

Regional Rent-Seeking in Canadian Sales Tax Reform*

Xavier de Vanssay
Department of Economics
Glendon College, York University
Toronto, Ontario M4N 3M6

Zane A. Spindler
Department of Economics
Simon Fraser University
Burnaby, British Columbia V5A 1S6

Although Canadian tax reform can be viewed as an ongoing process (Spindler and Walker 1988), the most recent round officially started with a document issued by Finance Minister Michael Wilson in 1987 outlining his proposals for changing the Canadian tax structure. Part of the official justification for reform was that Canada soon would be at a competitive disadvantage if it did not realign its tax system with those of its major trading partners—the United States (which recently underwent a major tax reform) and Europe. The major problems perceived with Canada's tax structure at the time were that (1) Canada's income tax rates and deductions were not comparable to those in the new U.S. system, and (2) Canada's system of commodity taxation, which relied on a manufacturer's sales tax (MST) at the federal level and retail sales taxes (RST) at the provincial level, was not comparable with commodity tax systems in either the United States or Europe.

The Canadian income tax system was reformed in 1988, but reform of the commodity tax system was not undertaken at the same time because of technical, strategic, and political considerations (see Spindler and Walker 1988). Thus, in April 1989 the minister of finance issued a prospectus on a goods and services tax (GST), followed by a

*Comments by S. T. Easton, J. M. Munro, C. G. Reed, G. Tullock, B.-A. Wickstrom, and two anonymous referees are gratefully acknowledged. An earlier version of this paper was presented at the European Public Choice Society meetings, Meersburg, West Germany, April 18-21, 1990.

technical paper in August, and then by draft legislation in October 1989. A House of Commons commission held hearings across Canada, issued a report, and the Conservative government announced further revisions to their legislation—which consisted mainly of dropping the proposed rate from 9 to 7 per cent—on December 19, 1989. The House of Commons passed the act by 144-114 on April 10, 1990, with a target implementation date of January 1, 1991.

As of this writing, the GST is still before the Senate which is holding its own hearings and was, until recently, dominated by the opposition. The number of government supporters is now adequate to ensure passage of the bill, however.

But the GST cannot yet quite be considered a *fait accompli*. Naturally, the opposition parties have vowed to “fight tooth and nail” against it, numerous special-interest groups have lined up to testify against the tax, labour has threatened a general strike, and polls have revealed a near unanimity of public opinion for scrapping the GST in particular and commodity taxation in general. But the most important potential adversaries (or allies) of the federal government in the Canadian tax reform process are the Canadian provinces. Public statements by the federal government suggest that it would still like to incorporate the provinces into the reform process by integrating provincial and federal sales taxes into a national sales tax (NST). Failing that, it would prefer to obtain provincial support and cooperation in implementing the GST. Thus, even if the GST is implemented in essentially its current form without substantial provincial participation, such participation might still be an agenda item for further reform and adjustment of Canada’s tax system.

The provinces have their own diverse interests in supporting or opposing the imposition of a GST to replace the existing MST, or in cooperating with the substitution of an NST for the MST. While Alberta is distinct in its opposition to all commodity taxation of any form (unlike the other provinces, it has no provincial sales tax), other provinces are concerned about the federal infringement on one of their major revenue bases.¹ Furthermore, all provinces not only reflect the interests of provincial pressure groups but also have their own interest in the regional redistribution of real income that would result if the

¹For example, as Ontario’s provincial treasurer said, “There’s no advantage for Ontario to piggy-back. You know that we have a mature sales tax system at 8 percent returning us \$9 billion. It’s not politically very popular, but it pays a lot of bills. Now, if [Finance Minister Michael Wilson] is going to insist, as the Government of Canada is apparently going to do, moving into all of the provinces with this new tax—he has every right to do so—our taxpayers and our retailers and our customers are going to find themselves paying two sales taxes, two different rates on two different bases” (CBC, “The Journal”, November 9, 1989, as transcribed and quoted by Miljan 1990).

GST replaced the MST. Regional redistribution would be inevitable if provinces differed substantially in production and consumption patterns for Canadian manufactured goods versus goods and services in general.

Here we investigate whether such differences might give rise to varying provincial positions on tax reform, experienced as different bargaining stances in a rent-seeking tax reform game or as different patterns of popular support as recorded in polls. The first section discusses the tax reform game and sketches a theoretical rationale for provincial positions. It is followed by a discussion of the empirical basis for provincial positions and poll results and concluding remarks.

Provincial Stakes in the Federal Tax Reform Game

Tax reform can be viewed as a public choice game between various special-interest groups that are rent-seeking by lobbying over the details of tax legislation and administration (see Hartle 1988; Hettich and Winer 1988; Spindler 1990a, 1990b; Spindler and Walker 1988; Tullock 1988). Although the ultimate players are the special-interest groups, these players act through public institutions at various levels (federal, provincial, municipal) and divisions (legislature, administration, bureaucracy) of government or at various levels (national, regional, local) or forms (television, radio, newspapers) of the media, which may be considered as proximate players. This results in an ongoing revision of the *de facto* administration of specific tax legislation, which in turn implies an ongoing revision of the property rights regime throughout the economy.

This paper will focus on two major proximate players in the sales tax reform game in Canada: (1) the federal government, and (2) the provincial governments as a group in a bilateral game or as individuals in a “multi-bilateral” game. We will briefly set out their respective positions, both official and surmised, and show that the provinces may not have an incentive to act as a single player.

Federal Government

The Canadian government apparently initiated this sales tax reform game and ultimately will be responsible for a politically satisfactory resolution.² Its official objectives are as follows:

²Given the economic and budgetary connections between this tax reform game and other reform games of the current government—such as the recent Canada-U.S. free trade agreement, the FIRA/Investment Canada transformation, and the privatization program—one might speculate that all these games were instigated by major Canadian and non-Canadian multinational corporations who are seeking policy

[A] key element of the government's strategy to strengthen Canada's economy and to safeguard essential programs is the replacement of the federal sales tax. This initiative will improve Canada's ability to compete in the world economy while providing the federal government with a more stable and a more reliable tax system. Equally important, sales tax reform will improve the overall fairness of the Canadian tax system. As a result of reform, the distribution of the tax burden will be more progressive and lower income Canadians will be better off. (Wilson 1989)

This rationale stresses economic efficiency, revenue stability, and taxpayer equity and may well be part of the agenda underlying this game.³ But an understanding of the Canadian provincial/federal political nexus and an alternative reading of the documentation provided by the minister of finance suggests a possible "hidden agenda", which is not necessarily incompatible with or mutually exclusive of the stated objectives. First, the federal government may be using this reform to increase its power over the provinces. For example, by increasing the size of its sales tax base, the federal government will encroach on the sales tax bases of the provinces. Furthermore, after this reform all special-interest groups will have to lobby both the federal government and the provinces to obtain exemptions of certain goods or services from sales taxation. Finally, current or future federal sales tax reform may be an additional card for the federal government to play in the context of a larger bargaining game with the provinces. The ongoing decentralization and recentralization struggle between the federal and provincial governments constitutes the most important Canadian political game. Such elements as regional development or equalization programmes, constitutional amendments, and Senate reform may all be linked in this game.

Second, there may be a hidden provincial redistribution agenda serving federal purposes or special interests in the politically and economically dominant provinces of Quebec and Ontario.⁴ In fact, this question has been addressed and denied by the federal government:

It is sometimes argued that the economic benefits of replacing the existing federal sales tax with a multi-stage tax like the Goods and Services Tax will not be well balanced regionally. In particular, some have claimed that Central Canada with its relatively heavy concentration of manufacturing industries will benefit to the detriment of Atlantic Canada and Western Canada. These concerns are misplaced. (Wilson 1989: 17).

harmonization and so-called level playing fields worldwide. Another possibility is that the major manufacturing provinces, Ontario and Quebec, are inducing these reform games either as special-interest players on their own behalf or as proximate players on behalf of the multinationals.

³See Spindler and Walker (1988) for a statistical analysis of the basis for this view.

⁴There also may be a hidden private-to-public redistribution agenda. Given the exemption of certain public sector user fees, there would be relative price effects between the private and public sectors favouring the expansion of the latter.

But, because the proposed GST is a value-added tax on both goods and services—as opposed to the MST which is an *ad valorem* tax on manufactured goods only—the regions that add relatively more (less) value on goods and relatively less (more) value on services will be net gainers (losers), contrary to the federal government's statement.

Provincial Governments

The provincial governments reportedly have been engaged in ongoing negotiations with the federal government over the possible integration of provincial and federal sales taxes into a national sales tax similar to the national income tax system in Canada. Although there have been occasional comments to the press,⁵ there are no official provincial position papers or statements available for public perusal.⁶ Before the House of Commons approval of the GST, Finance Minister Wilson had ruled out joint collection because of the lack of agreement between the provinces and the federal government. But after the Meech Lake Accord failed to be ratified, Quebec and the federal government moved to negotiate provincial administration of the GST for Quebec. Each provincial government, of course, along with its bureaucracy and opposition parties, will have a special interest in guarding and enhancing its own power—both absolutely and relative to that of the other provinces and the federal government. Thus, each will have a special interest in blocking any federal initiative to enhance federal power or to redistribute power or real income among provinces, unless such redistribution is in its favour. This might explain in part the lack of unanimous, publicly announced support of the GST by the provinces. Lack of unanimous opposition by the provinces may be explained in part by the fact that the final agenda—especially that dealing with a national sales tax—has not yet been negotiated and in part by the fact that the net benefits of the GST for each province are not expected to be uniformly positive.

Since all provinces except Alberta levy their own provincial sales taxes at varying rates and on a non-value-added or a "cascading" basis, all potentially stand to lose tax revenues with the introduction

⁵British Columbia's premier, for example, said that the federal government should reduce its budget rather than introduce a GST. Alberta's provincial treasurer declared that he is opposed to the GST and to sales taxes. In fact, 90 per cent of national press coverage of the GST has had a national focus, with the rest of the coverage focused largely on the opposition of Ontario and, to a lesser extent, Alberta (Miljan 1990).

⁶According to an anonymous referee, "At the time of the First Ministers' Conference in November 1989, a paper was prepared presenting the provinces' opposition. The federal Finance Department wrote a rebuttal. As events unfolded, these papers were not publicly discussed because Meech Lake dominated the meeting". Unfortunately, these papers were not available to us for analysis.

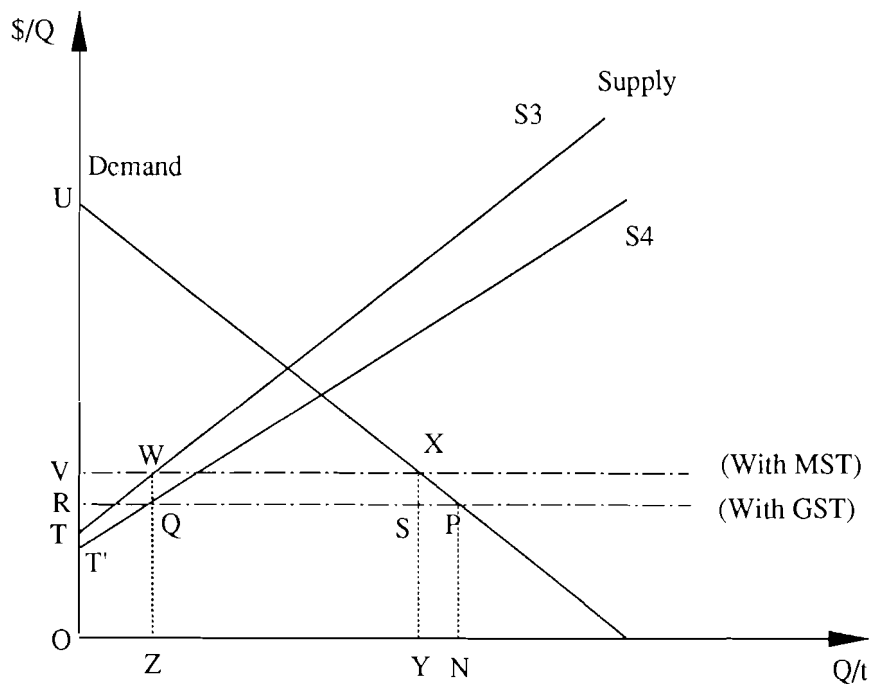


Figure 2

GOODS INDUSTRY IN A GOODS-POOR REGION BEFORE AND AFTER INTRODUCTION OF THE GST

though the region's consumption increases by YN . This gain is entirely captured by the producers located in the goods-rich region.¹⁰

In summary, producers in the services-poor or goods-rich provinces should welcome the GST reform since it will lead to an expanded output of goods and virtually no decrease in the output of services. For producers in the services-rich or goods-poor provinces, however, the GST reform will lead to a decrease in the output of services and virtually no increase in the output of goods. Of course, these conclusions are based on a partial equilibrium model and are dependent on assumptions made about the relative cost functions and the price-taker statuses of importing and exporting provinces. The general presumption of relative gain and loss seems reasonable, however. The services-poor and goods-rich regions will gain more in the goods industry (and lose less in the services sector) than will the goods-poor and services-rich regions.

¹⁰This conclusion rests on the conventional price-taker assumption with respect to imports as explained in note 8.

For consumers, general conclusions are more difficult to draw, but it is certain that services-oriented consumers will lose relative to goods-oriented consumers. Because consumers are not homogeneous in their tastes, the GST reform may be welcomed by some but not by others. To the extent that consumers have "voted with their feet" to sort themselves among provinces according to their preferences for the mix of provincial output, polls might reflect some differential levels of GST opposition in accordance with a province's services- or goods-rich status.¹¹ But, to the extent that in its present or future form the GST is not expected to be tax revenue neutral—but instead tax revenue increasing—most consumers will have an interest in opposing this reform.¹²

Evidence of Provincial Stakes

Evidence of the provincial stakes in this tax reform game is sketchy at best, but what does exist reveals a basis for differential provincial support or opposition. The most recent data on interprovincial relationships are presented by Whalley and Trella (1986), who offer the following caveat: "While these estimates do provide a measure of the trade imbalance in goods and services for each province, they also include a significant error component" (102). With this in mind, we extracted and adapted their data for presentation here (Tables 1 and 2).

Table 1 shows that Quebec, Ontario, and Alberta are net service exporters, but these provinces do not overwhelmingly dominate the service market. The situation for manufactured goods is more revealing (Table 2): Quebec and Ontario are net exporters and the other provinces are net importers. If 1981 is considered a representative year, these data suggest that the replacement of the MST by the GST would encounter less resistance and opposition from Ontario and Quebec businesses and provincial governments.

Alternatively, consider that GST reform will lower the prices of manufactured goods relative to services. This in turn will raise the growth rate of manufacturing relative to service output. Thus, provinces with higher ratios of manufactured goods to services may benefit more from this reform and therefore may offer less resistance to

¹¹But it is more likely that individuals have sorted themselves provincially by income-earning opportunities than by consumption preferences. Thus, polls need not reflect provincial goods/services differences.

¹²Indeed, most press commentary on the GST stresses other countries' experiences with ever-rising sales tax rates and the expectations of experts and the general public that the initial GST tax rate is just the thin edge of a potentially very large wedge.

Table 1
VALUE OF 1981 INTERREGIONAL AND INTERNATIONAL IMPORTS AND EXPORTS OF PERSONAL AND BUSINESS SERVICES, EXCLUDING TRANSPORTATION, BY REGION (MILLIONS OF 1981 \$)

Region	IMPC (1)	IMPW (2)	EXPC (3)	EXPW (4)	(3+4) - (1+2)	(3) - (1)
Atlantic	1,911.4	133.3	1,654.2	290.2	-100.3	-257.2
Quebec	5,754.9	974.7	6,628.8	828.2	+727.4	+873.9
Ontario	6,775.2	2,666.5	10,137.5	2,112.1	+2,807.9	+3,362.3
Manitoba/Sask.	2,740.0	177.6	2,369.7	335.1	-212.8	-370.3
Alberta	4,256.1	342.3	4,588.8	492.6	+483.0	+332.7
British Columbia	2,975.1	435.3	2,389.9	861.4	-159.1	-585.2

Source: Adapted from J. Whalley and I. Trella. 1986. *Regional Aspects of Confederation*. Toronto: University of Toronto Press.

Note: IMPC = imports from rest of Canada; IMPW = imports from rest of world; EXPC = exports to rest of Canada; EXPW = exports to rest of world.

it. By this criterion as well, Ontario and Quebec would be expected to offer less resistance to the proposed GST reform than the other provinces.

Finally, GST reform will reduce the cost of Canadian exports, making them more competitive abroad. Thus, exporters will benefit, and provinces that have a greater concentration of exporters will be less resistant to GST reform. Again, the data on exports to the rest of the world, given in column (4) of Tables 1 and 2, suggest that Ontario and Quebec would be less opposed to GST reform. The other side of the coin, however, is that imported manufactured goods will lose the relative advantage, provided by the MST, over Canadian manufactured goods and, consequently, importers are likely to oppose GST reform. They may be countered, of course, by the support for GST

Table 2
VALUE OF 1981 INTERREGIONAL AND INTERNATIONAL IMPORTS AND EXPORTS BY REGION FOR LIGHT MANUFACTURING, LUMBER, PAPER, PRINTING, METAL, MACHINERY, AND VEHICLES (MILLIONS OF 1981 \$)

Region	IMPC (1)	IMPW (2)	EXPC (3)	EXPW (4)	(3+4) - (1+2)	(3) - (1)
Atlantic	4,734.6	2,317.3	996.3	1,678.4	-4,377.2	-3,738.3
Quebec	8,649.8	14,692.4	11,451.7	11,089.2	-801.3	+2,801.9
Ontario	8,132.7	36,984.8	20,730.3	27,181.1	+2,793.9	+12,597.6
Manitoba/Sask.	4,837.6	3,205.8	1,541.0	2,041.3	-4,461.1	-3,296.6
Alberta	8,123.0	4,890.9	2,169.7	1,904.9	-8,939.3	-5,953.3
British Columbia	4,382.9	6,299.3	2,471.8	8,609.9	+399.5	-1,911.1

Source: Adapted from J. Whalley and I. Trella. 1986. *Regional Aspects of Confederation*. Toronto: University of Toronto Press.

Note: IMPC = imports from rest of Canada; IMPW = imports from rest of world; EXPC = exports to rest of Canada; EXPW = exports to rest of world.

reform by Canadian manufacturers who will gain from import substitution, but the balance of political influence at the provincial level as affected by these competing groups may result in a provincial government being more opposed to GST reform. This may be particularly important for Ontario, which, as shown in column (2) of Table 2, not only has the largest level of imports of all provinces, but also has, by a substantial absolute amount, the largest margin of imports over exports. Goods imported from the rest of the world relative to goods exported outside Canada are also substantial for the Prairie provinces, suggesting that, if it is reflected in the balance of political influence, a more anti-GST stance will be found in those provinces.

Voter Perceptions of Tax Reform

Quantitative data on provincial government opposition to the GST are not available. However, a survey of the business community was conducted in December 1989, and the results were published in March 1990 in the monthly magazine *Small Business*. The sample of 1,584 consisted of the readers who chose to respond to the magazine's questionnaire; with this kind of survey, of course, selection bias is unavoidable, and it should be kept in mind. According to the results given in Table 3, the two provinces least opposed (less than 50 per cent) to the proposed GST are Quebec and Ontario. This is consistent with our expectations; however, the opposition rate, in absolute terms, is still very high for every province (average for Canada: 51 per cent).

To gauge consumers' attitudes by province, Gallup Canada Inc. conducted an opinion poll on September 6-9, 1989, and asked 1,051 adults, 18 years and older: "Are you in favour of replacing the manufacturers' sales tax with a new national sales tax, or not?" The results are summarized in Table 4, which reveals that the level of opposition is very high (nationally, 72 per cent) and relatively uniform across provinces (the interprovincial variation is less than 3 per cent). This may be considered consistent with voters' perceptions that they will

Table 3
VERDICT ON THE GST (PER CENT)

Region	In favour	In favour with changes	Against
Atlantic	3	44	53
Quebec	4	46	50
Ontario	4	48	47
Prairies	5	41	54
British Columbia	2	40	58

Source: *Small Business*, March 1990, 28.

Table 4
 POLL RESULTS FOR GST REPLACING MST (PER CENT)

Region	Favour	Oppose	Don't know
Atlantic	12	73	15
Quebec	10	71	19
Ontario	12	74	14
Prairies	12	71	17
British Columbia	15	72	16

Source: Gallup Canada, Inc., press release, September 28, 1989.

lose on balance—either as consumers or producers of services or as a result of the expected increase in their net burden from explicit, legislated taxes.

Although various other polls with diverse formats have been conducted on the same subject since August 1989, press releases often give only the national results which are not broken down by province, and the different poll questions often yield incomparable results. For example, two polls were taken by Angus Reid over the period December 13-21, 1989. The first, released by the Canadian Federation of Independent Business, reported simply that 68 per cent of Canadians opposed the GST and that 27 per cent approved of the tax. The second Angus Reid poll, released by the National Citizens' Coalition, asked a very different question: "How strongly would you approve or disapprove of a 7 per cent GST if taxes were increased in other areas instead?"¹³ This poll reported an overall 61 per cent disapproval rate (that is, the rate "disapproving" or "strongly disapproving"), which differed significantly among some provinces.¹⁴ One major characteristic of the Angus Reid results was the confirmation of a trend of unfavourable opinion against the GST, especially in Western Canada and Quebec.

A pairwise comparison of the latter Angus Reid disapproval rates for each province with that of Ontario (as the major Canadian manufactured goods-exporting province) supports our regional redistribution hypothesis—except in the case of Atlantic Canada. But a pairwise comparison of disapproval rates by province in relation to Quebec does not support our hypothesis—except in the case of Ontario and Alberta. Since in answering these polls consumers may consider the balance between their *own* relative preferences and relative produc-

¹³Essentially, this question compares the replacement of the MST by the GST with another (unspecified) tax increase, instead of comparing the MST with the GST as in the Gallup poll cited above.

¹⁴Disapproval rates were: 71 per cent, Alberta; 65 per cent, Quebec; 64 per cent, Manitoba and Saskatchewan; 59 per cent, British Columbia; 56 per cent, Ontario; and 52 per cent, Atlantic Canada (Sequin 1990: A9).

tivity, we would not necessarily expect such polls to reflect regional productivity alone.

The most recent poll, conducted by Toronto's *Globe and Mail*, found Canadians favouring Senate rejection of the GST legislation by a two-to-one margin (60 per cent versus 29 per cent). While the full results were not reported by province, it was reported that "Quebeckers were much more favorably inclined to the GST, with 39 per cent supporting passage of the tax, compared with 26 per cent in the rest of the country. By contrast, the lowest support for the legislation was recorded in the Prairies" (Waddell 1990: A5). These results, as reported, could be interpreted as being consistent with our hypothesis.

Conclusion

Is there a basis for a regional influence in Canadian sales tax reform? Despite the weaknesses in the data, they do suggest that GST reform will have regional redistribution implications, which are reflected in part in differential rates of provincial interest group and voter opposition. The tax reform game depends not only on the actual interests of competing special-interest groups, but also on their abilities to organize to apply political pressure (Becker 1983).

Given Olson's (1965) analysis of special-interest group formation, one would expect special-interest groups representing consumers (such as Canadians AGAST, Council of Canadians, and Pro-Canada Network), or the many small, service-oriented firms (such as the Canadian Federation of Independent Business, which has been quite visible publicly but *apparently* ineffective politically) to be less effective in applying political pressure than those groups representing the larger manufacturing firms (such as the Canadian Manufacturers' Association, which has been maintaining a relatively low public profile on the GST)—whether through the provincial governments to the federal government or directly at the federal level.

In the Canadian context, our analysis suggests that such provinces as Quebec and, to a lesser extent, Ontario, acting in their own self-interest or as proximate interest groups, tend to be less opposed to GST reform than other provinces. Not only do the provincial statuses of Ontario and Quebec give them an important advantage over other non-provincial interest groups in producing political pressure on the federal government, but their share of representatives in both houses of Parliament gives them a natural advantage over other provinces as well. Taking into account current Canadian political reality, it seems inconceivable that the GST could have passed the House of Commons

if it had been seen as harmful to Quebec's (or even Ontario's) interest on balance.¹⁵

Given the contending GST special-interest groups and their abilities to produce political pressure, a transitory political equilibrium already has resulted in passage of the GST by the House of Commons and may well yield a win for the GST in the Senate. But, as emphasized earlier, tax reform is a cyclical game. Further sales tax reform or "refinement" can be expected to result from the rent-seeking competition of special-interest groups and further bargaining tactics by the federal and provincial governments.

References

- Becker, G. S. 1983. "Theory of Competition among Pressure Groups for Political Influence", *Quarterly Journal of Economics*, 98 (1983):371-400.
- Hartle, D. G. 1988. *The Expenditure Budget Process of the Government of Canada: A Public Choice-Rent-Seeking Perspective*, Tax Paper No. 81. Toronto: Canadian Tax Foundation, 1988.
- Hettich, W., and S. L. Winer. 1988. "Economic and Political Foundations of Tax Structure", *American Economic Review*, 78 (1988):701-712.
- Hull, B. 1990. "It's Time Provinces Came Clean about Their Opposition to the GST", *Globe and Mail*, Jan. 27, 1990, A6.
- Miljan, L. 1990. "Goods and Services Tax: Tax Innovation Leaves Consumers Concerned and Confused", *On Balance*, 3:1-8.
- Olson, M. 1965. *The Logic of Collective Action*. Cambridge, Mass.: Harvard University Press.
- Seguin, R. 1990. "61 Per cent Opposed Tax, Poll Finds", *Globe and Mail*, Jan. 16, 1990, A9.
- Spindler, Z. A. 1990a. "A Rent-Seeking Perspective on Privatization", *Review of Economics and Finance*, 1(1).
- . 1990b. "Is Tax Reform Really Worthwhile?" (mimeo).
- Spindler, Z. A., and M. Walker. 1988. "Canadian Tax Reform as Public Choice", *Contemporary Policy Issues*, VI(4):70-84.
- Tullock, G. 1988. "Rent Seeking and Tax Reform", *Contemporary Policy Issues*, VI(4):37-47.
- Waddell, C. 1990. "Majority Wants Senate to Kill GST", *Globe and Mail*, July 8, 1990, A5.
- Whalley, J., and I. Trella. 1986. *Regional Aspects of Confederation*. Toronto: University of Toronto Press.
- Wilson, M. H. 1989. *Goods and Services Tax*. Ottawa: Department of Finance.

¹⁵Indeed, in a speech to his Quebec constituency on July 30, 1990, Prime Minister Brian Mulroney claimed that the MST cost Quebecers \$4.5 billion yearly and that sales tax reform would add \$1.5 billion to real production in Quebec.