GST Plan: A Productive Idea

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The National Post (FP Comment), October 24, 2007

Last week the *National Post* reported that a plan is in the works to harmonize provincial sales taxes with the Federal GST in the five provinces that still have not done so. An important part of the motivation is to eliminate the existing sales tax applying to business purchases of machinery and equipment, a tax that discourages investment and hampers Canadian productivity. Though productivity is hardly a concept to generate excitement, people from all walks of life should applaud the Harper government's proposal. Indeed, a recent panel of senior policy thinkers ranked this policy near the top of an extensive list of proposals designed to improve economic and social well-being in Canada.

Productivity is a measure of how much output we produce for each hour of work we do. And despite the fact that most people begin to snooze whenever the P-word is mentioned, its importance cannot be over-emphasized. If you want to understand why average Canadian real incomes are so much higher today than they were in the days of our grand-parents—an increase of roughly 300 percent since 1947—the answer is that our productivity is higher by roughly the same amount. Canadian workers are better educated, better trained and healthier than workers were back then, we have more and better equipment with which to work, and we also have much improved knowledge—about management, production, distribution, transportation, and marketing. Productivity is nothing to snooze about—not for policy makers and policy thinkers.

Given that productivity growth is such an important determinant of our rising living standards, it is unfortunate how little we actually know about its source. Despite some ongoing debates among economists, there is general agreement on one basic idea: if employers have a larger stock of up-to-date machinery and equipment, their employees will be more productive.

The Harper government's proposal to harmonize the provincial sales taxes with the GST will improve Canadian productivity for two reasons. First, by eliminating the tax that firms now pay on their purchases of machinery and equipment, firms will find such investment more profitable, thus increasing the stock of productive capital that employees have to work with. This greater "capital intensity" really matters. In 2001, the average Canadian worker had 15 percent less machinery and equipment to work with than his or her American counterpart, which explains in large part why personal incomes in Canada are 20 percent lower than in the United States. Greater investment in Canada will help to close this income gap.

A secondary effect of increased investment is an improvement in technology in the Canadian workplace. As firms decide to purchase more capital equipment, they will invariably purchase the latest and most up-to-date machinery, the machinery embodied with the best technologies. Economists have long recognized that such technology embodiment is perhaps the most compelling reason for firms to invest.

Policies that reduce business taxes are usually supported by those on the political right and opposed by those on the left. But any policy that leads to a widespread productivity increase ought to be applauded by all Canadians, for the simple reason that higher productivity makes us richer as a nation. Some of these gains will accrue to firms and their shareholders. But workers will also receive pay raises as a result. And government revenues will also increase without the need to raise tax rates, thus making all manner of public programs more affordable. Economists are famous for reminding us that there is no such thing as a free lunch—and there isn't—but policies that lead to higher productivity are probably as close as we will ever get.

The widespread benefits from greater productivity explain why the proposal to reduce the provincial sales taxes on machinery and equipment was recently supported by a panel of wise policy thinkers. The Institute for Research on Public Policy in Montreal just released *A Canadian Priorities Agenda*, the results of a two-year project to steer a policy course for Canada. The project involved several stages, and each one required the participants to select the best policies and weed out those that looked less appealing. In the final stage, six eminent policy thinkers sat in judgment and were required to create a "preferred package" of five policies from among the overall collection of twenty-four. With so many policies on the table, and the judges coming from such varied backgrounds, it is surprising that they agreed on anything. Yet they did agree on a range of fundamental issues, including the need for greater environmental protection and the importance of human capital development.

The IRPP's judges also showed a preference for policies that are easy to implement and have an easily predictable effect on the economy—the low-hanging policy fruit. Four of the six judges included in their packages the tax-harmonization policy that the Harper government is now proposing. As the judges and many other economists recognize, this proposal is an economic "no brainer" and is long overdue.

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Jeremy Leonard, Christopher Ragan, and France St-Hilaire are the co-editors of *A Canadian Priorities Agenda*, available for purchase from the Institute for Research on Public Policy. An overview of the CPA project and results can be found at *www.irpp.org*.