

# NATIONAL POST

Transfer real taxing power to the provinces

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Going into this week's meeting of provincial and federal finance ministers in Niagara-on-the-Lake, Premier Dalton McGuinty of Ontario has mused that Ottawa might hand over revenues from the Goods and Services Tax to help the provinces fund social services. We'd like to suggest a different -- and more rewarding -- reform: Ontario and the other provinces should put their own tax on the GST base, while the federal government cuts federal transfers and its GST rate to compensate.

At first glance, the idea may seem crazy. After all, the GST is one of the most disliked taxes in Canadian history, and the federal government has committed itself to cutting, not raising, the GST rate. But our proposal would allow Ottawa to deliver on its commitment to cut the GST, while both reducing federal transfer commitments and improving transparency and lines of accountability for both levels of government.

Under the current system, the federal government raises some \$40-billion in taxes each year that it simply transfers to the provinces to spend on health, education and social services. Ottawa and the provinces are "co-dependents" in the sense that Ottawa raises the money and the provinces spend it. The result of this fiscal churning is that no government has clear responsibility for delivering key programs, and both sides readily blame the other when something goes wrong.

When the premiers call for more federal transfers, they pretend this could be done without increasing the federal tax burden on their own citizens. It is only the current system of murky shared responsibility that makes this seem like more than a pipe dream.

The dynamics of the blame game are evident in the history of the Canadian Health and Social Transfer (CHST), where the federal cash allocated to the program has increased in virtually every federal budget since the initial cuts of 1995 -- usually in response to provincial brinkmanship at the summer ministers' conferences. Provincial governments have little incentive today to set their own fiscal houses in order, since spending restraint must weaken the case for future increases in federal transfers. Arguably, provincial governments may even be induced to manufacture "crises" in health care to get federal attention to the issue.

Premier McGuinty's idea is just the old wine in a new bottle: once again, he'd like to see the federal government set the tax rates, with the provinces free to spend the proceeds.

In contrast, our proposal to transfer real tax powers to the provinces would help put an end to the continued renegotiation of federal transfers and the resulting fiscal illusion for voters. If provinces wished to spend more on health care, they would have to increase the sales tax rate directly and face the wrath of voters on election day if their decision was the wrong one.

Before creating a provincial GST, fundamental reforms are needed in the five provinces - Ontario, P.E.I. and the western provinces other than Alberta -- that continue to operate an antiquated "retail" sales tax (RST) in place of a modern value-added tax like the GST.

RSTs raise a large proportion of their revenue through a hidden tax on purchases by businesses, including purchases of capital goods. In contrast, value-added taxes seek to tax only consumer purchases of finished products.

Of course, the issue is not the appropriate tax burden on businesses compared with ordinary Canadians. Higher taxes on business purchases lead to higher costs and are ultimately paid by consumers in the form of higher prices. But this additional burden is very unequally distributed among consumers and industries, which is unfair, as well as bad for the economy. Particularly bad are the RST taxes on investment goods, which lower productivity in the economy and perhaps even its long-run potential to grow.

These arguments are no doubt familiar to finance ministers, but they have yet to trump the simple fact that a hidden tax like the RST seems easier to swallow than a highly visible one like the GST.

But the ministers should have a look at the evidence.

Since 1996, four provinces have already replaced their RSTs with value-added taxes similar to the GST. Since then, investment per capita has risen more than 16% faster in those provinces than in those that have retained their RSTs.

Some of that difference is no doubt due to the offshore investment boom in Newfoundland, which replaced its RST, and perhaps to other policy changes in the reforming provinces. But there is a clear suggestion nonetheless that lower taxes on investment goods can matter in a highly visible way.

Many issues remain to be worked out, and Ottawa will have to budge on some long-held positions, as will the provinces. Some additional issues can be resolved as part of the current negotiations over the equalization program. But a GST tax point transfer has the potential to end the annual blame game among Canadian governments, and it could be a tonic for an economic boom.

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