

Commentary

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I'd like to start by saying that I'm all for harmonization. I very much applaud the research that Michael discussed today because I think that's exactly the sort of ammunition we're going to need in the battle to convince politicians and voters to pursue harmonization.

I'd like to talk about four options for tax reform. The third and fourth I will spend most of my time on, but I'll also briefly speak about options one and two.

The political optics of RST harmonization is a core issue. And because I've been spending more time lately on the political dimensions of public finance issues I will refer to the political issues somewhat. The GST cut can be considered a first option – we know the federal government is anxious to pursue that. The government wants to move more quickly as it appeals to the voters and it satisfies an election promise. All this is very appealing for the federal government.

The second option is RST-GST harmonization in its variety of forms that we have talked about today. This option, on the other hand, is very politically challenging. In the past, it's been very difficult in provincial negotiations to make any progress on this. And it's politically challenging now for politicians and, in particular, the governments that are in place in the non-harmonized provinces. It's not an obstacle that we can ignore. However, most would argue that GST-RST harmonization is a sound tax reform that is worthy of pursuing. I think we now have the best shot that we've had in a while to pursue this tax reform, so let's get on with it.

Option three involves combining the GST cut with harmonization. It is, I think, a reasonable compromise. It improves the political optics for the politicians in the non-harmonized provinces. And that's a good thing if it helps move it forward.

The benefits of harmonization in option three we've all discussed, and they are well known. If I take the Smart and Bird numbers, I understand harmonization would be almost revenue-neutral if we go with the current RST rates, and the provinces pursue some sort of PVAT option. Then you add to that a GST cut, and that's more politically feasible than to think about pursuing harmonization per se. At least it improves the political optics, and I think we should be taking that into consideration in helping move things forward. One would hope it might reduce voter resistance as well. But I may be less optimistic on that.

The political obstacles are not small. All these non-harmonized provinces have provincial elections coming up, with Ontario's provincial election being particularly pressing. I could see Ontario not really wanting to move on this issue until after the provincial election. Whereas the federal government is going to want to move sooner rather than later, I think. And there have been hints about wanting to announce the second GST cut in the spring budget.

I don't have to convince you that voters hate sales taxes. In a recent survey asking consumers what they thought was the most unfair or worst tax, sales taxes ranked right up there in a league

of their own. So we can't discount the political negatives that go along with harmonization because voters perceive it as a tax grab. These are very visible taxes. Voters see these taxes every day.

So what are we to do on option three? Maybe I'm a bit of an optimist, but I think that, with the GST cut, the non-harmonized provinces have the best chance that they've had in a long time to be able to successfully implement harmonization. So I think we should be pursuing this with great vigour. Timing is clearly important, so we want to take that into consideration. How do we sell it? Recently, I got an e-mail about the new Ontario government's fairness web page. I don't know if any of you have looked at it. But if Ontario would vigorously promote the benefits of harmonization in the same way as they're promoting fairness issues, we'd have a really good shot at convincing the voters.

A further point is that perhaps hiding the GST may be useful. One always hesitates to say that because, as devout public finance economists who are in favour of harmonization, we like taxes to be visible because it improves accountability and transparency and all those good things. But the consumer doesn't. The consumer likes it to be hidden, so we might think about that as a way to get it through the political process.

Just a few words on the Smart and Bird proposal. When I think about the two issues of GST-RST harmonization and fiscal imbalance, I'm more optimistic about harmonization, but perhaps that is not saying much. In addition, I want to talk briefly about combining harmonization with the tax-point transfer idea as a fourth option. This option considers GST/RST harmonization, plus a reduction in the GST rate with provincial governments taking up that tax room. And bring in the add-on feature of reducing the cash transfers by \$10 billion. If we tie the solution to the so-called fiscal imbalance problem to GST harmonization we'll probably derail any hope we have of harmonization.

Smart and Bird point out the added benefits of harmonization – improved competitiveness and removal of the taxation inefficiencies. Plus we could argue that we have potentially improved accountability, and potentially improved fiscal sustainability as well in the sense of sustainable health care systems. I'm not so convinced of these, but they are certainly things we could hope for. Sustainable health care reforms and improved accountability are longer-term goals, and they're not going to happen overnight. So provinces may be forced to take up vacated tax points, or worse I suspect that they might be tempted to raise other taxes instead to pay for rising health care costs. If I'm correct, in the HST provinces, to recoup some revenue losses, they implemented new capital taxes or increased existing capital taxes to make up for some of the revenue losses. That's certainly not a desirable option to see.

I, too, would like to refer to the 1977 tax-point transfer and ask the question, did it improve accountability? Did we see fiscally sustainable health care systems? Did it solve federal-provincial bickering over health care? No, to all of these questions.

My final point is that if we don't eliminate cash transfers altogether, and we leave money on the table, there will always be an attempt to bicker over that money. Either we get rid of the cash transfers and really do the tax-point transfer thing right, or that problem is still going to be there.

My bottom line is that I'm not a big fan of tying harmonization and the GST cut together with a cut in cash transfers as well because I think it will just be a non-starter. If we carve off part of the Smart-Bird proposal and go with what Michael is emphasizing today, the benefits of harmonization per se, I think we'll be much closer to success in that endeavour.