus is likely to have more influence on the Minister than is the Finance Committee. Although the Committee does make recommendations, its main role is to test concepts that originate from the government, the Minister or committee members themselves. So, where one does see correspondence between measures recommended by the Committee and actions taken by the government, it is far from clear who has influenced whom. The Committee also believes that it provides a service simply by allowing different points of view to be placed on the public record. Add to this the fact

¹⁷ Interview No. 19.

that Committee majority reports are often accompanied by minority reports offering differing views and it becomes exceedingly difficult to know what is the best way to judge the contribution of the Committee to tax policy making.

5. Comparison of Empirical Findings to Theory

This chapter shows that there have basically been no changes with respect to position rules since the time of Good's research in the late 1970s. The Minister of Finance, officials of the Department of Finance and other federal departments, provincial government officials, business and non-business interest groups, tax professionals, public policy think tanks, academics, Members of Parliament, the Office of the Auditor General, the courts, and individual taxpayers were all present then and now. Within the category of Department of Finance officials, the creation of the Communications and Consultation Branch is a minor exception.

However, the previously discussed changes to the authority and information rules, which had the effect of giving various players greater access to information and greater latitude for action have necessitated enabling or accommodating changes to the boundary rules so that more potential participants could enter the tax policy making process through the existing structure of positions. Very important in this regard are the gateways established to control or facilitate access to the Minister of Finance and the House of Commons Standing Committee on Finance for the purpose of pre-budget consultations. Also important is the greater freedom accorded officials of Tax Policy

Branch to seek information and advice from interested parties outside the government in the course of policy design and implementation.

While essentially no new positions were created, the increased number of participants possessed of greater authority and information means that certain players or groups of players have increased importance today compared to the late 1970s. Because of this I revisited and added to the “models of the individual” implicit in Good’s descriptions of the important players as they existed at the time he made his observations.

In one sense, the aggregation rules have not changed since the late 1970s: both then and now the final say on tax policy rests with the Minister of Finance. However, the calculus that he employs in making his decisions must surely have changed in response to changes in other institutional rules. By admitting more participants and therefore more points of view, and recognizing as well the fact that some long time participants such as the provinces and other federal government departments have increased in stature, an expectation is raised that they will have a material influence on the decisions that the Minister makes. In a sense, therefore, the Minister is more constrained in what he may choose to do.

Another factor constraining the Minister of Finance is the economic environment of the country, in particular its relationship to the world financial community. That Canada is facing a debt and deficit crisis has become a taken for granted fact. Although

the Minister of Finance retains some room to maneuver, his freedom is circumscribed by environmental pressures to deal with that institutionalized reality.

In terms of comparison of the observed situation to the theory developed in chapter 2, I find that my conclusions with respect to the boundary and aggregation rules are essentially identical to those I arrived at in considering the authority and information rules. I do notice, however, how much the rules are interrelated. I even wonder whether it makes sense to consider each category of rules as separate independent variables; however, it will be necessary to leave this question to be answered by other case studies.

Chapter Seven: Strategies and Impacts

1. Introduction

In Chapters 4, 5 and 6 we used a revised version of Elinor Ostrom's framework¹ for the description of institutions as a guide to the examination of the nature and causes of institutional changes affecting the tax policy making process in Canada. Ostrom's framework itself does not provide any explanation for institutional change. To explain institutional change we drew upon sociological and economic theories. In this chapter we will turn our attention to the consequences of institutional change, breaking down the consequences into two broad categories: strategies and impacts.

Central to Ostrom's thinking is the notion that institutions can be described in terms of a series of rules. Institutional change, therefore, implies changes to rules. There is an underlying assumption that human beings are rule-following by nature so that one would expect a change in an institution, thus defined, to be manifested in the observance of the new rules by the people whom they affect. There is a cause and effect relationship between the rule changes and the changes in observed rule following, but this is not the most interesting relationship from the perspective of a study of policy making. On the other hand, an examination of the cause and effect relationship between changes in institutions-as-rules and the strategic behaviour of people operating within institutions is

¹ Elinor Ostrom, "An Agenda for the Study of Institutions," *Public Choice*, 48 (1986), pp. 3-25.

more interesting. The change in behaviour goes beyond simple compliance with new rules to changes in the way people pursue their objectives given that the rule changes will involve some combination of changes to resources (e.g. information) and changes to constraints. Also, it is possible that changes to institutions may evoke changes to participants' objectives.

In previous chapters, I find that institutional changes affecting the tax policy making process have provided government with easier access to certain avenues for the acquisition and dissemination of information. Also, the government has a measure of choice regarding the characterization of legislative amendments as being either of a "technical" or "policy" nature. Further, the institutional changes have facilitated the more frequent adoption of cooperative strategies among participants. Finally, interest groups are better able to use parliamentary committees as vehicles for lobbying and for communicating their policy positions, but may be influenced by the venue in their choice of policy positions and comportment during hearings.

The present chapter looks at impacts on tax policy making in terms of five performance variables: its flexibility in bringing to bear differing viewpoints, its capacity for handling a large number of issues, its effectiveness in resolving issues, the legitimacy of the system in the eyes of those who will be affected by policies that it generates, and the accountability between principals and agents in the process.

With respect to flexibility, I find that while the Department of Finance still controls the agenda for the most part, institutional changes have made it possible for other participants to place issues on the agenda from time to time. Another indicator of flexibility is the source of potential solutions considered by the policy making process. Here, I find that the Department of Finance continues to take the lead, with other participants mainly reacting to Finance proposals.

I find that institutional changes have not increased the capacity of the process to solve problems -- the impact of resource constraints seems to swamp the impact of institutional changes. Regarding effectiveness, I look at process inputs rather than outcomes, and conclude that institutional changes have led to improvements that should manifest themselves in policies that are more capable of sound implementation.

Using subjective assessments of political support for policies as a surrogate for legitimacy, I find that institutional changes have helped create an environment where tax policy changes are generally favourably received by participants and the public. With respect to accountability, I find little improvement that can be attributed to institutional changes.

As was the case for the last chapter, this chapter relies most heavily on the data collected in interviews with the sample of 32 current and former participants in the tax policy making process. It is primarily a record of their perceptions and opinions.

2. Government Strategies

Relaxation of the constraints imposed by the information rules allows the government to pursue two strategies in combination. One strategy focuses on obtaining input for decision making. An example of this strategy in action is the publication of draft legislation so as to invite critical comment that can be used to identify and correct technical flaws before statutes are enacted.

The other strategy focuses on disseminating information about the government's problems, constraints, ideas and intentions. Despite its ostensible purpose to obtain input for decision making, people interviewed for this study regarded the pre-budget consultations process as embodying a strategy for getting out the government's message in a way that will neutralize critics and make the government's actions appear to be responsible and appropriate.²

The more relaxed information rules also facilitate the government floating trial balloons hinting at policy changes that could appear in a future budget. Again, while this might cause important information about the planned initiative to surface, it might also be used in a manipulative fashion to raise the spectre of harsh measures which will never materialize. The public, finding that its worst fears have not been realized, will be less likely to voice strong criticism of whatever less draconian measure the government puts forward. However, the use of the trial balloon need not be manipulative. Fully accurate

information about a policy change that will have negative consequences could be floated just to give the public time to reflect upon and come to accept the necessity of the initiative.

The separation of technical and policy measures into separate bills also sets up the opportunity for strategic behaviour by the government. In practice, the distinction between technical and policy matters is not all that clear. Anything having a significant revenue impact would probably be considered a policy matter. Similarly, the introduction of any kind of a tax incentive, even if it did not entail a significant revenue impact would probably be considered a policy matter. But situations arise which are not so apparently clear cut. This allows the Minister of Finance to choose the manner in which some items will be presented, although there is probably more flexibility to present technical matters in the budget than there is to present policy matters in a technical bill.

Technical material is rather turgid and the purpose of technical “fixes” is often to close off a tax avoidance opportunity or to rectify an anomaly. Given that Ministers of Finance have a preference for up-beat budgets, including technical matters in a budget may be contrary to the desired tone. Also, the audiences for technical bills and budgets tend to be different. Technical bills are primarily directed to tax professionals while budgets are directed to the general public. However, the 1994 budget announced highly technical changes to the foreign affiliate rules because the budget contained the theme of “tightening the corporate income tax system.”

² Interview Nos. 4, 8, 10, 17, 18, and 30.

One person suggested that the introduction of the annualized budget could enable the government to make budget-like announcements at any time (through so-called economic statements or whatever) without invoking the rights of the Opposition in Parliament to conduct a Budget debate.³

3. Federal-Provincial Cooperative Strategies

Good's characterization of tax policy making as a process in which the "insiders" of the tax community try to anticipate the needs of, but rarely consult with, various categories of "outsiders" suggests an essentially non-cooperative game. Since cooperation depends on exchange of information, the previous complete curtain of secrecy around budget making pretty much ensured this result. However, as secrecy is relaxed, the possibility of cooperation among participants is increased. In practice, results have been mixed, but there have been some notable successes in achieving cooperation.

There is ample reason for the federal and provincial governments to cooperate in the tax policy field. The size of the federal and provincial governmental sectors are each large enough in relation to the other to create a threat that the objectives of one level of government could be undermined by uncoordinated tax policies in place at the other level of government. In 1993, the federal government lowered its surtax on personal income

tax to 3 percent from 4.5 percent tax only to have the desired effect partially wiped out when the Province of Ontario raised its surtax on personal income tax to 17 percent from 7 percent. As regards personal income tax, the revenue of those provinces that are parties to the tax collection agreements is vulnerable to fluctuation due to changes in the computation of the federal tax base, since provincial tax is calculated as a percentage of Basic Federal Tax. In its 1991 Budget,⁴ the federal government announced measures to limit the deductibility of provincial payroll and capital taxes, citing as the reason increased use of these taxes by provinces leading to loss in federal corporate tax revenue. A similar situation occurred years earlier in respect of provincial resource royalties, which were deductible for federal corporate income tax purposes. This led the federal government to substitute a fixed allowance for full deductibility of provincial royalties in order to protect the federal corporate income tax base.

With federal and provincial governments both taxing the same businesses and corporations, there is a danger, from the taxpayer's point of view, that combined tax rates will become too high for them to remain viable and/or competitive. The banking industry complains that as provincial and federal governments both increase their capital tax rates the industry must carry a disproportionate burden as compared to other industries. However, as banks continue to post record profits, neither government nor the public is overly sympathetic to banks' concerns. On the other hand, recent changes to the resource

³ Interview No. 10.

⁴ *The Budget* (Ottawa: Canada, Department of Finance, February 26, 1991), pp. 149-153.

allowance rules⁵ illustrate a remarkable cooperative effort among three federal government departments (Finance, Natural Resources, and National Revenue), provincial governments, and industry representatives. In this instance, industry and the provinces provided data and Natural Resources Canada did most of the research. After much informal and formally-organized dialogue among the participants a new regime was fashioned to replace the old one, which had been rendered untenable by the availability of tax planning techniques that were severely eroding the tax base.

Specific examples such as the resource allowance regime aside, federal-provincial cooperation has been generally facilitated by the federal government's movement to a regular annual budget schedule. More often than in the past the federal government will approach the provinces to obtain their support for proposed measures that it expects may be controversial or to obtain a better understanding of the likely impacts of a proposed measure on industries with which the provinces have closer ties and are, therefore, more aware of issues that may arise. Federal and provincial governments have a common interest in ensuring that their combined tax regimes are competitive with those existing in other countries. Likewise, they have a common interest in sharing information that can

⁵ For income tax purposes, taxpayers are permitted to deduct from income a "resource allowance," which is an amount computed as a percentage of "resource profits." A problem arose for the government when taxpayers began to deduct certain amounts from income but not from resource profits and the practice was upheld by the courts. Taxpayers could benefit from the anomalous situation where resource profits could be kept high, which in turn made for a high resource allowance, while income could be kept low. The solution to the problem (worked out among the federal government, provincial governments and industry representatives) involved tightening the rules for determination of resource profits.

lead to the closure of tax loopholes and to combating noncompliance with both tax systems.

4. Interest Group Strategies

Now that the Finance Committee has a greater role to play in tax policy making, some interest groups attempt to use the Committee as a pressure point. For example, groups representing the charity sector pushed via the Finance Committee for enriched tax breaks for charities.

However, many interest groups regard appearances before House of Commons and Senate Committees just as opportunities to place their views on the record. They do not feel that the Committees themselves have great policy influence. So, for example, an industry association is more likely to focus attention on individual Members of Parliament who comprise an informal “caucus” for that particular industry, perhaps because they come from ridings in which that industry is an important employer.

Members of major interest groups have an expectation that the organizations they support will be active in representing their interests and participation in high-profile activities such as pre-budget consultation provides evidence that these organizations are doing their jobs. For that reason, these groups cannot afford not to participate. The aim is not to persuade as much as it is to generate interest in their position that can be pursued further in another venue. Also, appearances before Committees allow organizations, via

the media or by getting mentioned in the Committee's report, to communicate to their members the organizations' positions on issues. In this respect, public consultations are better than private meetings with the Minister. Nevertheless, one of the interest group representatives interviewed reported that his group's pre-budget consultation efforts were decreasing -- the benefits are sufficiently dubious and the opportunity costs sufficiently high to make the venture unattractive.⁶

One of the government's objectives in moving to a round table format for pre-budget consultation, whether at the Ministerial level or in the Finance Committee, was to force interest groups to use different consultation strategies. In a round table a group making a clearly self-interested plea must make a case justifying why it and not some other deserving group or class of citizens should benefit from government support. By playing off groups against each other the focus of attention shifts away from the government.

With respect to the Standing Committees' role in scrutinizing legislation that has been tabled in Parliament, interest groups are unlikely to seek participation unless they are faced with legislation to which they are strongly opposed. In this case, they may try to use the Committee as a court of last resort.

Interest groups welcome the general opening up of communication lines between them and Finance's Tax Policy Branch for the opportunities it provides to feed into the

⁶ Interview No. 13.

groups' "early warning systems." Groups do not like to fight policy battles at the last minute when decisions may already have been made. The sooner they can make their representations the better. Even if decisions are not made at the bureaucratic level, the presumption is that bureaucrats will alert their superiors to the interest group's concerns and that ultimately the Minister will be briefed, if the issue is significant.

At times, interest groups will pursue first- and second-best alternatives in parallel, using different strategies. Opposition to a proposed policy will be voiced at the political level in an attempt to have the policy fundamentally changed as a first-best alternative. Meanwhile, the interest group will work at the bureaucratic level on introducing technical changes to the proposed policy so as to mitigate its undesirable effects should it ultimately be adopted. Efforts aimed at politicians also support the efforts aimed at bureaucrats. This two-tiered strategic approach reflects the fact that groups are risk averse and are unwilling to gamble on an all or nothing political assault.

5. Cooperation Among Interest Groups

While changes to institutions provide interest groups with the potential to pursue different strategies, the actual choice of strategy will depend on other factors, not the least of which is availability of resources. This factor is causing groups to band together on certain issues.

A number of interest group representatives interviewed indicated that their organizations were involved in cooperative efforts with like-minded organizations. For example, they spoke of coalitions formed to address issues such as possible changes to the rules governing Registered Retirement Savings Plans or the regime of taxation for employee benefits, such as health and dental plans. It does not seem that such efforts can be attributed to any of the institutional changes discussed in this study. An exception is the joint effort by social policy oriented interest groups to produce an alternative budget, which is made possible by the regularized federal budget process.

6. Flexibility -- Agenda Setting

In Chapter 2, I defined the first phase of the policy life cycle as “stimulus,” and characterized it as consisting of real phenomena. Ignoring for the time being the possibility that stimulus phenomena result from previous iterations of the tax policy life cycle, this phase is treated as exogenous in relation to institutional variables within the tax policy making system. Therefore, I do not expect to find impacts appearing in this phase from changes to institutions. However, the second (attention) and third (analysis-argument) phases of the policy life cycle is another matter. These are the phases that encompass agenda setting activities, and these activities may be affected by institutional changes.

For the most part, the government has a firm grip on the tax policy agenda. Despite changes to authority, information, and boundary rules favourable to interest

groups, many do not regard themselves as having a big role in setting the tax policy agenda. They generally find themselves reacting to issues that the government has put on the table. During the late 1980s, income and sales tax reform dominated the tax policy scene and were placed there by the government. In the last two or three years, first the replacement of Goods and Services Tax and then its harmonization with three Atlantic provinces have been major agenda items sponsored by the government.

Nevertheless, in recent years the government is having to deal with issues that it did not place on the agenda. The Department of Finance does not enjoy complete control of the agenda. To what extent did institutional changes play a role in bringing about this phenomenon?

The tax treatment of child support payments is an example of an issue placed on the agenda through the courts. This can be traced to changes to the scope rules following from the introduction of the equality provisions of the Canadian Charter of Rights and Freedoms. The courts have always been a source of technical tax issues so it is not the involvement of the courts per se that marks a change. Rather, it is the character of the issue that is different. This is not to say that court-derived technical issues are necessarily less significant than a Charter-based issue.⁷

⁷ For example, a Supreme Court ruling [*Her Majesty the Queen v. Phyllis Barbara Bronfman Trust*, (87 DTC 5059)] involving a question about when interest is deductible for income tax purposes overturned long-standing principles and threw tax policy into turmoil. Years later, the Department of Finance has still been unable to re-establish workable principles for interest deductability (one of the most fundamental problems of income determination for tax purposes). The difference with respect to the interest

Another source of tax policy agenda items over the past decade or so has been the reports of the Auditor General of Canada. In 1977, the mandate of the Auditor General was expanded to allow the Auditor General to examine matters relating to the economy, efficiency and effectiveness of government programs. This mandate change was focused on government expenditures, not revenues, and so did not have a direct impact upon the Auditor General's activities with respect to tax policy. However, it did bring about a change in the organizational culture of the Office of the Auditor General. Imbued with this new culture, yet relying on other sections of the Auditor General's legislated mandate, officials having expertise in taxation began to examine and report on tax policy-related matters.

One can note that this shift in practice is an example of March and Olsen's notions of normative order and demographic order at work.⁸ The broad cultural change within the Auditor General's office made it normatively appropriate for its staff to examine tax issues from a value-for-money perspective. The arrival of staff with tax expertise (in March and Olsen's terms, a change in the cohort structure) then enabled the Office of the Auditor General to adapt its behaviour to fill the space created by the new norms.

deductibility issue as compared to the child support issue is that we cannot look to an important institutional event like the enactment of the Charter for its origins; the difference has nothing to do with the importance of the respective issues.

At times the Auditor General's reports have dealt with problems that were well-known among tax professionals but which were not politically high profile. An example is the Auditor General's 1993 report concerning the use by Canadian corporations of foreign affiliate corporations to shelter income from Canadian income tax. At other times, the Auditor General's reports have brought to light situations that were not widely known. In 1996, the Auditor General drew attention to a series of transactions in which family trusts were used to facilitate the movement of assets out of Canada without triggering Canadian capital gains tax. In response to both of these reports the government introduced legislative changes. In the former case, the changes may have been forthcoming anyway, but in the latter case there is no evidence that changes were planned.

7. Flexibility -- Discussion of Policy Options

The regular publication of tax expenditure estimates is an example of the way that information rules have changed. The assessment of the impact of this practice is sharply divided, basically with Department of Finance insiders expressing disappointment with the impacts and outsiders expressing general satisfaction with the impacts. Finance officials complain that tax expenditure estimates are used in a very simple minded way that is not helpful in generating viable tax policy options.⁹ Specifically, the argument is often made that the way to get rid of the deficit is to eliminate all tax expenditures. This

⁹ James G. March and Johan P. Olsen, "The New Institutionalism: Organizational Factors in Political Life," *American Political Science Review*, Vol. 78 (1984), p. 744.

view equates tax expenditures with tax loopholes. But some tax expenditures are so well entrenched in the tax system that they could easily be taken as partially defining the tax base, rather than as deviations from some notional base. Registered Retirement Saving Plans are a good example.

The media, during the run up to the budget, like to play a guessing game about which tax expenditures may be on the chopping block. The problem with this approach to the analysis of tax expenditure accounts is that it rarely produces specific proposals about which a serious debate can be conducted. A better quality debate would address the merits and level of a particular tax preference.

In part, opponents of tax expenditure estimates are concerned that the estimates themselves are misleading. One cannot simply take for granted that were a particular tax expenditure to be eliminated the government's tax revenue would increase by the amount at which the tax expenditure is valued. Taxation brings with it complex incentive effects. If a tax expenditure were to be eliminated taxpayers currently benefiting from it would change their behaviour to mitigate the effect of the change on their tax liability. The outcome would likely be some increase in tax revenue, but quite probably not by the amount at which the tax expenditure was valued.

In contrast, proponents of tax expenditure estimates regard them as facilitating a more informed discussion of government revenue sources. They have been used most

⁹ Interview Nos. 3, 4, 6, and 10.

widely in discussions about the relative merits of spending cuts versus reductions of tax expenditures as strategies for dealing with the debt-deficit issue. Approached in this way, the interpretation of tax expenditure estimates reflects undercurrents of left-right ideological differences. There are some tax expenditures that serve social objectives and others that serve economic/business objectives. Different camps target different tax expenditures for possible elimination.

Provincial governments make use of federal tax expenditures estimates to obtain a sense of the national impacts of tax preferences. However, provincial governments need to supplement this information source with their own economic modeling in order to determine the impacts of tax preferences on their province.

A number of people interviewed for this study shared the view that the annualized budget process gives interest groups more time to prepare their submissions, which means that they can better organize themselves and, in the end, produce better quality submissions.¹⁰ The preparation of the “Alternative Budget” by the Centre for the Study of Policy Alternatives was cited as an initiative that is made possible by having regularly scheduled federal budgets.¹¹ Although led by the Centre, the production of the Alternative Budget is the product of a joint effort by a number of organizations. A working group is struck some six months before the anticipated date of the federal budget and a fairly intense period of work follows. Given the scarceness of their resources, for

¹⁰ Interview Nos. 8, 9, 10, 14, 22, and 23.

¹¹ Interview Nos. 17, 19, and 30.

some groups the commitment to this effort represents a major strategic decision; participating groups are expected to assign high-quality staff to the task and to allow them enough time away from their other duties to enable them to make a solid contribution.

While pre-budget consultations may bring to the surface broad policy options, with respect to tax proposals more narrowly defined Department of Finance officials feel that they are the source.¹² A minor exception is the case of proposals coming from other government departments, agencies and Crown corporations for “earmarked” taxes to replace funding lost due to government downsizing. A recent, public, proposal of this kind dealt with a tax for the purpose of supporting the Canadian Broadcasting Corporation.

Other participants tend to react to the creative work done within the Department. I do not find this surprising given that few, if any, of the participants having the resources to do tax policy work have any interest in proposing new taxes or tax regimes. For example, professional tax advisors, while highly skilled, have no reason to advocate new taxes that would further burden their clients. This is where academics play a vital role. Academics may be very knowledgeable yet unencumbered by business affiliations and, therefore, freer to examine issues and policy options objectively. Some interest groups -- especially non-business interest groups -- must content themselves with keeping alive issues and marketing options developed by others.

So, although the tax policy making process is more open than it was in the past, constraints on resources and the highly complex nature of the subject matter combine to impair the chances for augmenting the quality of input, at least as regards the generation of new tax policy alternatives. Also, the notion that you cannot increase taxes has taken on the stature of a political myth. So secure is this tenet of the right wing agenda that even left-leaning groups find it pointless to talk about the possibility. Similarly, one person suggested that some features of the tax system have such a high degree of acceptance that discussion of alternatives to them is pre-empted.¹³ The example cited was the regime for Registered Retirement Savings Plans. Debate on this feature is virtually limited to a discussion of the appropriate ceiling for contributions -- no other design changes would be seriously considered. Views such as this suggest that more open participation may or may not, on its own, allow for a full airing of alternative views. If the various voices go through a conscious or unconscious screening of potential options to eliminate those that are generally out of favour, the discussions that ensue will appear to be more free and thorough than they really are.

Despite the apparent advantages of a public consultation process, one social policy interest group representative expressed a preference for the Finance Minister-focused round tables used by the Mulroney Tories.¹⁴ These, it is claimed, were characterized by real discussion and exchange of views rather than by presentations aimed at getting positions on the public record. Questions were posed by one interest

¹² Interview No. 12.

¹³ Interview No. 17.

group to another rather than by members of the Finance Committee, as it now happens. Without the jockeying for media sound bites by exchange of snappy one-liners, groups could strive to better understand each other's positions. Also, the Minister was not obliged to publicly defend his government's positions and could focus more intently on assimilating the arguments presented to him.

8. Capacity to Solve Problems

If you find truth in the old adage that "two heads are better than one" then you might expect that opening up the tax policy making process would increase, over all, the amount of resources devoted to tax policy development and thus increase the capacity of the process to solve problems that confront the tax system. It appears, however, that this is not the case. Leaving aside budgetary issues (which are inherently difficult to resolve because they tend to involve differences in value judgments) and considering technical issues (clear deficiencies in legislation about which there may be no disagreement) we find a backlog of unresolved problems. Even though technical issues may involve more agreement as to the nature of the problem, it by no means follows that solutions are easier to find. Issues like interest deductibility and the taxation of foreign affiliates are enormously complex and resistant to final resolution. Tax Policy Branch maintains a "black book" of known technical deficiencies awaiting attention.¹⁵

¹⁴ Interview No. 17.

¹⁵ The fact that some technical deficiencies may remain unresolved in Tax Policy Branch's inventory for a time is not just dependent on the Branch's resources. There is a concern that too many changes at once to the tax system is destabilizing, so a conscious

Whether we are talking about budgetary or technical issues, the problem seems to be the same -- Tax Policy Branch has a very limited amount of resources. The Tax Policy Branch of the Department of Finance still plays a pivotal role in tax policy development and regardless of the amount of resources in total represented by participants in the tax policy process, the amount of resources possessed by Tax Policy Branch itself is the binding constraint. The Branch is asked to do more than it is capable of doing effectively. As one person outside government observed: "We have not seen an increase in Tax Policy Branch resources commensurate with the increase in the private sector tax industry and commensurate with the increase in the tax collection burden."¹⁶ Although some areas within the Branch have been left relatively unscathed so that they can focus on high-priority issues, overall, the Branch has fewer resources than it did 15 years ago. For any large sector of the economy, one or two people may have a lot of say about how it is treated for tax purposes. Or, as another participant noted: "Institutional wisdom is now very shallow."¹⁷ The regularized pre-budget consultation process, and in particular the involvement of the Finance Committee, can be viewed as coping mechanisms. To some extent the Committee's work of obtaining input from interest groups, exposing each group's ideas to the critical gaze of other groups, and finding ways to trade off the ideas has been off-loaded from the Department of Finance.

effort is made to make changes at such a pace that taxpayers and tax professionals can absorb them.

¹⁶ Interview No. 23.

¹⁷ Interview No. 7.

There is, therefore, one respect in which the greater openness of the tax policy making process impairs its capacity to deal with issues. Tax Policy Branch officers are dealing with more people, analyzing the information and proposals that they present. Although there is a greater quantity of information coming in, it is not necessarily of high quality. Officers try to separate the important from the unimportant, but the effort still takes time. In this respect, the development of Statistics Canada's SPSPD/M analytic tool is very important to social policy interest groups. Now having the ability to come to Finance with better analysis should help social policy interest groups in gaining the Department's attention.

One aspect of the capacity of the system to solve problems is the efficiency of the process. How quickly do problems flow through the system from the time they appear on the agenda until a policy change is implemented? What has been the impact of institutional changes on the system's efficiency? Opinion is divided on this question.

To the extent that different players within the federal government are involved in budget-making -- for example, the Privy Council Office, the Prime Minister, Cabinet ministers -- having a common understanding of the timetable for decision making facilitates the coordination of input. Budget making is a complex, time consuming process and having a definite target date is important for bringing about closure to the debates that go on within government. However, the fact that the process is time consuming is due to the requirement for consultation. In terms of the impact of the

institutional changes, opening up the process tends to slow it down while having the process adhere to a regular timetable serves to force decisions out of participants.

For budgetary matters that deal with taxation and for technical taxation issues, there is a further time lag during which consultations take place on the draft legislation to implement the changes. It is not uncommon for this phase to take over one or two years. After a change is announced in a budget there may be some delay before the draft legislation and explanatory notes are made available. Then time must be provided for interested parties to study and comment on the material. It will then take time for Tax Policy Branch officials to consider the feedback and make changes to the draft legislation. More than one iteration of this process may be needed. Meanwhile, administrative problems are created since the effective date of the change is generally the announcement date; Revenue Canada has to assess taxes (in practice, taxpayers must self-assess) without a firm legal basis.

A recent Department of Finance news release illustrates these points perfectly. Dated March 3, 1997, the News Release announces the tabling of a Notice of Ways and Means Motion to implement the income tax measures contained in the February 1996 budget (a one year lag) and Bill C-69, a revised package of technical amendments first announced in April 1995 (almost a two year lag). The news release advises readers to complete their 1996 tax returns in accordance with the proposed amendments, but

acknowledges that should Parliament not pass the amendments as is, the tax returns would need to be amended.¹⁸

9. Effectiveness -- Impact on Policy Choices

It seems certain that the institutional changes affecting the tax policy making process will have an impact on policy choices, both in terms of kind and quality . However, any attempt to judge the effectiveness of the tax policy making system by examination of the outcomes it produces is hampered by a lack of information.

With respect to changes in the scope rules, the conclusion regarding the kinds of policies that will be pursued follows as a matter of definition. In Chapter 4 we concluded that some past policy choices -- that is, the introduction of expensive tax expenditure programs -- could not happen in today's environment with today's scope rules. Also, the presence of the Canadian Charter of Rights and Freedoms will be a perennial consideration whenever measures that differentiate among classes of people are contemplated. Tax legislation will continue to contain differential treatments, but policy makers will design them with the Charter in mind. Finally, having an open consultation process should make it less likely that budgets will be tilted heavily towards either the left or the right.

¹⁸ "Government to Proceed with Income Tax Legislation," News Release (Ottawa: Canada, Department of Finance, March 3, 1997).

There is a quality-of-policy rationale for opening up the budget process. As one Member of Parliament put it: “[Government] should approach the matter of budget making with humility.”¹⁹ The idea is that mistakes will be made, but they can be minimized by offering proposals for public exposure. Within the Finance Committee, for example, there is an opportunity for government and opposition members to exchange views. There is also a chance to hear first hand from witnesses their reaction to government proposals and their ideas for alternatives. Moreover, there is support for the process of public review of draft legislation.²⁰ Because of the intricacies of particular industries and financial markets it is essential to obtain as much expert opinion as is feasible as to the existence of flaws in the legislation. “Flaws” in this context include both unintended adverse impacts on taxpayers and potential loopholes. If the process is successful, the Department of Finance will be able to achieve its policy intent while responding to taxpayers’ legitimate concerns. The practice of having private sector experts seconded to the Department of Finance is supported for exactly the same reasons.²¹

One Department of Finance official interviewed indicated that an open process does not facilitate the use of any consistent set of principles in designing tax policy.²² While this is not meant to imply that use of such a set of principles was evident before the process was opened up, the institutional changes that have happened are not expected to

¹⁹ Interview No. 24.

²⁰ Interview Nos. 5, 10, and 29.

²¹ Interview No. 27.

²² Interview No. 4.

improve performance in this regard. The system is set up to raise revenue in a politically expedient way. Acknowledging that political expediency will often prove more compelling than public finance principles of tax design, and that sophisticated ex post analysis will be needed to get a reasonably true picture of the impacts of particular measures, such as tax incentives for research and development or for natural resource exploration, there are reasons to believe that certain of the institutional changes under examination will lead to improved policy outputs. At the very least, an open process should reduce the chances that seriously flawed and ill-considered policies such as the Scientific Research Tax Credit and the Lifetime Capital Gains Exemption will be implemented.

The 1977 amendments to the *Auditor General Act* gave the Auditor General a mandate to report to Parliament instances in which “satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.”²³ Recommendations arising from the Auditor General’s work on tax expenditures helped persuade the government to provide the Department of Finance with resources to set up a unit within Tax Policy Branch to perform evaluations of tax measures. Ultimately, government cutbacks led to the withdrawal of the resources for this specialized unit but the Department is still expected to perform evaluations. The impact of a tax policy change may take years to be felt and may involve hard-to-measure factors such as the effects on incentives to work. One of the downsides of tax expenditure estimates is that they cannot provide this kind of

sophisticated analysis, yet there is a tendency to use them for rough-and-ready evaluation of tax measures.

10. Legitimacy -- Support for Policies

Federal budgets in recent years have not been met with the kind of hostile reaction that met the 1981 MacEachen budget. There are a number of possible reasons for this; included among them -- directly and indirectly -- is the institutional changes we have discussed. Consider the following argument that links institutional effects on preferences and support for budgetary policies.

We assume that a person's satisfaction with an outcome is a function of the degree to which the perceived outcome accords with that person's preferences. Institutions can influence both the selection of outcomes and the acquisition of preferences. If we observe increased satisfaction with outcomes, therefore, we might look for an explanation in either the ability of decision makers to choose attractive outcomes (perhaps because they have a richer selection of alternatives to choose from) or in a modification of preferences (perhaps through education). Of these two possibilities, the latter seems more likely. If we assume a population with non-homogeneous preferences, it may be very difficult to find an outcome that would have wide appeal. On the other hand, if it were possible to bring a greater degree of homogeneity to the preferences, then the probability of finding a widely acceptable outcome is bound to increase.

²³ *Auditor General Act R.S.C 1985, Chapter A-17, paragraph 7(2)(e).*

Comments from the people interviewed for this study tend to favour an explanation that involves homogenizing preferences through a process of education.²⁴ For example, I was told that the public, multi-lateral pre-budget consultation format inhibits groups from taking strongly self-interested positions because it is hard for them to justify why they, and not others, should be accorded special benefits.²⁵

With so many different sectors and groups touched by budget policy it is hard to get a consensus, even with the aid of extensive consultations. However, it does seem that consultation serves to highlight the extreme positions, the rough edges that cause those who are most affected to react negatively to particular proposals. These can then be addressed in order to mollify the affected groups. For example, when the federal government announced that it was going to combat the problem of cigarette smuggling by drastically reducing its tobacco taxes, a cry of protest was heard from anti-smoking groups who felt that the resulting lower price would encourage more smoking, particularly among young people. The government maintained the tax reduction, but responded with complementary measures to address the anti-smokers' concerns.

At the level of the general public, the support for recent budgets is attributed to a careful assessment of public opinion and even shaping or preparing public opinion.²⁶ The widespread acceptance of the need for the federal government to address its deficit -- a

²⁴ Interview Nos. 4, 6, 8, 9, 17, and 19.

²⁵ Interview Nos. 4 and 8.

notion which was reinforced through the pre-budget consultations process -- has gone a long way towards ensuring a favourable response to "bad news" budgets. Pre-budget consultations provide useful information on how to position the budget. The practice of floating trial balloons helps the public to get used to the idea of what might be coming. Eliminating adverse reaction attributable to feelings of shock or surprise is very important, in particular for measures that are aimed at a large cross-section of people. Take for example the new seniors' benefit. While not popular with seniors and near-seniors it was nevertheless better received than the Old Age Security reform proposals of a few years ago. It came to be recognized that something had to be done. The current system was simply not sustainable.

Public consultation is also important because, if nothing else, people feel better when they have had their day in court. People appreciate being listened to and if they sense that they have had input into the budget making process they accord the government a measure of goodwill. This is not to suggest that the public can be made to support absolutely anything provided it is accompanied with the right public relations strategy. It is necessary to "get the economics right" or else the budget will be fall prey to a credibility problem. Also, when the Minister of Finance announces an increase in taxes for some industry sector or for some class of taxpayers, they will not be pleased about it, regardless of whether the increase has been foreshadowed in the course of consultations. Consultation is not a universal balm.

²⁶ Interview Nos. 3, 4, 6, 7, 8, 10, 14, 17, 18, 19, 21, 28, and 30.

Furthermore, despite the trend towards pre-budget consultation, not all budget initiatives are aired in public before they are announced. The 1995 budget announced that self-employed individuals would have to adopt the calendar year as their business fiscal period.²⁷ The purpose of the measure, which was targeted to high income professionals, was to eliminate opportunities for the deferral of income. Since no amount of acclimatization would have made this class of taxpayer happy with the change, the government did not bother with consultation. It was able to adopt this approach because this diverse group does not represent a strong lobby.

Although the Finance Committee-led pre-budget consultation is a high-profile example of the opening up of the tax policy-making process, it must be emphasized that it is not the only vehicle for consultation, and probably not even the most important one. Interest group representatives consistently ranked meetings with the Minister and contacts with the Department of Finance bureaucracy as more useful than appearances before the Finance Committee in terms of influence over substantive policy.²⁸ For the business community, the access gained through secondment of experts to Tax Policy Branch is highly valued.²⁹ Given these opportunities for input, interest groups are more likely to have their concerns addressed and, therefore, be more supportive of the policy outputs. There is an expectation by the Department of Finance that when it does something to merit the support of an interest group the interest will acknowledge the fact in a suitably visible manner.

²⁷ *Budget Speech* (Ottawa: Canada, Department of Finance, February 27, 1995), p. 22.

²⁸ Interview Nos. 9, 13, 16, 17, 21, 25, and 31.

Part of the reason why the budget is generally well-received is that in some ways it is overshadowed by big policy announcements made at other times of the year. Also, people are not necessarily looking for as much in budgets because there is growing belief that the government should not be looked upon for the solution to every problem.

11. Accountability of Decision Makers

Given the increased openness of the tax policy making process, it is natural to ask whether this has made decision makers more accountable for the choices they have made. The more voices that have been heard and the more questions that have been raised, one would think that the more likely it is that decision makers would have to explain why some policy proposals have been accepted and others rejected. However, among the people interviewed it was far from unanimous that accountability had increased demonstrably.³⁰

The work of the Auditor General is cited by some as having brought about more accountability by officials of Tax Policy Branch.³¹ For broad tax policy the vehicle for exacting accountability remains ministerial responsibility. However, the Auditor General is credited with having shone a spotlight on a few technical and administrative issues. The complexity of technical issues defies Parliamentary scrutiny without the aid of the

²⁹ Interview No. 27.

³⁰ Interview Nos. 2, 5, 7, 9, 11, 17, 21, 23, 27, 28, and 31.

expert staff of the Auditor General's office who have privileged access to information contained in the files of Revenue Canada and the Department of Finance. Although academics and think tanks have the expertise and independence to criticize the government, their limited access to information places them at a disadvantage in comparison to the Auditor General.

12. Comparison of Empirical Findings to Theory

In Chapter 2, I indicated that I would take note of any alterations in the strategies employed by participants that appeared to have been occasioned to some extent by institutional changes.

I found that institutional changes affecting the tax policy making process have provided government with easier access to certain avenues for the acquisition and dissemination of information, for example floating trial balloons about proposed policy initiatives. Also, the government has a measure of choice regarding the characterization of legislative amendments as being either of a "technical" or "policy" nature, which has implications for the route that must be followed in implementing the amendments. Further, the institutional changes have facilitated the more frequent adoption of cooperative strategies among participants. People interviewed described various combinations and permutations of cooperative relationships applied to tax policy

³¹ Interview Nos. 1, 5, 23, and 30.

making.³² Finally, interest groups are better able to use parliamentary committees as vehicles for lobbying -- although not their preferred forum -- and for communicating their policy positions to the media, interest group members, the general public, and politicians. On the other hand, the parliamentary committee may at times be able to play off one interest group against another, and groups' awareness of this possible tactic may influence them in their choice of policy positions and comportment during hearings.

Also in chapter 2, I set out a series of propositions concerning five performance characteristics of a policy making system (flexibility, capacity, effectiveness, legitimacy and accountability), suggesting how these might be affected by institutional rules and by the elements of the action situation (which, in some cases, are themselves affected by institutional rules).

An area which is very revealing of the extent of *flexibility* in the system is that of agenda setting. Participants interviewed for this study indicated that despite institutional changes directly involving the tax policy making process, the Department of Finance has maintained its ability to control what issues come on the agenda.³³ However, other institutional changes exogenous to the tax policy making process have had an impact on agenda setting. The advent of the Canadian Charter of Rights and Freedoms has caused issues (notably, the tax treatment of child support payments) to be placed on the tax policy agenda via the court system. A second exogenous institutional change affecting

³² Interview Nos. 1, 3, 5, 9, 12, 13, 15, 17, 18, 21, 23, 25, 27, 28, 30, and 31.

³³ Interview Nos. 2, 3, 4, 12, 21, 25, 30, and 31.

tax policy making has to do with facilitating the intervention by the Auditor General in setting the tax policy agenda.

Leaving the topic of agenda setting and considering other ways in which flexibility is manifested in a policy making system, my findings indicate that, except for the Department of Finance, participants in the tax policy making process do not present solutions in anything but the most general terms. It is up to the Department of Finance to introduce concrete proposals. In this respect, the institutional changes that have occurred do not appear to have had any effect. However, once Finance has put out a proposal, other participants are very active in suggesting ways to fine tune it so that it will function as intended -- given innumerable complexities in the environment that Finance was unaware of and thus incapable of taking into account. This part of the process has been facilitated by institutional change.

At least as regards the regularization of the budget process, institutional changes have affected the supply/occurrence of choice opportunities. Nevertheless, this has not resulted in an increased *capacity* to solve problems. More important than the process is the supply of energy and expertise available to address problems. Resource constraints within government and the non-governmental organization sector mean that relatively few problems can be worked on seriously. The fact that many of the problems are highly technical and difficult adds to the delay in coming up with solutions.

Any attempt to judge the *effectiveness* of the tax policy making system by examination of the outcomes it produces is hampered by a lack of information. However, as an alternative one can look at the inputs to the policy making process and at the process itself to draw, in an indirect manner, an inference about their impact to policy outcomes. Using this approach, I found reason for optimism that institutional changes may lead to better policy outcomes. Essentially, groups affected by proposed tax policy changes and professional tax advisors are being given more opportunity to comment on policy proposals and their critical analysis is useful in uncovering potential unintended effects and technical flaws that can be remedied prior to policy implementation.

March and Olsen argue that political institutions shape preferences through a combination of education, indoctrination, and experience.³⁴ I did not ask the people I interviewed about their preferences, but I did ask about their perceptions of the support that the government receives for its tax policies. Here, I am taking “support” to be a proxy for “*legitimacy*.” There is a feeling that government has enjoyed a high level of support for its budgets for a number of years.³⁵ The greater openness evident in the tax policy making process is not necessarily indicative of greater *accountability*. However, the work of the Auditor General has contributed to government accountability in respect of certain technical and administrative issues.

³⁴ March and Olsen, “The New Institutionalism: Organizational Factors in Political Life,” p. 739.

³⁵ Interview Nos. 4, 12, 19, 23, and 30.

Chapter Eight: Final Reflections and Conclusion

In this last chapter I wish to present a series of final reflections that I consider relevant and interesting, though not central to the argument presented in the dissertation. They provide context for the central argument and, I believe, help clarify and/or demonstrate why the central argument is important. I feel it is appropriate to present these reflections at the end rather than the beginning of the dissertation for two reasons. First, because they are not central to the argument of the dissertation, presenting them earlier would have risked leading the reader off on a tangent. Second, they combine theory with empirical findings and so depend on what has been said earlier for much of their content. Following these reflections, I recap my conclusions from the study.

1. Reflections on the Reform of Representative Institutions

This study is about institutions that play a part in the tax policy making process. However, these institutions and this process exist within the context of the Canadian system of representative government. It may be useful to review the study's findings with this context more explicitly in mind.

The Canadian system of representative government can be understood in terms of the “doctrine of big loose control” articulated by Yates in his examination of the problem

of control of American federal bureaucracies.¹ With appropriate modifications to adjust to the Canadian Westminster-style system, the doctrine holds that the Prime Minister and his or her fellow Cabinet ministers, members of their personal staffs, Parliament and its committees and officers, interest groups, the media, other levels of government, the courts, various federal government departments and agencies, and others may all engage in attempts to control the actions of any one government bureaucracy.² These control efforts are uncoordinated, however, so at times the level of control may be stifling and at other times there may be significant gaps in control. Gaps are particularly prone to appear in respect of relatively small, detailed, day-to-day bureaucratic activities.

Yates argues that some of these control mechanisms are of particular importance in a democratic society.³ Controls exercised through representative institutions are more legitimate than controls exercised through non-elected, elite organizations, for example. In Canada, we have seen this view reflected in the movement to reform Parliament in a way that enhances the role of elected representatives.⁴ Efforts to increase the opportunity for direct input by citizens through consultation processes are no doubt motivated, at least

¹ Douglas Yates, *Bureaucratic Democracy: The Search for Democracy and Efficiency in American Government* (Cambridge, Mass.: Harvard University Press, 1982), pp. 157-163.

² A similar idea is expressed by Doern, Maslove and Prince, who refer to seven overarching institutions that affect budgetary decision making and budgetary norms. These are: federalism, cabinet parliamentary government, the Charter of Rights and Freedoms, capitalism, interest groups and interests, mass media, and international institutions. See G. Bruce Doern, Allan M. Maslove, and Michael J. Prince, *Public Budgeting in Canada: Politics, Economics, and Management*, (Ottawa: Carleton University Press, 1988), pp. 35-40.

³ Yates, *Bureaucratic Democracy*, pp. 163-168.

⁴ C. E. S. Franks, *The Parliament of Canada*, (Toronto: University of Toronto Press, 1987), *passim*.

in part, by the same desire to counteract any advantage that elites may hold in influencing government.

Bearing this in mind, we can see that the general thrust of the institutional changes affecting the tax policy making process is consistent with a broader movement that encourages institutions to develop in a way that enhances democratic control of government. In this vein, one of the people interviewed for this study said, “We are in the era of consultations.”⁵ There is an expectation widely held by members of the public and by interest groups that they will be given a chance to voice their opinions on matters of public policy. In Canada, there has been no more graphic illustration of this than the consultations undertaken prior to the referendum on the Charlottetown Accord and, indeed, the referendum itself. Other federal-level examples are easy to find: the recent Social Security Review and the Canada Pension Plan Review come quickly to mind. At the provincial level one can point to the work of the Ontario Fair Tax Commission and the process followed in Quebec to obtain input for the Parti Quebecois’ “declaration of independence.” The changes involving consultation on tax policy discussed above mirror changes that can be observed in other policy fields and at the provincial government level as well.

Yates’ work addressed the problem of powerful bureaucracies that, for a variety of reasons, are resistant to efforts by outsiders to control them. In the case of tax policy making in Canada, the institutional changes we have discussed operate at the margin to relax the grip held by the “tax community” as defined by Good. However, many of the

factors that led to the tax community's tight grip remain. Among these, the highly technical nature of much of tax policy will ensure that a select group of experts will always have the greatest influence over the field.

2. Reflections on the Tax Policy Making Process at a Broader Level – Tax Policy Networks

The objective of this study was to examine the nature, causes and consequences of institutional changes affecting the tax policy making process in Canada. Regarding nature, the approach taken is to break down the institutional changes according to an enhanced version of the rules framework developed by Ostrom. While this approach is useful, it suffers from the disadvantage of focusing attention at a very detailed level and obscuring from view the picture of the tax policy making process taken at a broader level. In this section, I step back from the detail in order to see what the process looks like from a different vantage point, applying the categorization of policy networks suggested by Coleman and Skogstad to the realm of tax policy. Their categorization, which emphasizes structure rather than function, is broadly institutionalist in nature and so is consistent with the overall theme of this study.

2.1 The Dimensions of Tax Policy. Taxation, as a policy instrument, is used for many different purposes. Its basic purpose is to raise revenue to finance government operations. In addition, it is used as a vehicle for making transfer payments for social services, such as the Child Tax Benefit and the Goods and Services Tax Credit. It has

⁵ Interview No. 6.

been used to encourage investment in a variety of economic sectors. It has been used to promote Canadian cultural industries.

As a result, one can make a credible claim that what is commonly referred to as “tax policy” is, in fact, an amalgam of economic policy, social policy, cultural policy, and so on, with “pure” tax policy. It follows, then, that there is not one tax policy community, nor is there one tax policy network. It is possible to identify each of the six policy network structures identified by Coleman and Skogstad within the field of tax policy, broadly defined.

Moreover, I have found myself throughout this study dealing with tax policy making and budgetary policy making virtually in the same breath. The reason for this is historical. Until recently, tax changes were habitually announced as part of a Budget. The study of the tax policy making process and the study of the budget making process were essentially one and the same. As earlier chapters have noted, tax policy announcements are now a much smaller part of the budget. Meanwhile the budget remains an important vehicle for announcing a host of initiatives in every area of government activity. Here again, there is not one budgetary policy community nor one budgetary policy network.

2.2 Variety of Policy Network Types. Coleman and Skogstad⁶ identify three types of pluralist policy networks. All three have in common a fragmented state

⁶ William D. Coleman and Grace Skogstad, “Policy Communities and Policy Networks: A Structural Approach,” in *Policy Communities and Public Policy in Canada: A*

authority and organized interests that exist within a weak associational system. Each interest group approaches the state independently. The term “pressure pluralism” denotes a policy network in which interest groups take on the role of advocating policies to an autonomous state. It is this kind of network that the round table style pre-budget consultation process, whether Finance Minister focused or Finance Committee focused, is meant to cater to.

Clientele pluralism, the second kind of pluralist network, occurs when state officials become dependent on interest associations for information and expertise and, in order to obtain these, invite them to participate in policy making. We see evidence of this kind of network in the process by which the Department of Finance obtains technical feedback on draft legislation. This categorization is somewhat weak because the feedback tends to come mainly from two sources: the Joint Committee of the Canadian Institute of Chartered Accountants and the Canadian Bar Association and the Tax Executive Institute. However, each of these organizations draws its membership from a wide range of industrial sectors or has membership which serves a wide range of industrial sectors and so has a pluralist element.

The third pluralist network is called parantela pluralism, and occurs when organized interests are able to place members in prominent bureaucratic positions. Coleman and Skogstad predict that this form of network is more likely to be found at the regional level than at the national level. In the context of the tax policy making process,

a weak example of this style of network relationship is the “executive interchange” arrangement in which private sector experts join the Department of Finance on a temporary basis to work on specialized tax policy initiatives.

Contrasting with the pluralist networks are two types of closed network. Here, the state possesses -- and typically has possessed for some time -- concentrated, well-coordinated decision-making capacity. Organized interests play a prominent role through highly-developed associational systems. These interests monopolize the attention of the dominant government agency.

The first type of closed network is the corporatist network. This is a multilateral network in which conflicting producer/consumer groups work with the state to formulate and implement policy. It differs from clientele pluralism by virtue of its multilateral character and a stronger position for the state. Something approaching this network arrangement exists with respect to a review currently under way of certain aspects of the *Excise Act* and *Excise Tax Act* as they apply to the beer, wine and distilled spirits industries. Although these three industries compete with one another, representatives of their respective industry associations plus representatives of provincial liquor control boards are cooperating with the Department of Finance to complete the review.

In a concertation network, one association represents an industry sector in its dealings with a counterpart state agency over policy formulation and implementation. Coleman and Skogstad cite the banking sector as an example of a concertation network.

The findings of this study support that conclusion. The banking sector was once widely perceived as having the ability to avoid paying its fair share of income tax. The government was determined to correct the problem, and while the banking sector no doubt would have preferred not to incur the additional tax burden, it was obliged to work with the Department of Finance to put in place an effective capital tax regime.

The final category of policy networks identified by Coleman and Skogstad is the state-directed networks. In this category, state agencies are highly autonomous and coordinated while the associational system of the sectoral interests is weak. Sectoral interests are not important either as advocates or participants so that the state is able to dominate policy making. Of all the categories, this one is least exemplified in the tax policy making process. Comments by two people interviewed for this study suggest that, in the past, the disabled, though not a powerful advocacy group, nevertheless were able to capture the attention of the Minister of Finance.⁷ At his urging, the Department of Finance took the lead in implementing tax measures favourable to them.

Coleman and Skogstad note that it is not uncommon for a single policy community to contain different types of policy networks. The fact that the tax policy making process shades into the budgetary policy making process, together with the fact that both tax and budgetary policy are relevant to a variety of interests exhibiting different stages of organizational development, makes it unsurprising to find evidence that all categories of policy network exist to some extent in these policy fields. However, the state-directed network is weakest, and this should perhaps be expected given the

institutional changes that have tended to open up and encourage participation in the tax policy making process.

3. Reflections on the Institutional Changes Affecting the Tax Policy Making Process from a “Critical” Point of View

3.1 Critical Theory and Policy Studies. There is a current movement within the field of policy studies that takes its inspiration from so-called “critical theory.” The critical theory school, at least as it applies to policy studies, is founded on Habermas’ work on communication, or “speech acts”. According to Habermas, speech acts are accompanied by four underlying validity claims.⁸ These are: (1) that the speaker’s message is understandable; (2) that the speaker sincerely believes in the truthfulness of the message; (3) that it is appropriate or legitimate for the speaker to talk about the subject of the message; and, (4) that the message being spoken is, in fact, true.

Adherents to the critical theory school of policy studies maintain that policy arguments can be analyzed as speech acts, and that debate about policy represents an examination of the validity claims underlying the arguments advanced by advocates for a particular policy position. Whether or not the examination of validity claims is well performed is, in large measure, a function of the institutional framework within which the debate is conducted.

⁷ Interview Nos. 8 and 10.

⁸ Ray Kemp, “Planning, Public Hearings, and the Politics of Discourse,” in *Critical Theory and Public Life*, ed. John Forester (Cambridge, Mass.: MIT Press, 1985), p. 183;

The key is the extent to which participants in the debate are free from constraints on their participation. Ideally, all potential participants should have the same chance to initiate and perpetuate the debate. They should also have the same chance to express their attitudes, feelings and intentions. All potential participants should be equally able to express support for or opposition to the ideas advanced, and be equally able to permit and forbid others from advancing arguments. They should have the same opportunity to make or accept promises and to provide or call for justifications. Finally, all potential participants should have the same chance to give interpretations or explanations and to question any validity claims. No view should be exempt from consideration or criticism.⁹

Critical theorists find that these ideal conditions are inevitably violated with the result that some classes of potential participants are systematically advantaged or disadvantaged. Differences in power can cause or be caused by deviations from the ideal conditions. Of particular concern is the weakening of the citizen's role occasioned by the growth of economic and political institutions. Citizens are marginalized by the practice of treating political issues as technical issues while the role of experts is enhanced. Elites possess a firm grip on the policy process.¹⁰

John Forester, "Critical Theory and Planning Practice," in *Critical Theory and Public Life*, ed. John Forester (Cambridge, Mass.: The MIT Press, 1985), pp. 208-209.

⁹ Kemp, "Planning, Public Hearings, and the Politics of Discourse," pp. 186-188.

¹⁰ Frank Fischer and John Forester, "Editors' Introduction," in *The Argumentative Turn in Policy Analysis and Planning*, eds. Frank Fischer and John Forester (Durham: Duke University Press, 1993), p. 36.

3.2 A Critical Theorist's View of Institutional Changes. The question to be addressed in this section is the extent to which a critical theorist would be heartened by the institutional changes that have affected the tax policy making process.

In terms of the modified Ostrom framework used in this study, the critical theorist's criteria cited above are addressed primarily to authority and information rules. This is logical, given critical theory's roots in a communication-centred philosophy. However, it appears that it would be possible to develop additional, complementary criteria that address other elements in the framework. The applicability of the critical theorist's philosophy to position, boundary and aggregation rules seems obvious; its applicability to scope, payoff and timing rules may be more difficult to demonstrate. In any event, that is not the task of this study but, rather, a task to be undertaken by critical theorists themselves.

Some of the more prominent critical theorists who write in the public policy field are interested in urban planning, and have focused attention on the public hearing process.¹¹ The closest analogy to the public hearing process within the context of tax policy making is the work of the House of Commons Finance Committee in performing special policy studies and pre-budget consultations. Although the extent of this kind of activity has increased along with the number of participants, the format of the Committee proceedings does not facilitate the degree of openness, objectivity and rationality envisaged in the critical theorist's ideal discourse. While participants have more

opportunity to express their views, the opportunity to challenge other participants is limited. This is partly due to time constraints and partly due to the control over the proceedings exercised by the Committee chairperson, some of whom are reputed to have verbally abused witnesses with whose views they are not sympathetic. Similarly, the chairperson has huge influence over the content of the final report, and may not choose to ensure a fulsome and balanced account of the debate. This is not to say that the institutional changes that have occurred to date are not potentially supportive of the critical theorist's ideal; rather, it is a comment on other long-standing institutional rules that continue to give great power to the chairperson. In the end, whether or not there is a fair debate on an issue depends on the kind of leadership exhibited by the chairperson.

Institutional changes such as the distribution of draft legislation for comment, the publication of tax expenditure estimates and the production of the SPSP/M software tool all contribute to the advancement of the process of tax policy making toward the critical theorists' ideal. However, all three changes (especially the first, distribution of draft legislation) tend to favour the participation of elites because the information contained in these media demands of its potential users a high level of technical skill and knowledge. This mitigates but does not negate the value of the institutional changes. They should make it easier for participants outside the government to initiate discussion of issues, express attitudes, provide interpretations of and explanations for the phenomena described, and to point out problems in the underlying validity claims advanced by the government in relation to the phenomena/issues described.

¹¹ Kemp, "Planning, Public Hearings, and the Politics of Discourse"; Frank Fischer, "Citizen Participation and the Democratization of Policy Expertise: From Theoretical

Increased interventions by the Auditor General in the tax policy field can be traced, in part, to institutional changes outside the tax policy making process itself (i.e. the enlargement of the Auditor General's mandate in the late 1970s). This change is evaluated in much the same way as those discussed in the preceding paragraph. While the Auditor General himself is closely identified with the government's bureaucratic elites he does possess a significant measure of independence from the government itself. This fact allows him to initiate debates and to make available to other potential participants information that may be useful for the purposes of their interventions.

The advent of the Canadian Charter of Rights and Freedoms -- in particular the equality provisions -- is an interesting case. In terms of the means of communication available to potential participants, it does not represent any change. Nevertheless it does have an impact on the ability of potential participants to provide interpretations and explanations of issues. By asserting a fundamental Canadian societal value it provides legitimizing context for interpretations and explanations that apply "equality" as a norm.

Critical theorists take aim at what they regard as distorted, manipulated and secretive policy processes that resist revealing themselves to any community of inquirers. Their prescription is a set of institutional arrangements that ensures as few restrictions as possible on competent participation in policy discourse and on the kinds of empirical and

normative arguments that may be advanced.¹² The institutional changes affecting the tax policy making process are a movement in the right direction, according to this criterion. However, the amount of movement is probably not great. One fundamental impediment to any significant democratization of the tax policy making process is that the arcane nature of tax policy and legislation makes it extremely difficult for “competent participation” by anyone but members of highly knowledgeable technocratic elites.

4. Conclusion

Institutions exist to solve co-ordination problems. The objective of this study was to identify and explain changes that have occurred since about 1980 to the institutions that govern the tax policy making process. By approaching the task from the theoretical perspective known as the new institutionalism, the study complements earlier work on the tax policy making process in Canada.

In addition to identifying and explaining changes to the rules that comprise the institutions of interest, the study sought to explore the impacts of the institutional changes on the strategies employed by participants in the tax policy making process and on certain performance characteristics of the policy making process (which I identified as flexibility, capacity, effectiveness, legitimacy and accountability).

¹² John S. Dryzek, “Policy Analysis and Planning: From Science to Argument,” in *The Argumentative Turn in Policy Analysis and Planning*, eds. Frank Fischer and John Forester (Durham: Duke University Press, 1993), pp. 229-230.

Following Elinor Ostrom, institutions are understood as sets of rules.¹³ Ostrom identifies seven categories of rules -- scope, payoff, authority, information, position, boundary, and aggregation rules -- to which I added an eighth category -- timing rules. Changes to institutions can be explained by a combination of sociological and economic factors.

Isomorphism is the label given to a sociological phenomenon involving the spread of institutional forms through a copycat process as organizations seek to mimic the success of others or to enhance their own legitimacy by being seen to possess institutional characteristics similar to others who are successful. The mimicry may be voluntary or may be the result of coercion by forces in the environment.

According to one economic theory, various institutions are characterized by certain transaction costs. The term refers to the kind of costs -- inefficiencies -- that result because people are characterized by bounded rationality and by a tendency to opportunistic behaviour. To minimize transaction costs, people choose from among available institutional designs the one best suited to a particular coordination problem. Alternatively, the potential for a positive net benefit in terms of reduced transaction costs will spark the creation of new institutional designs.

¹³ Elinor Ostrom, "An Agenda for the Study of Institutions," *Public Choice*, 48 (1986), pp. 3-25.

To complete the study, it was necessary not only to use concepts associated with institutions and institutional change, it was also necessary to use concepts associated with policy making. Hence, I introduced my own idea of the life cycle of a policy issue.

The notion of the life cycle of a policy issue is that policy issues spring from some real world condition or event (the stimulus) and are then turned into socially-constructed entities when they capture the attention of some person or persons who evaluate the condition or event according to their values, norms, preferences and interests. If this evaluation signals the existence of a problem to some person or persons who are prone to take action, they will perform further analysis and prepare arguments to support their interpretation of the problem and to offer proposed solutions. Conflicting accounts are likely to arise, setting up a competition. The issue may then pass into the next phase of the life cycle in which a decision is made and a solution is implemented. In the final phase, the issue returns to the real world in the form of some outcome. At this point, a new set of initial conditions is established and the cycle may be repeated.

Decisions of one kind and another are made at various points in the life cycle of an issue by different participants in the policy making process. Each of these points can be thought of as an action situation. The term "action situation" is taken from Ostrom, but I have modified its meaning to reflect a synthesis with Cohen, March and Olsen's¹⁴ notion of a "garbage can" and with some of my own ideas. The eight elements of the action situation -- participants, information, language/vocabulary, technical knowledge,

¹⁴ Michael D. Cohen, James G. March, and Johan P. Olsen, "A Garbage Can Model of Organizational Choice," *Administrative Science Quarterly*, Vol. 17 (1972), pp. 1-25.

resources, initial conditions, problems and solutions -- together with the eight categories of rules of which institutions are composed become variables for use in explaining impacts on the performance characteristics of the policy making system.

In addition to impacts on the performance characteristics of the policy making system, the study looks for alterations in the strategic choices made by participants.

These could involve the ways in which participants:

- a) gather and disseminate information;
- b) form alliances with each other;
- c) posture or position themselves on issues or in negotiations; and
- d) select the nature and timing of their interventions in the policy making process.

This study identifies three significant changes to scope and payoff rules: (1) limitations on the design and use of tax expenditures; (2) limitations on the imposition of compliance costs on taxpayers and others; and, (3) requirements for the observation of Charter rights and freedoms. The chapter also speaks of reinforcing the rule requiring the use of transitional arrangements when introducing tax policy changes. The changes and the emphasis on the rule concerning transitional arrangements can be explained by sociological (isomorphism) and/or economic (transaction cost minimization) factors

The income tax reforms of the mid- to late 1980s, in which the tax base was broadened through the elimination of numerous tax expenditures and tax rates were

lowered, are an expression of mimetic isomorphism following a wave of similar reforms elsewhere among western industrialized countries.¹⁵ As more and more countries undertake tax reform, pressure grows on those remaining to do the same. As particular features of tax reform gain acknowledged approval, the likelihood is greater that late-reforming countries will adopt generally accepted strategies.

Such pressures are harder to resist the more there are stakeholders in the environment, such as major multinational corporations and international institutions, that implicitly or explicitly endorse the strategies and on which a late-reforming country is somehow dependent for support. Isomorphism was facilitated by the close economic ties between Canada and the United States such that Canada had to maintain competitive marginal tax rates in order to avoid the flight of labour and capital to its large, powerful neighbour.

Underpinning the tax reform movement was an ideological shift in favour of tax systems that do not distort business decisions. The trend away from the introduction of new tax expenditures and towards the removal of existing ones is consistent with the dominant economic ideology of the day. There are transaction costs associated with maintaining a system that falls out of favour; by reforming the system along the lines supported by the dominant economic ideology, transaction costs are minimized.

¹⁵ B. J. Arnold, formerly a professor of law at the University of Western Ontario, in a conversation with the author, noted that Canada's tax reforms were more modest than those which took place in other countries. This suggests a question for further research:

Another very significant factor contributing to the shift in attitude towards tax expenditures was the perceived abuse and uncontrolled take-up of tax expenditure programs. This is an example of opportunism on the part of taxpayers that imposes a cost on the government, in the form of lost revenue. The limitations on the design and use of tax expenditures are institutional responses aimed at economizing on these costs.

The theory of transaction cost minimizing behaviour also explains the increasing preoccupation with the reduction of compliance costs incurred by individuals and businesses as a consequence of their obligations to keep records and report financial information to taxation authorities. The record keeping and reporting obligations are meant to mitigate opportunistic behaviour by taxpayers (that is, under-reporting of income). One kind of transaction cost (record keeping and reporting) is substituted for another kind of transaction cost (under-reporting of income leading to loss in tax revenue). However, these costs are borne by different interests -- taxpayers versus the government.

With the existence and magnitude of compliance costs now more generally understood, there is pressure upon tax policy makers to consciously design tax provisions in order to minimize those costs. This compliance cost minimization rule belongs to the class of scope rules, since it deals with an outcome of the tax system -- the resources consumed in operating the tax system.

Might it be that there are institutional factors that prevent Canada from going as far with tax reform as have other countries, such as New Zealand?

Transaction cost minimization theory may also explain the tendency -- which runs counter to the general trend in reduction of tax expenditures -- for the use of the tax system to deliver social benefits, such as the child tax benefit and the GST Credit. Transaction costs are minimized in relation to an alternative which would see the government having to maintain a separate system having much overlap and duplication with the tax system.

In the case of the 1981 MacEachen Budget, one observes taxpayers' reaction to what many regarded as opportunistic behaviour by government. Assumptions about the fiscal regime upon which financial decisions had been made were turned upside down. The government violated an institutional rule requiring that adequate transitional measures be designed to protect taxpayers who had made commitments based on the former fiscal regime and in so doing had imposed significant transaction costs on taxpayers. These transaction costs would take the form of unanticipated tax liabilities. Taxpayers' emphatic reaction to the government's actions served to reinforce the observance of this rule in the future.

The changes to the search and seizure provisions of the *Income Tax Act* and the *Excise Act* are the outcome of the process of coercive isomorphism. The status of the *Canadian Charter of Rights and Freedoms* demands that tax policy makers align the statutes governing the tax system to the *Charter*. While Charter-based court challenges to tax provisions have been successful with respect to guarantees of security against unreasonable search and seizure, they have been unsuccessful with respect to rights

regarding freedom of conscience and religion and equality. However, in one case, an unsuccessful Charter-based court challenge played a key role in bringing about legislative change through political action.

Changes to the authority, information and timing rules are manifest in the following five ways: (1) increased use of formal mechanisms of consultation over taxation and budgetary matters, involving the Minister of Finance and Parliament; (2) increased use of informal mechanisms of consultation over taxation and budgetary matters, involving Department of Finance bureaucrats; (3) the separation of budgetary and technical issues in the legislative process; (4) the observation of a more rigorous annual timetable for budget preparation and presentation; and, (5) increased public availability of information relevant to tax policy analysis and accountability. Once more, the notions of transaction cost minimization and isomorphism can be used to explain the changes.

The MacEachen budget of 1981 is found to be a principal cause of the changes. Taxpayers, their advisors, politicians and bureaucrats all sought to reduce the transaction costs associated with the extant notion of budget secrecy and which were made obvious in the aftermath of the budget. Both taxpayers and professional advisors, on the one hand, and the Minister of Finance and his officials, on the other hand, had experienced the transactions cost associated with budget making. For taxpayers and professional advisors the costs had to do with uncertainties created by their exclusion from the budget making

and legislative drafting processes. For the Minister and his officials, the costs were political -- adverse reaction to and loss of legitimacy for his proposals.

To reduce the likelihood of such costs recurring, a new climate was created that was characterized by increased consultation, although the form of consultation has varied over time. The number of formal and informal meetings and conversations between Finance officials and interest group representatives grew. Finance officials engaged interest group representatives to assist in working out implementation problems associated with new policy initiatives. Likewise, professional tax advisors were encouraged to help Finance officials identify technical flaws in existing and proposed legislation.

Underlying the greater openness is a reinterpretation of the doctrine of budget secrecy. Now, strict secrecy is maintained only where possessing knowledge of an upcoming budget announcement would permit someone to garner some pecuniary advantage. In line with this is a separation of matters of tax policy from purely technical matters. The latter are openly discussed and are dealt with outside the budgetary process. The budgetary process has also been reformed to follow a much more predictable timetable, thus facilitating consultation activities.

Parliamentary reforms that gave standing committees increased scope for action paved the way for greatly increased attention to tax and budgetary policy by the House of Commons Standing Committee on Finance, as it is now known. Openness and debate are

also fostered by the provision of increased information resources. The general thrust of the institutional changes affecting the tax policy making process is consistent with a broader movement that encourages institutions to develop in a way that enhances democratic control of government.

Professional tax advisors were forceful advocates of changes to authority, information and timing rules applicable to the technical amendments process. Finance was able to resist pressures for change as long as the social legitimacy of reform proposals was low due to limited public concern over the need for reform. Once the issue captured the attention of the public, the social legitimacy of the proposals rose and Finance was obliged to make more serious gestures of acceptance.

Finance's ability to resist the pressures for change emanating from tax practitioners may have been relatively low even before the 1981 budget was brought down. The highly technical nature of tax legislation and the limited in-house resources of the Department meant that there was a high degree of dependence by Finance on technical input from practitioners in order to implement, via statute, the government's desired tax policy changes. Because of this dependence, a fairly high degree of interconnectedness had developed between Finance and its environment. Reinforcing this tendency, was the desire expressed by some Finance Ministers for a loosening of the constraints of secrecy.

There have basically been no changes with respect to position rules since the time of Good's research in the late 1970s. Changes to boundary and aggregation rules appear to be consequential to the changes in the authority and information rules. For the latter changes to take effect it was necessary to make enabling or accommodating changes to the boundary rules so that more potential participants could enter the tax policy making process through the existing structure of positions. As for aggregation rules, it remains the case that the Minister of Finance has the final word on tax policy. However, he is subject to many more influences, and the information he obtains from the expanded network of participants cannot help but affect his decision making.

It must be acknowledged that, in recent years, the Minister of Finance has had his policy freedom constrained by the economic circumstances facing Canada and that this factor, more than any institutional changes, may explain the performance of the tax policy making system.

In terms of comparison of the observed situation to the theory of institutional change, I find that my conclusions with respect to the boundary and aggregation rules are essentially identical to those I arrived at in considering the authority and information rules.

Turning to the effects of institutional changes on participants' strategies, the study concludes that institutional changes affecting the tax policy making process have provided government with easier access to certain avenues for the acquisition and

dissemination of information, for example floating trial balloons about proposed policy initiatives. Also, the government has some freedom to choose whether legislative amendments are to be classified as either “technical” or “policy” in nature, and this has implications for the route that must be followed in implementing the amendments. Further, the institutional changes have facilitated the more frequent adoption of cooperative strategies among participants. Finally, interest groups are better able to use parliamentary committees as vehicles for lobbying -- although not their preferred method -- and for communicating their policy positions to the media, interest group members, the general public, and politicians. On the other hand, the parliamentary committee may at times be able to play off one interest group against another, and groups’ awareness of this possible tactic may influence them in their choice of policy positions and comportment during hearings.

The first of the performance characteristics of the tax policy making system examined for possible effects due to institutional changes was flexibility. Evidence of flexibility can be observed in agenda setting activities. Despite institutional changes directly involving the tax policy making process, the Department of Finance has maintained its ability to control what issues come on the agenda.

However, other institutional changes exogenous to the tax policy making process have had an impact on agenda setting. The advent of the Canadian Charter of Rights and Freedoms has caused issues (notably, the tax treatment of child support payments) to be placed on the tax policy agenda via the court system. A second exogenous institutional

change affecting tax policy making has to do with facilitating the intervention by the Auditor General in setting the tax policy agenda.

Another aspect of flexibility has to do with the presentation of solutions to problems that appear on the tax policy agenda. Except for the Department of Finance, participants in the tax policy making process do not present solutions in anything but the most general terms. It is up to the Department of Finance to introduce concrete proposals. In this respect, the institutional changes that have occurred do not appear to have had any effect. However, once Finance has put out a proposal, other participants are very active in suggesting ways to fine tune it so that it will function as intended -- given innumerable complexities in the environment that Finance was unaware of and thus incapable of taking into account. This part of the process has been facilitated by institutional change.

As for policies that are entrenched in the tax system, the publication of tax expenditures estimates has given participants outside the Department of Finance information that can be used for analysis and commentary.

At least as regards the regularization of the budget process, institutional changes have affected the supply/occurrence of choice opportunities. Nevertheless, this has not resulted in an increased capacity to solve problems. The continued revelation of tax policy problems -- budgetary and technical, big and small -- combined with greater participation by experts and non-experts from outside the Department of Finance and

limited availability of experts within the Department of Finance strains the capacity of the tax policy making system to resolve, in a timely manner, all the issues that come to light.

On the other hand, institutional changes (including the advent of the Charter of Rights and Freedoms) have at times had a material impact on policy choices and have improved the technical quality of legislation, thus paving the way for more successful implementation. Groups affected by proposed tax policy changes and professional tax advisors are being given more opportunity to comment on policy proposals and their critical analysis is useful in uncovering potential unintended effects and technical flaws that can be remedied prior to policy implementation. Thus, one expects the final policy to be more effective than it would otherwise have been.

Having a more regularized annual budget process has facilitated coordination of input by the federal and provincial governments and by interest groups. By providing greater opportunities for participants to have input into budget making, the federal government has been rewarded with a generally high level of support for its budgets. To some extent, one can regard this support as evidence that the policies are viewed as legitimate by participants in the policy making process and by the public.

The greater openness evident in the tax policy making process is not necessarily indicative of greater accountability. However, the work of the Auditor General has

contributed to government accountability in respect of certain technical and administrative issues.

Bibliography

Arnold, Brian J., 1990. "The Process of Tax Policy Formulation in Australia, Canada and New Zealand." *Australian Tax Forum*, No. 7.

Atkinson, Michael M., 1993a. "Introduction: Governing Canada." In Michael M. Atkinson (ed.), *Governing Canada: Institutions and Public Policy*. Toronto: Harcourt Brace Jovanovich.

Atkinson, Michael M., 1993b. "Public Policy and the New Institutionalism." In Michael M. Atkinson (ed.), *Governing Canada: Institutions and Public Policy*. Toronto: Harcourt Brace Jovanovich.

Barnard, Chester I., 1938. *The Functions of the Executive*. Cambridge, Mass.: Harvard University Press.

Brooks, Neil, 1992. *The Canadian Goods and Services Tax: History, Policy, and Politics*. Sydney: Australian Tax Research Foundation.

Brooks, Neil, 1993. "The Changing Structure of the Canadian Tax System: Accommodating the Rich." *Osgoode Hall Law Journal*, Vol. 31, No. 1, 137-193.

Bucovetsky, M. W., 1975. "The Mining Industry and the Great Tax Reform Debate." In Paul A. Pross (ed.), *Pressure Group Behaviour in Canadian Politics*. Toronto: McGraw-Hill.

Butler, Allison Scott, 1995. "Charter Challenges to Income Tax Provisions." In *Report of Proceedings of the Forty-Sixth Tax Conference*. Toronto: Canadian Tax Foundation, 29:1-27.

Canadian Tax Foundation, 1981. *The National Finances, 1980-81*. Toronto: Canadian Tax Foundation.

Canadian Tax Foundation, 1988. *The National Finances, 1987-88*. Toronto: Canadian Tax Foundation.

Canadian Tax Foundation, 1994. *The National Finances, 1994*. Toronto: Canadian Tax Foundation.

Canadian Tax Foundation, 1995. *Finances of the Nation, 1995*. Toronto: Canadian Tax Foundation.

Canadian Tax Foundation, Committee on the Budget Process, 1982. "On Opening Up the Budget Process: A Report to the Honourable Allan J. MacEachen, Minister of Finance, from a Committee Formed Under the Auspices of the Canadian Tax Foundation." *Canadian Tax Journal*, March-April, 161-178.

Canadian Tax Foundation, Committee on the Budget Process, 1986. "The Canadian Budget Process." *Canadian Tax Journal*, September-October, 989-1094.

Canadian Tax Foundation, Tax Legislative Process Committee, 1978. "The Tax Legislative Process." *Canadian Tax Journal*, March-April, 157-182.

Canadian Taxpayer, 1988. "Statscan Tax Model Available for Public Use." January 5.

Cohen, Marshall A., and Donald R. Huggett, 1978. "The Budget Process and Income Tax Changes." In *Report of Proceedings of the Twenty-Ninth Tax Conference*. Toronto: Canadian Tax Foundation, 6-40.

Cohen, Michael D., James G. March, and Johan P. Olsen, 1972. "A Garbage Can Model of Organizational Choice." *Administrative Science Quarterly*, Vol. 17, 1-25.

Coleman, William D., and Grace Skogstad, 1990. "Policy Communities and Policy Networks: A Structural Approach." In William D. Coleman and Grace Skogstad (eds.) *Policy Communities and Public Policy in Canada: A Structural Approach*. Mississauga: Copp Clark Pitman.

Corrado, Frank M., 1984. *Media for Managers: Communications Strategy for the Eighties*. Englewood Cliffs: Prentice-Hall.

Davis, Lance E., and Douglass C. North, 1971. *Institutional Change and American Economic Growth*. New York: Cambridge University Press.

DiMaggio, Paul J., and Walter W. Powell, 1991. "The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields." In Walter W. Powell and Paul J. DiMaggio (eds.), *The New Institutionalism in Organizational Analysis*. Chicago: University of Chicago Press.

Doern, G. Bruce, Allan M. Maslove, and Michael J. Prince, 1988. *Public Budgeting in Canada: Politics, Economics, and Management*. Ottawa: Carleton University Press.

Doerr, A. D., 1971. "The Role of White Papers." In G. Bruce Doern and Peter Aucoin (eds.) *The Structure of Policy-Making in Canada*. Toronto: Macmillan.

Downs, Anthony, 1972. "Up and Down With Ecology -- the "Issue-Attention Cycle." *The Public Interest*, Vol. 28, 38-50.

Drache, Arthur, 1982. "Improving the Budget Process." *Policy Options*, September-October, 15-17.

Dryzek, John. S., 1993. "Policy Analysis and Planning: From Science to Argument." In Frank Fischer and John Forester (eds.), *The Argumentative Turn in Policy Analysis and Planning*. Durham: Duke University Press.

Fischer, Frank, 1993. "Citizen Participation and the Democratization of Policy Expertise: From Theoretical Inquiry to Practical Cases." *Policy Sciences*, Vol. 26, 165-187.

Fischer, Frank, and John Forester, 1993. "Editors' Introduction." In Frank Fischer and John Forester (eds.), *The Argumentative Turn in Policy Analysis and Planning*. Durham: Duke University Press.

Forester, John, 1985. "Critical Theory and Planning Practice." In John Forester (ed.), *Critical Theory and Public Life*. (Cambridge, Mass.: The MIT Press).

Frankovic, Joseph, 1995. "Thibaudeau Case Overturned by Supreme Court." *Tax Topics*, June 8, 1995. CCH Canadian Limited.

Franks, C. E. S., 1987. *The Parliament of Canada*. Toronto: University of Toronto Press.

Gillespie, W. Irwin, 1983a. "Tax Reform: The Battlefield, The Strategies, The Spoils." *Canadian Public Administration*, Vol. 26, No. 2 (Summer), 182-202.

Gillespie, W. Irwin, 1983b. "The 1981 Federal Budget: Muddling Through or Purposeful Tax Reform?" *Canadian Tax Journal*, Vol. 31, No. 3 (November-December), 975-1002.

Gillespie, W. Irwin, 1984. "The Department of Finance and PEMS: Increased Influence or Reduced Monopoly Power?" In Allan M. Maslove (ed.), *How Ottawa Spends 1984: The New Agenda*. Agincourt: Methuen.

Gillespie, W. Irwin, 1991. *Tax, Borrow and Spend: Financing Federal Spending in Canada, 1867-1990*. Ottawa: Carleton University Press.

Gillies, James, 1981. *Where Business Fails: Business Government Relations at the Federal Level in Canada*. Montreal: Institute for Research on Public Policy.

Globe and Mail, 1996. "Tax on Child Support to Die." March 5.

Good, David A., 1980. *The Politics of Anticipation: Making Canadian Federal Tax Policy*. Ottawa: Carleton University School of Public Administration.

Gow, James Iain, 1994. *Learning from Others: Administrative Innovations Among Canadian Governments*. Toronto: The Institute of Public Administration of Canada.

Grady, Patrick, 1992. "Conservative Federal Tax Increases." *Canadian Business Economics*, Vol. 1, No. 1, 16-24.

Gunther, Magnus, 1991. "Reform of the Committee System." In Magnus Gunther and Conrad Winn (eds.), *House of Commons Reform*. Ottawa: Parliamentary Internship Program.

Hale, Geoffrey E., 1996. *The Politics of Canadian Tax Policy: 1978-88 -- Tax Reform as Constitutional Change*. Unpublished Ph. D. Dissertation, University of Western Ontario.

Habermas, Jurgen, 1979. *Communication and the Evolution of Society*. Boston: Beacon Press.

Hartle, Douglas G., 1982. *The Revenue Budget Process of the Government of Canada: Description, Appraisal, and Proposals*. Canadian Tax Paper No. 67. Toronto: Canadian Tax Foundation.

Hirsch, Paul M., and Michael D. Lounsbury, 1996. "Rediscovering Volition: The Institutional Economics of Douglass C. North." *Academy of Management Review*, Vol. 21, No. 3, 872-884.

Howard, R., G. C. Ruggeri, and D. Van Wart, 1995. "Federal Tax Changes and Marginal Tax Rates, 1986 and 1993." *Canadian Tax Journal*, Vol. 43, No. 4, 906-922.

Jepperson, Ronald L., 1991. "Institutions, Institutional Effects, and Institutionalism." In Walter W. Powell and Paul J. DiMaggio (eds.), *The New Institutionalism in Organizational Analysis*. Chicago: University of Chicago Press.

Jepperson, Ronald L., and John W. Meyer, 1991. "The Public Order and the Construction of Formal Organizations." In Walter W. Powell and Paul J. DiMaggio (eds.), *The New Institutionalism in Organizational Analysis*. Chicago: University of Chicago Press.

Kemp, Ray, 1985. "Planning, Public Hearings, and the Politics of Discourse." In John Forester (ed.), *Critical Theory and Public Life*. Cambridge: MIT Press.

Kitchen, Brigitte, 1979. "A Canadian Compromise: The Refundable Child Tax Credit." *Canadian Taxation, A Journal of Tax Policy*, Vol. 1, No. 3, Fall.

Lawlor, William R., 1986. "Surplus Stripping and Other Planning Opportunities with the New \$500,000 Capital Gains Exemption." *Canadian Tax Journal*, Vol. 34, No. 1 (January-February), pp. 49-110.

Liberal Party of Canada, 1993. *Creating Opportunity: The Liberal Plan for Canada*. Ottawa: The Party.

- Lindquist, Evert A., 1985. *Consultation and Budget Secrecy: Reforming the Process of Creating Revenue Budgets in the Canadian Federal Government*. Study No. 86. Ottawa: Conference Board of Canada.
- MacDonald, Leslie T., 1985. *Taxing Comprehensive Income: Power and Participation in Canadian Politics*. Unpublished Ph.D. dissertation, Carleton University.
- Malloy, Jonathan, 1996. "Reconciling Expectations and Reality in House of Commons Committees: The Case of the 1989 GST Inquiry." *Canadian Public Administration*, Vol. 39, No. 3 (Fall), 314-335.
- March, James G., and Johan P. Olsen, 1984. "The New Institutionalism: Organizational Factors in Political Life." *American Political Science Review*, Vol. 78, 734-749.
- March, James G., and Johan P. Olsen, 1989. *Rediscovering Institutions: The Organizational Basis of Politics*. New York: The Free Press.
- Maslove, Allan M., 1989. *Tax Reform in Canada: The Process and Impact*. Halifax: Institute for Research on Public Policy.
- McDonnell, Thomas E., 1995. "Toward Getting It Right: Reflections on 50 Years of the Tax Legislative Process in Canada." *Canadian Tax Journal*, Vol. 43, No. 5, 1131-1143.
- McQuaig, Linda, 1987. *Behind Closed Doors: How The Rich Won Control of Canada's Tax System...And Ended Up Richer*. Markham: Penguin Books.
- Meyer, John W., and Brian Rowan, 1991. "Institutionalized Organizations: Formal Structure as Myth and Ceremony." In Walter W. Powell and Paul J. DiMaggio (eds.), *The New Institutionalism in Organizational Analysis*. Chicago: University of Chicago Press.
- Mintz, Jack, and Stephen R. Richardson, 1995. "The Lifetime Capital Gains Exemption: An Evaluation." *Canadian Public Policy*, Vol. 21, Supplement, November.
- Mintz, Jack, and Thomas A. Wilson, 1995. "Realization and Revenue Effects of Lifetime Capital Gains Exemptions." *Canadian Public Policy*, Vol. 21, Supplement, November.
- Nolan, J. T., 1981. "Business Beware: Early Warning Signs in the 80s." *Public Opinion*, April-May, 14-17;57.
- North, Douglass C., 1981. *Structure and Change in Economic History*. New York: W. W. Norton & Company.
- North, Douglass C., 1990. *Institutions, Institutional Change and Economic Performance*. New York: Cambridge University Press.

- O'Brien, Robert J., 1988. "The Finance Committee Carves Out a Role...and Bloodies some Three-Piece Suits in the Process." *Parliamentary Government*, Vol. 8, No. 1, 3-10.
- Okun, Arthur M., 1981. *Prices and Quantities: A Macroeconomic Analysis*. Washington: The Brookings Institution.
- Oliver, Christine, 1991. "Strategic Responses to Institutional Processes." *Academy of Management Review*, Vol. 16, No. 1, 145-178.
- Ostrom, Elinor, 1986. "An Agenda for the Study of Institutions." *Public Choice*, 48:3-25.
- Perry, J. Harvey, 1989. *A Fiscal History of Canada - The Postwar Years*. Canadian Tax Paper No. 85. Toronto: Canadian Tax Foundation.
- Plamondon & Associates Inc., 1993. *GST Compliance Costs for Small Business in Canada: A Study for the Department of Finance Tax Policy* (Ottawa).
- Poddar, Satya, 1988. "Integration of Tax Expenditures Into the Expenditure Management System: The Canadian Experience." In Neil Bruce (ed.), *Tax Expenditures and Government Policy*. Kingston: John Deutsch Institute for the Study of Economic Policy.
- Posner, Richard A., 1992. *Economic Analysis of Law*, Fourth Edition. Boston: Little, Brown and Company.
- Powell, Walter W., 1991. "Expanding the Scope of Institutional Analysis." In Walter W. Powell and Paul J. DiMaggio (eds.), *The New Institutionalism in Organizational Analysis*. Chicago: University of Chicago Press.
- Robertson, Ronald, 1988. "The House of Commons Committee and the Aftermath of the Royal Commission on Taxation." In W. Neil Brooks (ed.) *The Quest for Tax Reform: The Royal Commission on Taxation Twenty Years Later*. Toronto: Carswell.
- Rutherford, Malcolm, 1994. *Institutions in Economics: The Old and the New Institutionalism*. Cambridge: Cambridge University Press.
- Sandford, Cedric, 1993. *Successful Tax Reform: Lessons from and Analysis of Tax Reform in Six Countries*. Bath: Fiscal Publications.
- Schelling, Thomas C., 1960. *The Strategy of Conflict*. New York: Oxford University Press.
- Schotter, Andrew, 1981. *The Economic Theory of Social Institutions*. Cambridge: Cambridge University Press.

Scott, W. Richard, 1991. "Unpacking Institutional Arguments." In Walter W. Powell and Paul J. DiMaggio (eds.), *The New Institutionalism in Organizational Analysis*. Chicago: University of Chicago Press.

Smith, Roger S., 1979. *Tax Expenditures: An Examination of Tax Incentives and Tax Preferences in the Canadian Federal Income Tax System*. Canadian Tax Paper No. 61. Toronto: Canadian Tax Foundation.

Stanbury, W. T., 1988. *Business-Government Relations in Canada: Grappling with Leviathan*. Scarborough: Nelson.

Steinmo, Sven, 1993. *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State*. New Haven: Yale University Press.

Stewart, John B., 1977. *The Canadian House of Commons: Procedure and Reform*. Montreal: McGill-Queen's University Press.

Surrey, Stanley S., 1973. *Pathways to Tax Reform: The Concept of Tax Expenditures*. Cambridge, Mass.: Harvard University Press.

Sutherland, S. L., 1991. "The Consequences of Electoral Volatility: Inexperienced Ministers 1949-90." In Herman Bakvis (ed.), *Representation, Integration and Political Parties in Canada*. Toronto: Dunburn Press.

Thompson, Dennis F., 1987. *Political Ethics and Public Office*. Cambridge, Mass.: Harvard University Press.

van Gunsteren, Herman R., 1976. *The Quest for Control: A Critique of the Rational-Central-Rule Approach in Public Affairs*. London: John Wiley & Sons.

Wildasin, David E., 1988. "Tax Expenditures: The Personal Standard." In Neil Bruce (ed.), *Tax Expenditures and Government Policy*. Kingston: John Deutsch Institute for the Study of Economic Policy.

Williamson, Oliver E., 1985. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: Free Press.

Yates, Douglas, 1982. *Bureaucratic Democracy: The Search for Democracy and Efficiency in American Government*. Cambridge, Mass.: Harvard University Press.

Young, Robert A., 1983. "Business and Budgeting: Recent Proposals for Reforming the Revenue Budgetary Process." *Canadian Public Policy*, Vol. 9, No. 3, 347-361.

Zucker, Lynne G., 1991. "The Role of Institutionalization in Cultural Persistence." In Walter W. Powell and Paul J. DiMaggio (eds.), *The New Institutionalism in Organizational Analysis*. Chicago: University of Chicago Press.

Appendix: **Research Methodology and Sources**

1. Primary Sources

1.1 Participant-Observation

I am a Chartered Accountant, and hold the position of Principal in the Office of the Auditor General of Canada. Since November 1987, I have been responsible for conducting financial and value-for-money audits in the Department of National Revenue. It is this experience which has given me an interest in the process of tax policy making in Canada.

The work of the Office of the Auditor General cited in this study was not executed or directed by me. However, it was performed by colleagues with whom I have enjoyed a close association, and this has given me privileged insight into this body of work.

My position with the Office of the Auditor General has also brought me into contact with a wide range of officials in the Department of National Revenue as well as some officials of the Department of Finance's Tax Policy Branch. Over the years I have obtained much general knowledge of how the two departments operate and, in particular, how they interact with one another.

Finally, in part because I am a professional accountant and in part because of my work with the Office of the Auditor General, I have made many acquaintances among and have had many discussions with practicing accountants and lawyers, academics, parliamentarians, Library of Parliament researchers, and interest group representatives having an interest in taxation.

While my research approach was not explicitly designed to incorporate my personal experiences and observations, it was inevitable that these experiences and observations would influence the conduct and the written record of the study. I can only hope that this influence is to the advantage and not to the detriment of the scholarly value of the study.

1.2 Interviews

A total of 32 people were interviewed for this study: 11 interest group representatives, 9 current or former federal Department of Finance officials, 3 tax professionals' organization representatives, 3 current or former parliamentary committee staff members, 2 current or former parliamentary committee members, 1 Office of Auditor General official, 1 other federal government department official, 1 provincial finance department official, and 1 unaffiliated parliamentary committee witness.

Table 3

INTERVIEWS CONDUCTED FOR THE STUDY

No.	Location of Subject	Interview Format	Date
1	Ottawa	In person	12 March 1996
2	Ottawa	In person	15 March 1996
3	Ottawa	In person	21 March 1996
4	Ottawa	In person	22 March 1996
5	Ottawa	In person	29 March 1996
6	Ottawa	In person	2 April 1996
7	Ottawa	In person	3 April 1996
8	Ottawa	In person	4 April 1996
9	Ottawa	In person	9 April 1996
10	Ottawa	In person	9 April 1996
11	Ottawa	In person	10 April 1996
12	Ottawa	In person	10 April 1996
13	Ottawa	In person	11 April 1996
14	Ottawa	In person	12 April 1996
15	Ottawa	In person	17 April 1996
16	Ottawa	In person	19 April 1996
17	Ottawa	In person	24 April 1996
18	Toronto	Telephone	24 April 1996
19	Toronto	In person	7 May 1996
20	Toronto	In person	8 May 1996
21	Toronto	In person	8 May 1996
22	Toronto	In person	9 May 1996
23	Toronto	In person	9 May 1996
24	Toronto	In person	15 May 1996
25	Ottawa	In person	10 June 1996
26	Toronto	Telephone	13 June 1996
27	Toronto	Telephone	14 June 1996
28	Toronto	Telephone	21 June 1996
29	Calgary	Telephone	21 June 1996
30	Ottawa	In person*	4 July 1996
31	Ottawa	In person	18 July 1996

* Two subjects were interviewed together

INTERVIEW GUIDE

Have the subject answer the following questions with respect to his/her most recent experience.

- What is the role of your organization in the tax policy making process?
- What does your organization consist of, and what are the roles fulfilled by its component parts?
- What other players does your organization interact with in fulfilling its role?
- What determines who gets to be a player in the tax policy making process?
- What are the roles of these other players?
- What kinds of actions is your organization permitted to take in fulfilling its role?
- What kinds of actions are the other players permitted to take in fulfilling their roles?
- What are the ends to which tax policy can be addressed?
- How does "the system" ensure that only permitted ends are pursued?
- How are tax policy decisions made and by whom?
- Through what channels and in what manner are each of the players permitted to communicate with each other?
- How does your organization benefit from participating in the tax policy making process?
- What does it "cost" your organization to participate?
- What are the benefits and costs that accrue to the other players?

Think back to your earliest experience with the tax policy making process. How was the situation different from that which you have just described? What caused the differences?

Prompts (to be used if necessary):

- More Finance white papers, discussion papers, draft legislation, etc.?
- Less frequent, more regular Budgets?
- Published tax expenditures estimates?
- Charter of Rights and Freedoms?
- Auditor General's reports?

What were the results of the differences?

Prompts (to be used if necessary):

- More or different participants?
- Change in the relative importance of participants?
- Degree of autonomy of particular participants?
- Nature and amount of information available?
- Openness or accountability of the process?
- Efficiency of the process?
- Extent of co-operation or competition among participants?
- Behaviour of participants?
- Manner in which tax policy agenda is set?
- Capacity and flexibility of the system to deal with the agenda?
- Ends of tax policy?
- Number and kinds of policy options presented?
- Criteria for judging "goodness" of tax policy?
- Kinds of policies adopted?
- Effectiveness of policies?
- Support for policies?

I was influenced by the approaches taken by Good and Hartle¹ and promised all of the subjects that their identity would be protected. Because of this, interviews referenced in the text are designated by number only. Exhibit 4 presents certain details about each interview in the hope that this will be sufficient to satisfy the demands of methodological rigor. Interviews ranged from 45 minutes to 2 hours in length. Most interviews lasted about one and one-half hours. The guide that I used in the interviews is reproduced in Exhibit 5.

2. Documentary Sources

2.1 Official Government Documents

Canada, Department of Finance, 1979. *Government of Canada Tax Expenditure Account: A Conceptual Analysis and Account of Tax Preferences in the Federal Income and Commodity Tax Systems*. Ottawa: The Department (December).

Canada, Department of Finance, 1980. *Government of Canada Tax Expenditure Account: The Account of Tax Preferences in the Federal Income and Commodity Tax Systems 1976-1980*. Ottawa: The Department (December).

Canada, Department of Finance, 1982. *The Budget Process: A Paper on Budget Secrecy and Proposals for Broader Consultation*. Reproduced in the *Canadian Tax Journal*, Vol. 30, No. 2, March-April, 171-178.

Canada, Department of Finance, 1985a. *The Canadian Budgetary Process: Proposals for Improvement*. Budget Papers (May). Reproduced in the *Canadian Tax Journal*, September-October 1986, 1015-1044.

Canada, Department of Finance, 1985b. *Account of the Cost of Selective Tax Measures*. Ottawa: The Department (August).

Canada, Department of Finance, 1987. *Income Tax Reform*. Ottawa: The Department (June 18).

¹ Good kept confidential the names of all of the persons interviewed for his study; Hartle, depending upon their wishes, either disclosed or kept confidential the names of persons interviewed for his study and the names of persons from whom he obtained comments on his manuscript (comments were published in the final study). See David A. Good, *The Politics of Anticipation: Making Canadian Federal Tax Policy* (Ottawa: Carleton University School of Public Administration, 1980) and Douglas G. Hartle, *The Revenue Budget Process of the Government of Canada: Description, Appraisal, and Proposals*, Canadian Tax Paper No. 67 (Toronto: Canadian Tax Foundation, 1982).

Canada, Department of Finance, 1991. *The Budget*. Ottawa: The Department (February 26).

Canada, Department of Finance, 1992a. *Government of Canada Personal Income Tax Expenditures*. Ottawa: The Department (December).

Canada, Department of Finance, 1992b. Information Release No. 92-102. Ottawa: The Department (December 23).

Canada, Department of Finance, 1993. *Government of Canada Personal and Corporate Income Tax Expenditures*. Ottawa: The Department (December).

Canada, Department of Finance, 1994a. *Response to Pre-Budget Consultations: Facing Choices Together*. Ottawa: The Department (February).

Canada, Department of Finance, 1994b. *Tax Expenditures*. Ottawa: The Department (December).

Canada, Department of Finance, 1995. *Budget Speech*. Ottawa: The Department (February 27).

Canada, Department of Finance, 1996. *Harmonized Sales Tax Technical Paper*. Ottawa: The Department (April).

Canada, Department of Finance, 1997. News Release. "Government to Proceed with Income Tax Legislation." Ottawa: The Department (March 3).

National Council of Welfare, 1976. *The Hidden Welfare System: A Report by the National Council of Welfare on the Personal Income Tax System in Canada*. Ottawa: November.

Statistics Canada, 1987. "Portable SPSP/M: Introduction and Overview." Mimeo.

2.2 Annual Reports of the Auditor General of Canada

Office of the Auditor General, 1984. *Report of the Auditor General of Canada to the House of Commons*. Ottawa: Supply and Services Canada

Office of the Auditor General, 1986. *Report of the Auditor General of Canada to the House of Commons*. Ottawa: Supply and Services Canada.

Office of the Auditor General, 1992. *Report of the Auditor General of Canada to the House of Commons*. Ottawa: Supply and Services Canada.

2.3 House of Commons Publications

House of Commons, 1985. *First Report of the Standing Committee on Procedure and Organization*. "The Canadian Budgetary Process: Proposals for Improvement." Ottawa: June 26. Reproduced in the *Canadian Tax Journal*, Vol. 34, No. 5, September-October 1986, 1045-1070.

House of Commons, 1986. *Fourteenth Report of the Standing Committee on Public Accounts*. Ottawa: June 26. Reproduced in 1986 *Report of the Auditor General of Canada to the House of Commons*.

House of Commons, 1989. *Second Report of the Standing Committee on Finance*. "Report on the Technical Paper on the Goods and Services Tax." Ottawa: November 21.

House of Commons, 1994a. *Ninth Report of the Standing Committee on Finance*. "Replacing the GST: Options for Canada." Ottawa: June 16.

House of Commons, 1994b. *Tenth Report of the Standing Committee on Finance*. "Confronting Canada's Deficit Crisis: Building Our Next Budget through Consultation." Ottawa: December 5.

House of Commons, 1995. *Standing Orders of the House of Commons*. Ottawa: December.

House of Commons, 1996. *Twenty-fourth Report of the Standing Committee on Finance*. "The Next Steps to Fiscal Health After a Year of Historic Progress: Building the 1996 Budget Through Consultation." Ottawa: January 17.

House of Commons, Standing Committee on Finance, Trade and Economic Affairs. *Minutes of Proceedings and Evidence*. Ottawa: Various Issues.

2.4 Legal Cases

Citations are to Dominion Tax Cases published by CCH Canadian Limited, Don Mills, Ontario.

Lawson A. W. Hunter, et al. v. Southam Inc., (84 DTC 6467).

Minister of National Revenue, et al. v. Kruger Inc., et al., (84 DTC6478).

Her Majesty the Queen v. Phyllis Barbara Bronfman Trust, (87 DTC 5059).

Jerilynn Prior v. Her Majesty the Queen, (88 DTC 6207).

Berl Baron and Howard Baron, C.A. v. Her Majesty the Queen, et al., (91 DTC 5055).

Elaine Schachtschneider v. Her Majesty the Queen, (93 DTC 5298).

Elizabeth C. Symes v. Her Majesty the Queen, et al., (94 DTC 6001).

3. Analysis of Witness Participation Before Parliamentary Committees

Chapter 5 contains counts of total and tax-related meeting days of parliamentary committees and counts of organizations and persons who appeared as witnesses. I personally performed these counts using minutes of proceedings and evidence as my source. For ease of data collection I chose to count “meeting days” rather than “meetings.” On some days, several meetings might be held, and some meetings may cover more than one topic. Given the purpose of my analysis -- to monitor gross trends in the amount of attention paid to tax policy matters -- I felt that the use of “meeting days” provided a fine enough measure of activity.

IMAGE EVALUATION TEST TARGET (QA-3)

APPLIED IMAGE, Inc
1653 East Main Street
Rochester, NY 14609 USA
Phone: 716/482-0300
Fax: 716/288-5989

© 1993, Applied Image, Inc., All Rights Reserved