Chapter 8
Canada and the Rest of the World

SO FAR, WE HAVE CONCENTRATED OUR ATTENTION on how much tax Canadians pay and how those taxes have been changing. This is useful information if one wants to compare Canada today with Canada in the past. It is sufficient to concentrate on the tax burden within our own country provided one is fairly isolated from the rest of the world. However, new technology and falling trade barriers are weaving the economies of the world closer together than they have ever been before and stripping away any efforts at isolation. This means that, when we consider our taxes, we also have to look at the tax rates and levels in the countries with which we have close ties.

How do we compare?

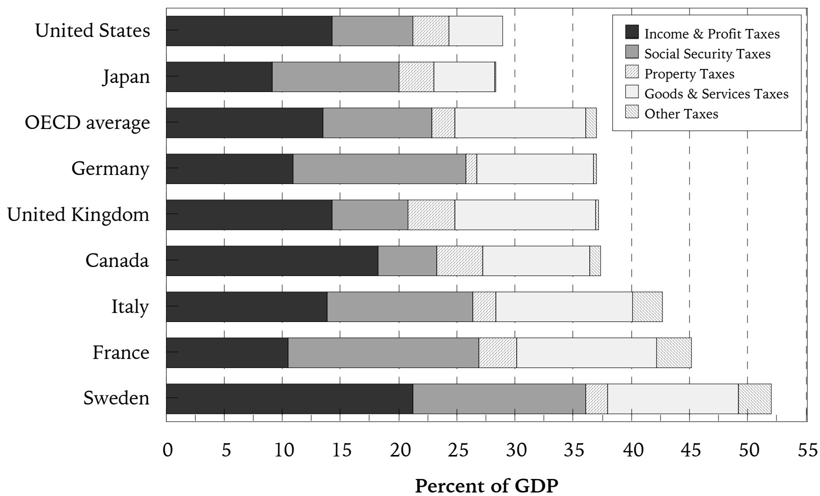
The Canadian tax system is complex and no single number can summarize it. The same is true of comparisons between Canada and the rest of the world. Foreign tax systems are different and governments abroad provide their citizens with different levels of services. This means that comparing the total amount of taxes paid in Canada and in, say, Japan may tell us little about whether taxes are too high in one country relative to the other. For example, Canada may tax more than other countries but it may provide more and better public services. That is, the tax price of government activity may be lower here. This sort of subtlety does not mean, however, that international comparisons are meaningless. There are some numbers that can give us a broad feel for the differences between the systems.

The level of taxes

Figure 8.1 shows the total amount of tax in Canada and other industrialized nations as a percentage of GDP in 1998. The horizontal bar for each country is divided into five sections: income and profit taxes; social security taxes; property taxes; goods and services taxes; and other taxes. Table 8.1 shows the numerical breakdown of the relative importance of each tax category. The comparison shows that Canada falls in the middle among these nations. A closer look reveals that Canada has the second highest income and profit taxes as a percentage of total taxes, the lowest social security taxes, and high property taxes. Some claim that these low social security taxes give Canada room to raise contribution rates but they miss certain facts.

- Canada's population is comparatively young so our social security taxes should be low. Japan has a relatively old population and social security taxes there are over one-third of the total tax bill.
- Canada Pension Plan contributions have already increased from the 1997 rate of 6.0% to 8.6% in 2001 and are scheduled to increase to 9.9% by 2003.
- "Although payroll tax rates are low compared with other OECD countries, the same is not the case for total taxes payable on labour, including both income tax and social security contributions.

Figure 8.1: International comparison of taxes paid as a percentage of GDP, 1998



Source: OECD, Revenue Statisics, 1965-1999, 2000

Table 8.1: International tax comparisons, 1998

	Total tax as a percent of GDP	Taxes as a percent of total taxes				
		Income and Profits	Social Security	Property	Goods and Services	Other
United States	28.9	49.5	23.7	10.6	16.2	0.0
Japan	28.4	32.1	38.4	10.5	18.8	0.2
OECD average	37.0	36.3	24.7	5.4	31.3	2.1
Germany	37.0	29.4	40.4	2.4	27.4	0.0
United Kingdom	37.2	38.4	17.6	10.7	32.6	0.0
Canada	37.4	48.5	13.7	10.4	24.7	2.6
Italy	42.7	32.6	29.4	4.8	27.4	5.4
France	45.2	23.3	36.2	7.3	26.6	6.3
Sweden	52.0	40.7	28.7	3.7	21.6	4.9

Source: OECD, Revenue Statistics, 1965–1999, 2000.

The average effective rate on labour income in Canada is 29%, which is higher than all except the continental European OECD members." (OECD 1997: 82).

- Canada's overall tax burden since 1965 has been rising rapidly. Table 8.2 shows that the percentage increase in our taxes as a share of GDP from 1965 to 1998 was 44.4%
- Canada's debt is a hidden tax that does not come out in this international comparison of visible taxes. Table 8.3 shows Canada's government debt as a fraction of GDP and compares it to other industrialized countries. Only Italy among the G-7 countries has a ratio of debt to GDP higher than that of Canada. Among the 18 OECD countries that report comparable debt statistics, Canada has the fourth highest ratio; only Italy, Austria, and Belgium have higher ratios of debt to GDP (OECD 2000).

Why bother comparing?

Comparing taxes is interesting because it indicates how well a country can compete in the international marketplace. Taxes raise the costs facing a business and, if there is no offsetting movement in the exchange rate, they may cripple its ability to undersell foreign competitors who come from countries with lower tax burdens. We must be careful before jumping to conclusions, however, because in return for paying taxes we receive government services that help us to be productive. Infrastructures such as roads, schools, and legal and penal systems that

Table 8.2: Change in taxes (as a percentage of GDP) from 1965 to 1998

	Total change (%)	Change by type of tax (%)			
		Income and profits	Social Security	Property	Goods and Services
United States	15.6	20.2	109.1	(20.5)	(16.1)
Japan	55.2	13.8	172.5	100.0	10.4
OECD average	43.4	50.0	100.0	0.0	17.7
Germany	17.1	1.9	75.3	(50.0)	(2.9)
United Kingdom	22.4	26.5	38.3	(9.1)	19.8
Canada	44.4	82.0	264.3	5.4	(12.4)
Italy	67.5	202.2	43.7	11.1	15.8
France	31.0	90.9	39.0	120.0	(9.1)
Sweden	48.6	10.4	254.8	216.7	2.8

Source: OECD, Revenue Statistics, 1965–1999, 2000.

Table 8.3: Net government debt as a percentage of GDP, 2000 (estimate)

Sweden	2.0%	**United States**	43.2%
United Kingdom	32.6%	**Germany**	41.7%
France	42.7%	**Canada**	48.1%
Japan	43.6%	**Italy**	99.8%

Source: OECD, *OECD Economic Outlook*, 68, December 2000.

work as they should are all vital aids to success in facing the challenge of foreign competition. This means that we have to ask whether a rising trend in Canadian and other taxes represents heavier investments in these productive infrastructures. It is imaginable that a higher tax burden does not represent a competitive disadvantage provided those taxes are being spent productively by government.

The evidence from 1966 to 1998 shows that the fraction of government budgets spent on these vital infrastructures is falling in Canada (table 8.4). A greater fraction of our tax dollar is going to finance interest payments on the debt and social service programs. These expenditures make up close to three-quarters of government budgets. A similar picture emerges for many of the foreign countries with which we have been comparing Canada in this chapter. Two economists from the International Monetary Fund, Vito Tanzi and Ludger Schuknecht, report in a book published recently by the Fraser Institute that average government spending in 17 industrialized countries rose from 28% to 46% between 1960 and 1996. Further, they reported that

Table 8.4: Composition of total government spending, 1966 and 1998

	1965/66		1997/98		Change (percentage point) from 1965/1966 to 1997/1998
	$millions	Percent of total	$millions	Percent of total	
General services	966	5.6	12,329	3.3	(2.3)
Protection of persons & property	2,268	13.2	28,506	7.6	(5.5)
Transportation & communication	2,149	12.5	16,999	4.6	(7.9)
Health	1,678	9.8	55,454	14.9	5.1
Social services	3,112	18.1	99,515	26.7	8.6
Education	2,982	17.3	55,305	14.8	(2.5)
Resource conservation and industrial development	870	5.1	12,651	3.4	(1.7)
Environment	435	2.5	8,630	2.3	(0.2)
Recreation and Culture	257	1.5	8,757	2.3	0.9
Labour, Employment and Immigration	51	0.3	2,367	0.6	0.3
Housing	23	0.1	4,589	1.2	1.1
Foreign affairs and international assistance	159	0.9	3,608	1.0	0.0
Regional planning & development	80	0.5	1,544	0.4	(0.1)
Research establishments	68	0.4	1,559	0.4	0.0
Transfers to own enterprises	270	1.6	n/a	n/a	n/a
Debt charges	1,718	10.0	60,072	16.1	6.1
Other Expenditures	122	0.7	989	0.3	(0.4)
Total expenditures	17,207	100.0	372,874	100.0	0.0

Sources: Statistics Canada, Public Finance Historical Data, 1965/66–1991/92, catalogue 68-512; Financial Management System data from the Public Institutions Division; calculations by the authors.

countries with "small" government sectors (public expenditure less than 40% of GDP) do not have worse indicators of social and economic well-being than countries with "big" governments (public expenditure greater than 50% of GDP) and that these "small" government countries often achieve better results (Grubel 1998). Results published elsewhere by the same authors (Tanzi and Schuknecht 1995) show that, between 1960 and 1994, average spending on interest payments in the 17 industrialized countries studied increased from 1.9% to 4.3% of GDP and average spending on subsidies and transfers increased from 8.3% to 23.0% of GDP. What this means is that, when we are comparing tax levels, it is right to think that a higher tax burden may make a country less competitive because much of the increase in the tax burden in Canada and other industrialized countries over the past four decades is due to government activities that do not enhance the productivity of a nation.

Canada and the United States

The United States buys about 86% of Canada's exports. The proximity of the United States and the increasing flow of goods and services over our border because of NAFTA means that it is the tax system of the United States with which we ought particularly to compare our tax system. According to economist Brian Bethune, taxes are about 27% higher in Canada than in the United States (Bethune 1993). The OECD estimates that Canadian governments collected 34% more revenue (as a percentage of GDP) than their American counterparts in 2000 (OECD 2000b). The OECD, in a recent country survey for Canada (OECD 1997), noted the following.

- Relative to the United States, personal income tax rates are quite high, especially for those with high incomes subject to federal and provincial surtaxes. For example, according to calculations by the OECD Secretariat, the marginal tax rate for a person earning twice the average production wage is 48% in Canada, compared with 43% in the United States and 47% in all OECD countries. Similar differentials exist for average tax rates. This could make it more difficult to attract and retain highly skilled persons, who are likely to be the most mobile internationally.

- The disincentive imposed on investment by corporate taxes and other taxes on business income tends to be relatively high for large firms. A recent study (Chen and McKenzie 1996) found that the marginal effective tax rate on investment in manufacturing was higher in Canada than in all the countries studied except Ger-

> many and Japan. Similar patterns prevailed for services, with the differential between Canada and the United States, in particular, being even larger.

Compared to our main trading partner, the United States, our tax rates and levels are high. Compared to other industrialized countries, our debt burden and resultant interest costs as a share of total government spending are high. These fiscal weaknesses detract from Canada's international competitiveness and are especially important in the face of falling trade barriers and increasing global competition.