



THE MACDONALD-LAURIER INSTITUTE



COMMENTARY/COMMENTAIRE

Why is good policy toxic politics?

By Brian Lee Crowley

Executive Summary/Sommaire

For the second time in two decades Canada has witnessed good tax policy making for very bad politics. It is a troubling combination in a democratic system.

The issue this summer was the decision by the Ontario and British Columbia governments to harmonize their provincial sales taxes with the federal GST into a new Harmonized Sales Tax or HST.

The HST, like the GST itself, is a much more sensible tax than the one it replaced and most criticisms of it are badly misplaced. But as with the GST, the governments that supported it have faced a bitter backlash.

There are several reasons for this outcome. One is the curious fact, repeatedly confirmed by pollsters, that Canadians prefer to be taxed secretly rather than openly. And on this point voters should be glad politicians have not yet listened to them. But the other is the failure of politicians seeking votes to be honest with the electorate.

Canada has seen many cases of a party cam-

paigning on one side of an issue then governing on the other, from Trudeau's wage and price controls to Mulroney's opposition to free trade to Chrétien's pledge to kill the GST. But these seem to be getting more frequent and, worse, the electorate is coming to take them for granted.

It is understandable that politicians succumb to the temptation to manipulate the public. But it is highly regrettable, as the price is ever-deeper cynicism among voters that makes honest conversation about tough choices ever harder. And from this point of view, that cynicism is primarily the fault of those who seek office.

As so often, the question of who made the mess is now secondary to the question of who is going to clean it up. In this regard it falls to all of us first to defend the HST on its merits and second to defend the decision to introduce it. But third, we must hold our politicians to a higher standard and ourselves as well, and reward those who speak frankly to us about hard choices before they have secured our votes.

Many able economists including Anne Golden of the Conference Board and Finn Poschmann at the C.D. Howe Institute have explained the main reasons why harmonizing the PST and the GST is a wise and prudent policy move. But for the most part they have not explained why it is such toxic politics.

Since the combination of good policy and bad politics is problematic in a democracy that subject merits our sustained attention.

Economic preliminaries

A few points on the economic side are worth making. First, the impact on consumers of the harmonization has been vastly overstated for five reasons:

a) sales taxes are often portrayed as regressive (i.e. falling harder on the poor than on the better off), despite the fact that one can never look at a single tax in isolation – one must look at the total burden imposed by all taxes, and by this measure Canada’s system is still quite progressive – and despite the fact that sales taxes help with tax equity, both because the well off spend far more in absolute terms and also because there are no exemptions – a criticism often made of income tax – and, finally, despite the fact that the credits for low income people essentially eliminate the issue of regressiveness for the poorest and most vulnerable in a way not provided for under PST regimes;

b) the new tax will apply to some purchases not now subject to the PST (even though the evidence is that the change in total tax burden on the average consumer is essentially a wash);

c) opponents of the new tax neglect the way in which the PST cascades through business purchases, adding far more to the price than simply an 8% tax on the final purchase – a cascading effect that will be eliminated by harmonization;

d) scepticism at the proposition that businesses will pass along their savings to consumers, despite strong evidence that competition chips away at such prices over time; and finally,

e) the belief that companies and businesses are the ultimate payer of taxes imposed on them.

This last point deserves a bit more attention. Businesses pay absolutely no taxes, except in the most trivial sense that the tax may be first imposed on their activities or their profits. But in every case, taxes on businesses are passed on to people, either consumers (when the taxes are added, like all other costs, into the final price of their goods and services), or investors (when the taxes reduce profits, and therefore dividends, including for pensioners and future retirees who have literally trillions of dollars invested in companies in the hope of earning a return that will allow

them to retire comfortably), or employees (when the taxes cut into the revenue available for wage increases that their productivity might otherwise have justified).



The notion that we can “tax” businesses and thereby stick it to the capitalist plutocrats in the Albany Club, while using the proceeds to

help “the little guy”, is pure fiction. But because it requires some thought to see why taxes are not paid by corporations, it does make good politics to get people exercised over the idea of a tax reform that is “regressive” and involves shifting taxes from those bad companies onto individual consumers.

The second economic point to be made is that while there are certainly many administrative efficiencies to the harmonization of federal and provincial sales taxes, these pale in significance to the way in which the reform will cease to penalize companies relative



to their competitors in more enlightened jurisdictions when it comes to making new investments in capital equipment. And such investment is, of course, a key component of raising productivity and hence the future incomes of workers. Sales tax harmonization is a pro-worker policy, since it is hard to see how a policy that harms employers can ultimately be in the interests of those who work for those employers.

Political essentials

So let me say loud and long how much we should be celebrating the decisions of both Ontario and B.C. to bring in this long-needed reform. These are courageous decisions that require great foresight and intestinal fortitude in the face of some very demagogic and negative opposition. But having celebrated this, we surely must ask a troubling question: Why is it so hard to make the case for such an important tax reform?

Here, alas, I am afraid that governments deserve much less credit, for two main reasons.

First, in neither B.C. nor Ontario did the government introducing this important tax change campaign in its favour in the last election. In fact, in B.C. the government explicitly promised it would *not* introduce such a tax. I have been unable to discover whether Mr. McGuinty made such a pledge, but I think it is quite fair to say that he gave no hint that this would be in his government's plans for its next mandate.

Such behaviour gives politics a bad name. Now I am not naïve, and this is hardly the first time that governments have said one thing on the campaign trail only to do something else once in office. Think only of price and wage controls, government auto insurance, free trade (both the Tories who denied they would promote it and the Grits who promised to scrap it), the National Energy Program and a host of other pol-

icies introduced by governments who swore it was no part of their intentions. But that's the point.

Political parties now regard such duplicitousness as just the price of doing business. And then governments turn around and deplore the cynicism of the electorate, the low participation rates in elections and the low esteem in which politicians are held. I must say that I find this all a bit hard to take, even though I admit that the ease with which public opinion can be manipulated must be extremely tempting to politicians.



Political duplicitousness is now just the price of doing business.

Just look at what polling tells us about public attitudes toward something like the GST. The GST was intentionally made a highly visible tax (i.e. not rolled into prices, but added to the final price at the till) as a means to hold politicians accountable and to make taxation transparent. An invisible tax is one that people are less aware of and therefore they are less likely to put pressure on politicians to keep it at a tolerable level. And yet pollsters consistently report that people would find the GST more palatable if it were made invisible. The wonder is that politicians have not surrendered yet to this clear desire on the part of voters to be kept in the dark.

Thus the second point is that if politicians are going to make misdirection and sharp practice the coin of their transactions with voters, they have no one to blame but themselves if the voters then disbelieve them when they lay out all the rational reasons why voters should “trust them on this one” – this one being the tax harmonisation we are here to discuss. By the way, this is in no sense a partisan comment despite the fact that it is Liberal governments in both cases that have now staked their reputations on harmonization.



In Ontario, for example, the Tories are storing up future trouble for themselves by making cheap political hay, pillorying the government with demagogic claims about the tax's effects while knowing full well that, far from eliminating the tax (as they imply but never state they will do) they will in fact happily tuck it into their arsenal of tax instruments when their turn in power comes again.

In doing so they will only be following the path already trod by Jean Chrétien, who helped to demonize the GST in the early 1990s, and then delighted in the revenue that it generated while he was struggling to bring down the deficit. And in B.C., the introduction of the HST has triggered what appears to be the first successful petition forcing a legislative or referendum vote on a bill since the law allowing such petitions was passed back in 1995.

How B.C.'s political parties will manage to seem to support such direct democracy while quietly preserving their option of keeping the harmonized sales tax remains to be seen, and may well not be pretty when it is. No party is covering itself with glory in this debate, which goes straight to what I would argue is our political class's increasing propensity to say one thing and do another. They deserve the credibility they've got.

So yes, by all means, let us celebrate the good policy that tax harmonization represents, and celebrate too the political courage that brought the governments of B.C. and Ontario to bring forward this important and difficult change. But let us not forget to draw the right lessons about the flaws in our politics, and remind ourselves to hold our politicians to a higher standard while not falling for demagogic manipulations. We'll all be the better for it.





THE MACDONALD-LAURIER INSTITUTE



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Allan Gotlieb, former Deputy Minister of External Affairs and Ambassador to Washington

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It is not often that Canadians talk about moving out of America's shadow—for far too long we have simply assumed that being in that shadow was the natural order of things. Crowley, Clemens and Veldhuis remind us that Sir Wilfrid Laurier thought that all things were possible for us, and they show, with an impressive array of facts to support their argument, that Laurier's plan for Canada can still carry us through to that Canadian century we have all been eagerly awaiting for over a hundred years.
-Allan Gotlieb, from the foreword



"As the U.S. and other nations struggle to defuse some potentially disastrous fiscal time bombs, The Canadian Century makes a compelling argument that the world should be looking to Canada for lessons on how to get reform right." - Robert Kelly, Chairman and CEO, BNY Mellon

"The Canadian Century reminds us that the temptation for governments to solve all our problems with higher spending always ends in grief—a lesson the U.S. will soon learn. It's a reminder that prosperity can be ours if we remember Wilfrid Laurier's legacy of liberty, lower taxes and smaller government." - Patrick Luciani, author, Economic Myths

"Crowley, Clemens and Veldhuis show that if we establish a real advantage vis-à-vis the U.S. on tax and other policies, that will increase both our attraction with emerging pow-

ers and our leverage with the US. The question the authors pose is whether we have the wherewithal to finish the job." - Derek Burney, former Canadian Ambassador in Washington

"The authors strike exactly the right balance with enough detail to keep the most ardent policy wonk captivated while writing in a breezy style that will engage non-economists. And as with a good novel, the authors leave us in suspense. I urge people to read this compelling tale and then, like me, anxiously wait for a sequel to see how the story ends." - Don Drummond, Senior Vice-President and Chief Economist, TD Bank Financial Group

"Entrepreneurship, hard work and self-reliance are deeply ingrained in our psyche. During the Redemptive Decade of the 1990s these virtues were resurrected. In tandem with

concerted actions by the different levels of government, we put right the debt and despair created by a couple of dark decades when we wobbled towards what the Wall Street Journal described as Third-World Status. Limited government, light taxes and fiscal discipline, argue the authors, are the ingredients that bring gold in the Olympiad of nations." - Colin Robertson, first Head of the Advocacy Secretariat at Canada's Washington Embassy

"This timely and provocative book will remind Canadians that the smart fiscal and trade policies pursued by governments of all stripes in the past two decades has made Canada a star at the beginning of this century. But history should not repeat itself. What we have achieved recently is what Wilfrid Laurier understood to be the right path forward for the last century. Instead, wars and economic

depression led to inefficient government spending, high taxes and deficits, and protectionism. Canada should avoid this poisonous policy recipe in the coming years to fulfil Laurier's dream of a truly great nation of the North, which we should rightly be." - Jack Mintz, Palmer Chair in Public Policy, University of Calgary

"This wonderful book is an urgent wake-up call for Canada's current leaders—of all political stripes—and raises crucial economic issues that should be top-of-mind in coming federal elections. Now is the time to reaffirm the power of Laurier's vision, to make some courageous policy decisions, and to thereby ensure that the 21st Century belongs to Canada in the way Sir Wilfred intended a hundred years ago. Will Canada's political leaders pay attention?" - Christopher Ragan, Clifford Clark Visiting Economist, Finance Canada