

REVIEWS

TAXES, TARIFFS, AND SUBSIDIES: A HISTORY OF CANADIAN FISCAL DEVELOPMENT. By J. Harvey Perry. Toronto: University of Toronto Press, 1955. 2 Vols. Pp. xviii, 324; xi, 439. \$25.00.

It is a matter of general record that Canada ranks among the leading industrial economies of the world.¹ This fact is now so widely recognized that it no longer requires any special emphasis in economic discussion.

However, two aspects of Canadian development are worth underscoring: first, the most spectacular economic changes have occurred during the past fifteen years; and second, throughout the course of its history—and never more so than in the post-World War II period—Canada's growth has been shaped largely by its close orientation to the world economy in general and to that of the United States in particular. Very much a reflection of the recentness of the maturing process is the relatively primitive state from which Canadian economic literature has only begun to emerge. At the same time, the broad American "trade-investment" context in which Canada has developed makes it increasingly important that the Dominion's economic achievements and problems be understood by its southern neighbor.²

In the light of these twin considerations, the book under review is doubly praiseworthy.³ It is commendable first as a comprehensive, carefully-written historical account of Canada's fiscal development since Confederation in 1867. And American readers (among others) will surely be impressed by this fact; as well as by the implications, for the United States, of Canadian experience

1. There is no standard set of criteria for comparing national levels of industrialization and economic wellbeing. Nor are the available quantitative estimates free from serious shortcomings. But it is sufficient, for purposes of this review, to note that in 1949 (the latest year for which broad statistical comparisons are available) Canada stood second only to the United States in terms of per capita national income; and that few countries can match Canada's present investment activity as a proportion of gross national expenditure. See NATIONAL AND PER CAPITA INCOMES: SEVENTY COUNTRIES—1949, at 9-12, 14-16, U.N. Doc. No. ST/STAT/SER. E/1 (1950); STATISTICS OF NATIONAL INCOME AND EXPENDITURE 63-81, U.N. Doc. No. ST/STAT/SER. H/7 (1955).

2. This is not to ignore the fact of basic socio-economic ties between Canada and the other members of the British Commonwealth; nor the real need for Canada and countries other than the United States to acquire a thoroughgoing appreciation of economic institutions and issues beyond their own borders. The point being made is, rather, that the "informational imbalance" between Canada and the United States is great; that it is heavily weighted against the latter; and that the United States, above all other countries, should understand the Canadian economy. See Mackintosh, *The Canadian Economy and Its Competitors*, 34 FOREIGN AFFAIRS 117 (1955).

3. See also PERRY, TAXATION IN CANADA (1954) (a study of the Dominion's current tax system); PETRIE, THE TAXATION OF CORPORATE INCOME IN CANADA (1952).

with federalism, and by the powerful impact of American policy (and, indeed, of American existence) on this experience.

The author begins his story with a lucid survey of the "Background of Union."⁴ Canada in the middle of the nineteenth century was a vast, resource-rich area whose western portion was largely unexplored and whose central and eastern regions were sparsely settled and unevenly developed. It was, moreover, an area plagued by rugged climate, by the most inadequate of transportation and communication facilities, and by a sharp cultural cleavage between English- and French-speaking groups. Superimposed on this combination of problems was the mother country's withdrawal of imperial trade preferences; and, far more serious, the ever-present pull of the powerful and rapidly growing United States—which only one year prior to Confederation had abrogated its free-trade Reciprocity Treaty with Canada, and which stood as a chronic threat to the survival of a country whose economic soundness left much to be desired.

In these adverse circumstances, it is hardly surprising that the constitutional arrangements for the new union envisaged a strong federal government clothed with both broad enumerated powers and all the ("residual") powers not specifically assigned to the agreeing provinces. Nor is it difficult to understand, in terms of the contemporary overwhelming importance of customs and excise duties, the vesting of "direct" (income and death) taxation authority in the provinces as well as in the federal government. The Fathers of Confederation would have had to possess superhuman foresight to realize that, in the years to come, the Judicial Committee of the Privy Council would so reinterpret the British North American Act as to transfer to the provinces many of the powers that had, in fact, been given to the national government;⁵ and that the gradual development of direct taxation as the chief source of tax revenue would substantially impede federal efforts to implement a satisfactory government allocation of fiscal authority and an effective contracyclical fiscal system.

This, then, was the outlook confronting the newborn federation into which the provinces had been coaxed by federal assumption of their existing debts and by generous unconditional ("statutory") federal subsidies—consisting of "per capita" grants, grants "in support of government," and "special" grants—intended mainly as compensation for the provinces' surrender of their powers of indirect taxation. There followed a period of twenty-three "Years of Frustration"⁶ during which disappointing economic growth intensified a fundamental controversy over tariff policy centering on the alternatives of reciprocity and protectionism. The year 1879 marks Canada's reluctant abandonment of strenuous and persistent attempts to obtain a renewal of reciprocity with an

4. Part I.

5. By way of ironic contrast, the author notes that "in the United States the central government, which was intended to be weak and subservient to the sovereign states, was clothed with enormous powers by the interpretation placed on the constitution by the Supreme Court." Pp. 8-9.

6. Part II.

indifferent United States, although this objective continued to haunt Canadian politics until shortly before the first World War. The National Policy of 1879 made protectionism a reality for Canada and was destined to exert a profound influence on the future course of Canadian economic development.⁷

In large measure, the 1890-1912 period spanned "Years of Fulfilment"⁸ for the young Dominion. "The railways and other expensive overhead equipment so laboriously constructed in the previous period began to pay off, and a new spate of capital expenditures poured out as the crest of a flood."⁹ All major sectors of the Canadian economy—agriculture, mining and manufacturing—partook of this prodigious growth, and it was natural that Canadians should decide that their National Policy was finally bearing fruit. This being the case, their rejection in 1911 of the United States' belated reciprocity offer was almost a foregone conclusion.

Meanwhile, subsidiary governments were beginning to flex their tax muscles. The earlier period had witnessed provincial and municipal tax changes, but they were either inconsequential or limited to relatively few governments. The distinguishing characteristics of the years between 1890 and 1912 were: (1) "the general entry of the provinces into the arena of direct taxation,"¹⁰ and (2) the extraordinary degree to which Henry George's "single tax" found acceptance in western municipal tax structures (only to fade out during World War I and the twenties).¹¹

"Financing World War I, 1912-19"¹² proved, with the benefit of hindsight, to be an object lesson in how public policy should not be conducted.¹³ To a considerable extent, the cost of the war was met through loans or currency expansion; and under these inflationary methods and the regressive tax structure employed, those individuals whose financial position was weakest suffered the heaviest burden.¹⁴ Nor could the result have been otherwise in view of

7. Not a few Canadians—concerned about the limited extent to which other countries, especially the United States, have followed the Canadian lead in the relaxation of trade barriers since the end of World War II—are now giving deep thought to the question whether the Dominion should again chart a "National Policy" course. For a cogently reasoned analysis of this problem, see Mackintosh, *supra* note 2.

8. Part III.

9. P. 93.

10. P. 108.

11. With reference to the single tax, the author points out that "there was heated public agitation for its adoption right across the country." P. 130.

12. Part IV.

13. The author does acknowledge an imposing set of rationalizations for this fact, including: (1) the general assumption that the war would be both short and inexpensive; (2) the unfortunate coincidence that the Dominion's "railway-salvaging" program reached its peak at almost the same time as did the war expenditures; (3) governmental reluctance to detract by high taxes from the position Canada had attained as a land of opportunity in the decade before the war; and (4) the hard fact that, by the time of the war's outbreak, the provinces and municipalities had already encroached heavily on the field of direct taxation, and that they continued these inroads during the war.

14. Between the fiscal years 1915 and 1920, total tax revenues amounted to only

the prevailing lack of appreciation of the "resource-channeling" role of taxation in wartime, and the consequent misconception of borrowing as a device for transferring the cost of war from the current generation to posterity. That these perverse financing techniques did not fundamentally interfere with Canada's wartime economic performance is to be attributed to the lightness of the demands made on government finances by the war.¹⁵ Equally fortuitous—and fortunate—was the fact that the federal financial program was not hampered by the lack of fiscal co-ordination with the policies of the provincial governments, which were making haphazard upward changes in, and additions to, their tax structures.

Nevertheless, by 1920 the Dominion had introduced three major revenue instruments—excise taxes and personal and corporate income taxes. Despite the reluctance with which this was done and the caution with which the new taxes were exploited, the foundation had been laid for a broad revenue system freed from exclusive reliance on the tariff. The "Troublesome Twenties"¹⁶ witnessed first the adoption and then the virtual elimination of the only modern federal tax weapon still lacking at the end of the war—the general sales tax. More important, those years "brought a resurgence of the economic expansion that had begun in 1896, and a further rapid development of municipal and provincial activities temporarily held back by the war. By contrast, the Dominion government, laboring under the burden of heavy outlays for debt interest and war pensions, played a diminishing role as the decade progressed."¹⁷

But the boom of the twenties had developed in an atmosphere of general ignorance of the cyclical process.¹⁸ And all levels of government had become increasingly vulnerable to any sudden decline in economic activity—the Dominion through a reversal of its course away from dependence on the tariff, and the provinces and municipalities through heavy expenditure commitments and increasing dependence on taxation of postponable luxury-type consumption spending. On this flimsy institutional structure, the "Great Depression"¹⁹ burst with unprecedented violence. The grim story of the thirties has been fully told in numerous other contexts. Paraphrasing the author's account of Canadian fiscal developments, it is sufficient to note that perhaps never was so much done by so many governments to aggravate such a widespread and crushing economic burden. At the very time when tax rates should have been lowered and expenditures increased, the most vigorous budget-

one-third of combined (war and other) expenditures; and "the personal income tax, one of the great pillars of the revenue system in World War II, produced less than 1 per cent of tax revenues in the earlier war." Pp. 163-64.

15. "It is estimated that war expenditure did not exceed 10 per cent of the national income during World War I, while in the later conflict at the peak nearly half of the national income was being turned to this purpose." P. 143.

16. Part V.

17. P. 193.

18. Canada was, of course, far from being alone in the enjoyment of its misguided pre-Keynesian bliss.

19. Part VI.

balancing efforts were made. Sizeable deficits were often incurred, to be sure, but only because incomes were too low to provide the desired revenue, and economic misery so great as to require substantial relief expenditures by the federal government. By the end of the thirties, moreover, the policies of severe retrenchment pursued by the subsidiary governments—which were, after all, harrassed by the fact of limited borrowing power in the face of enormous need for funds—had produced the double effect of seriously weakening whatever contracyclical measures the federal authorities did undertake and reducing Dominion-provincial fiscal relations to a state of near-chaos.

Out of this economic catastrophe came the 1940 *Report of the Royal Commission on Dominion-Provincial Relations* (Rowell-Sirois Report), “a landmark in Canadian history comparable to Lord Dunham’s Report of a century before.”²⁰ Quite apart from its pioneering contribution to Canadian economic research,²¹ the Commission is notable for its unqualified advocacy of contracyclical budgetary policy, and for the bold recommendation that the Canadian Constitution be amended so as to vest in the federal government exclusive control of the personal income tax, all corporation taxes and the succession duty. Compensation for the provinces’ loss of taxing power was to be rendered through (1) the Dominion’s assumption of provincial debts and prime responsibility for unemployment relief, and (2) payment of “fiscal” and “emergency” grants to the provinces. But although the *Report* has strongly influenced subsequent Canadian fiscal development, its main proposals (described in part XI of the book under review, along with earlier and more recent subsidy schemes) became casualties of the war and of a general reluctance to implement the sweeping changes suggested.

Canada proceeded, however, to apply itself with remarkable energy and intelligence to “Financing World War II.”²² Armed with a mature approach to fiscal theory, as well as with the Wartime Tax Agreements by which the provinces surrendered their income tax rights in return for federal grants, the Dominion succeeded in covering by taxation more than half of its enormous wartime expenditures—“almost the maximum of accomplishment, and . . . more than most countries achieved.”²³ The two chief instruments for reaching this result were the excess profits tax and the personal income tax. The most interesting feature of the excess profits tax was the elaborateness of its provisions defining “profits” and making allowance for tax relief under special circumstances; while the personal income tax “was given a greater prominence in the federal budget than ever before or since.”²⁴

20. P. 307.

21. See, especially, REPORT OF THE ROYAL COMMISSION ON DOMINION-PROVINCIAL RELATIONS bk. I (1940), and the following studies prepared for the Commission in 1939: S. BATES, THE FINANCIAL HISTORY OF CANADIAN GOVERNMENTS; F. A. KNOX, DOMINION MONETARY POLICY, 1929-1934; W. A. MACKINTOSH, THE ECONOMIC BACKGROUND OF DOMINION-PROVINCIAL RELATIONS.

22. Part VII.

23. P. 329.

24. P. 360.

In the final phase of development—"The Postwar Tax Experiment, 1946-54"²⁵—the keynote has been income and commodity tax reform designed to yield substantial compliance with the requirements of equity, income-employment stabilization, incentives to enterprise, and efficient administration. The 1947 balance-of-payments crisis, the 1950 outbreak of war in Korea and the 1951 enactment of a universal old age pensions law did, however, result "in the temporary restoration of tax rates at levels as high as those of World War II."²⁶ This has, furthermore, been the period during which: (1) under five-year agreements signed in 1947 and 1952 (excluding Quebec and Ontario, and Quebec respectively) provincial and municipal taxes were suspended in return for Dominion compensation; (2) Newfoundland in 1949 became the tenth Canadian province on the basis of tax-subsidy arrangements similar to those made with other members of the Confederation; (3) grave fiscal problems, temporarily set aside by wartime developments, have re-emerged to press heavily upon subsidiary governments struggling, with limited revenue sources, to provide the vast network of services demanded by an economy bursting with economic growth; and (4) through skilled negotiation on the international front (notably with reference to the General Agreement on Tariffs and Trade signed originally in 1947) the Dominion has made a significant contribution to world-wide lowering of commercial barriers.

Such, then, are the general outlines of Canadian fiscal history as definitively developed by Mr. Perry. There can be no question but that, in his careful marshalling and ordering of this complex material, he has performed an invaluable service for all those interested in this vital sphere of the Canadian economy. The author has also furnished the reader with a detailed factual account of "Main Events in Taxation, 1650-1954";²⁷ a thorough tabular presentation of Canadian fiscal statistics²⁸ which would otherwise be available only in widely scattered sources, and often in a form not easily understood; and an exhaustive bibliography of official and private sources dating from the earliest years of Canadian history to the present.²⁹ Finally, not the least of his achievements has been to create a vivid picture of Canada's rapidly growing awareness of the fiscal obstacles to smoother economic development and her interest in subjecting these obstacles to scientific analysis.

In all fairness, however, some critical remarks remain to be made. The author himself is quick to concede a serious deficiency in interpretation of the events that he has so voluminously recorded.³⁰ It would, for example, have been most illuminating to discover the reasons why the problem of inter-governmental allocation of tax and spending powers is as far from solution as it ever

25. Part VIII.

26. P. 439.

27. App. A.

28. App. C.

29. Pp. 715-53.

30. P. viii.

was;³¹ to gain deeper insight into the familiar observation that effective pursuit of contracyclical fiscal policy at the federal level is blocked by the failure to arrive at such an allocation; to ascertain the general principles that should guide the allocation of revenue and expenditure powers between provincial and municipal governments; and to learn, in more precise terms, of the impact of Canadian tariff policy on the country's economic growth. Mr. Perry could hardly include these issues among the fiscal "developments [that] speak for themselves."³²

Admittedly, lightness of interpretation may be the necessary price to be paid for thorough documentation of a historical record. It is, nevertheless, difficult to avoid the view that the price need not have been so high; and that it might have been reduced by incorporating an abbreviated part IX ("Subsidies and Other Fiscal Arrangements, 1867-1954") into the rest of the text, and by less detailed treatment of fiscal events at the subsidiary levels of government.³³ Such a change of emphasis, though by no means negligible, would not have altered the basic narrative theme, and might, in fact, have produced a more tightly-knit interpretative story.³⁴

But the author himself has dropped the gentle hint that his partial confession of failure on the "interpretation" front may be "a promise of yet another book."³⁵ This might well be a more fruitful course of action than the reviewer's suggestion that historical narrative should not be so comprehensive as to compel considerable sacrifice in terms of critical analysis. It is therefore to be hoped that Mr. Perry will soon find it feasible to build further upon his description of the basic fiscal structures.³⁶

In any event, his present effort stands solidly on its own as a major addition to Canadian economic literature. It is a book that richly deserves to be read by expert and laymen alike—and read with as much care as the author has obviously taken in writing it.

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31. The latest of a long series of inconclusive Dominion-Provincial Conferences was held in October 1955. Against a background of publicly expressed views that have often been something less than enlightened, the various governments are now considering a series of alternative "fiscal allocation" proposals submitted to that Conference.

32. P. viii.

33. In the interest of both clarity and succinctness, the author should, at the very least, have attached a concluding summary to each set of fiscal changes traced for the provincial and municipal governments.

34. The reviewer would not deny the contention that a detailed financial history of Canadian subsidiary governments has long been sorely needed. But, on grounds of manageable length for a single study, he would question the soundness of combining such a history with an equally full account of federal financial operations.

35. P. viii.

36. Indeed, the book under review represents just such a "further building" upon the author's *TAXATION IN CANADA* (1954).

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