

Properly Implemented, Carbon Tax Has Merit

Christopher Ragan
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The GST was introduced by the Mulroney Conservatives in January 1991 and quickly became the nation's most hated tax, a notoriety it retains today. For economists and tax-policy wonks, however, the GST is probably the best part of the Canadian tax system: for the revenue it raises, compliance is straightforward and it creates few economic distortions. Even the Chrétien Liberals in 1993, having promised to kill the GST once winning office, went back on their word after realizing just how good a tax it really is.

Some day in the distant future, if the Liberals ever make it back to power, we may all look back and say similar things about their proposed carbon tax. A broad-based carbon tax, if it is designed sensibly, could become such an integral part of the Canadian tax system that no future government would dare remove it.

The GST holds some important lessons for how a carbon tax should be designed. Today's Liberals would do well to think carefully about these lessons so that their proposed carbon tax is both politically successful and genuinely good for the country. Three lessons come to mind.

First, to win political acceptance the carbon tax must be truly "revenue neutral". Canadians need to be assured that their overall purchasing power will be left unaltered even though they face a higher price of carbon-based energy. Back in 1991, the GST was billed as being revenue neutral, but after a few years it was clearly generating more revenue than the tax it replaced. This is one of the reasons why the tax is still so vilified by many Canadians.

It is surely unsurprising that Canadians today, egged on by Conservative sneering, are suspicious of the Liberals' promise to reduce income taxes dollar-for-dollar with the carbon-tax revenue. The Liberals need to emphasize the personal income-tax cuts central to their proposed "green shift". In addition, the Liberals must avoid sneaking in some "green" expenditures or tax credits under the guise of tax cuts. In short, the Liberals need to show in a clear and credible way that every dollar Canadians spend on the carbon tax will come back to their collective pockets in the form of tax cuts. Making good on this promise will also pave the road for future increases in the carbon-tax rate, increases which must be an essential part of any sensible, long-term environmental policy.

The second lesson is to make the carbon tax as comprehensive as possible. In the case of the GST, the tax applies to (almost) all new goods and services, and as a result neither consumers nor producers are led by the tax to favour some goods over others. The same logic applies to any future carbon tax. Since the fundamental problem is the emission of greenhouse gases, the tax should apply in an equivalent way to all such emissions, exempting only those situations where the tax is impractical to implement. Yet the Liberals have already announced that gasoline will be exempt from their carbon tax. This exemption makes no sense at all. Canadians need to understand that the battle against climate change will require important changes in their behaviour, and thus *all* significant sources of greenhouse-gas emissions should be taxed at the same rate. Exempting gasoline from the carbon tax is like exempting all income earned on Wednesdays from an income tax. The Liberals should know better.

The third lesson is to integrate the carbon tax with the various provincial environmental policies. Back in 1991, five provinces chose to harmonize their provincial sales taxes with the GST, even though they maintained separate provincial rates. In the five remaining provinces, the sales taxes were left un-harmonized, and apply to firms' capital inputs. These provincial taxes therefore act as an important disincentive to investment, with negative implications for national productivity and real wages. The Conservative government is now trying to convince the five remaining provinces to harmonize their provincial taxes with the GST, but they are making little progress.

The lesson for today's Liberals is that harmonization is much more difficult after separate policies have been in place for several years. With this in mind, the Liberals should take the time to design their carbon tax so that it can be easily integrated with the new carbon taxes in Quebec and British Columbia and the cap-and-trade system being talked about in Ontario. Their goal should be to make the federal carbon tax the obvious template to be used by all provinces for their own policies.

The Liberal carbon tax is an idea well worth debating, but the Liberals are in danger of losing the battle in the political arena. With a broader vision and a little more attention to detail, the Liberals could propose a comprehensive, genuinely revenue-neutral, and fully integrated carbon tax, one which would result in all Canadians facing the same incentives to participate in a national project of reducing Canada's greenhouse-gas emissions. Do the Liberals have the necessary vision?

Christopher Ragan is an Associate Professor of Economics at McGill University.
Christopher.ragan@mcgill.ca.