

Commentary

Paul Hobson, Acadia University

What I will talk about today is the experience in what we're calling the HST provinces. Of course, there was big pressure in the four Atlantic provinces – Prince Edward Island, New Brunswick, Nova Scotia and Newfoundland – to harmonize back in 1995 and 1996. Ultimately, just three of them – New Brunswick, Newfoundland and Nova Scotia – chose to harmonize; PEI chose not to. I think a lot of the issues that we're addressing here were considered by PEI at that time.

Let me begin by saying that a legislative committee in PEI did study this issue quite closely and a lot of provincial consultation went on on the issue. And I think in principle, the legislative committee agreed with the idea of harmonization, but in practice felt it was not politically viable. Perhaps a better person to be up here today talking about the PEI case would be Pat Mella, who was the sole Conservative member of the legislature at the time and a member of that committee. Subsequently, in 1997 I guess, the Conservative government came in, and Pat Mella became the provincial treasurer.

I think in PEI the issue was a political one. There was a weak Liberal government at the time, the issue was contentious, there was a lot of opposition in terms of the public consultation, and the sense that the new tax would impose undue burdens on consumers. There was also a lot of concern about the long-term revenue implications for the province going from what was effectively a 10.7 percent RST rate to an 8 percent PVAT. I think at the time, they were estimating something like about \$23 million a year loss in revenue. Roughly \$60 million was on offer to PEI as compensation.

One could perhaps view this in terms of a bribe, and I think we've heard the notion of bribing the provinces come up today. But in looking at Michael's numbers for British Columbia and Ontario, the orders of magnitude there compare with the very significant projected revenue losses in the Atlantic provinces. So I think there was a very valid concern for the legislative committee making its ultimate recommendation not to harmonize.

There are other big issues in play as well. I don't know what exemptions currently exist within the Ontario system or the British Columbia system, but there were big exemptions in the Atlantic provinces. Just to take the PEI example (but Nova Scotia had these as well, and, I believe, New Brunswick): clothing under \$100 was exempted as was footwear under \$100. These were big items – relatively small expenditure-share items, but in the eyes of voters and in the perception of regressivity associated with the change to a broad-based value-added tax – and very real concerns. Electricity and heating oil are issues still with us as well.

We've heard a lot today about harmonization of rates. What I took from Charles McClure was that what's really wrong with harmonization, at least as it was implemented in those three

provinces, is the fact that they had to harmonize their rates, that they gave up their autonomy over rate-setting. That's not entirely true. Within the three provinces, what was required to lower the rate – in that unlikely scenario – would have been unanimity among the three provinces. In order to increase the rate, all that would have been required would be agreement of two out of the three provinces. So there was room to adjust, but it would take some agreement among the participating provinces. How that would translate into a national system I'm not entirely sure – where you'd have dominant provinces such as Ontario with very different economic circumstances compared to the HST provinces.

Of course, in moving to harmonization, the provinces had to accept not just the GST rules, but also rules on tax-exempt sales and zero-rated sales – all those sorts of things that were embedded in the tax system. This had some big implications for existing arrangements with municipalities, with hospitals, with universities, and so on.

One of the things I want to emphasize is that the money on offer at the time of the harmonization, approximately \$1 billion across the provinces, was not a bribe so much as it was compensation for revenue losses. This was being paid up front, so that it was very attractive. We should also remember we were in 1996 when these decisions were being made. The provinces were reeling from federal government cuts in transfers.

Another area of major concern and discussion at the time had to do with the tax treatment on used automobiles – existing provincial sales taxes taxed used auto sales fully – 10 percent in PEI. To move to a value-added tax, that would have involved not necessarily that great a revenue loss, but it was a very contentious issue from the point of view, of provincial treasuries, at least. There were big issues around alcohol, tobacco, and gasoline – what were the price impacts of harmonization going to be there? What the provinces talked about at that time was adjusting excise tax rates in order to ensure price neutrality with regard to those areas. If one looks at some of the impact effects that were projected at the time – the Department of Finance did a lot of these analyses then – the projection was that consumers would end up paying more in taxes and low-income families would be disproportionately impacted – again, in particular, because of the loss of exemptions for electricity, heating oil, clothing, and reading material – that was a very contentious issue at the time.

Again, to come back to the PEI case, unlike the other three provinces – by the way, I should point out that the other three provinces had Liberal governments in place at the time, working hand in hand with the Liberal government in Ottawa as opposed to the Conservative government, which came into power in PEI – the loss of autonomy issue was one that the legislative committee in PEI did, in fact, make much of. I think from the point of view of the broader discussions going on here today, when we talk about harmonization, there is a separate set of issues around harmonization across provinces – harmonization of bases and harmonization of rates across provinces – as well as harmonization with an existing tax structure, which is what I suppose is on offer from Ottawa at the moment.

Let me come to two points that I want to finish with. One is that I believe a cogent economic argument can be made for moving to a fully harmonized sales tax or value-added tax system in the country. Indeed, Robin Boadway has argued strongly for what he calls a national goods and

services tax, one that would be completely harmonized and administered at the federal level, with a formal revenue-sharing arrangement with the provinces. Indeed, he argues that this could play a very effective role along with ramped-up transfers under the Canada Social Transfer and Canada Health Transfer as a mechanism for dealing with the fiscal imbalance. So there are some very different views out there, and it's not clear to me that the argument for the provinces themselves becoming more autonomous with regard to value-added taxation is any stronger than the argument for moving to a completely centralized federal tax with formal revenue-sharing arrangements with the provinces.

Finally, let me come back to a very contentious issue in all the Atlantic provinces – home heating fuel. In New Brunswick and Nova Scotia, this is a very active topic of debate at the moment. In the past, what we've seen as ways of getting around the uniform rate with the federal base, the provinces have used rebate systems – basically linked into the income tax system – rebate cheques being cut to low-income households as a way of compensating people for rising home-heating costs. The big discussion now – and again, it's a way of getting around the harmonization with the federal base – is providing a point-of-sale rebate on home-heating fuel. Basically, you're effectively going to be charged the tax and immediately have it deducted from your transaction. So you're complying with the notion of a uniform base but getting an instant rebate at the point of sale. There are thus ways of getting around the so-called harmonized base and there is lots of experience with that in the context of the home-heating fuel issue in some of the existing HST provinces. So it's not clear what it really means to be fully harmonized.

I'll leave it there. I think that throws out a bit of a perspective on what was going on in the three harmonized provinces and, indeed, what went on in the province that opted *not* to harmonize.