



Hide and Seek

Voters might make different choices if they saw the hidden taxes they were paying



By Peter Diekmeyer

Taxation debates typically focus on three questions: Should taxes be higher or lower? Skewed more to the wealthy or to the middle class? Target income or consumption? But a large part of the taxes levied on the Canadian economy are “hidden” from the consumer. This makes it

difficult for taxpayers to assess whether they are getting their money’s worth from the government, since they do not know its true cost.

While most Canadians pay income taxes and the GST, few realize that these comprise only about 54.1% of the public sector’s revenues. Much of the rest comes from taxes that the consumer never sees, such as capital, payroll and corporate income taxes. A good example of hidden taxes is the so-called “sin” taxes that are levied on alcohol, tobacco and gasoline. According to the Fraser Institute’s calculations, 82.66% of the cost of a typical bottle of liquor is due to various sales, duty, government markups and excise taxes. Taxes also form a high proportion of the cost of both gasoline and tobacco. These statistics will not surprise the typical accountant; however, since the taxes are built into the price of these products — and do not show up as separate items on the price sticker — the consumer remains largely unaware of them.

Politicians love hidden taxes since they can be raised at will, with the proceeds used to buy votes by setting up or maintaining highly visible spending programs. The upshot is that politicians get the credit for the spending, but are not punished for increasing the hidden taxes that consumers don’t see.

Hidden taxes present two problems: The first is that if consumers only see a portion of the cost of government, they are inclined to believe that the

cost of public sector services is lower than it is. This can lead to public policy choices being made on the basis of erroneous information. There are also indications — despite the fact that pro-business groups tend to fight hardest against them — that hidden taxes are regressive.

While it may seem obvious that as a matter of public policy taxes should be made as visible as possible, this is much easier in theory than it is in practice. One of the more blatant examples of the dangers of making hidden taxes visible, is the Mulroney administration’s replacement of the Manufacturer’s Sales Tax (a hidden tax) with the GST (a visible tax).

The decision — which Mulroney still jokingly blames on his then finance minister Michael Wilson — is often cited by political observers as one of the key reasons for the demise of the Progressive Conservative Party. Oddly, when the GST was introduced in the early 1990s, a value-added tax was widely regarded as a good idea. The tax that the GST was destined to replace — the MST — was manifestly

unfair and out of date. The

MST taxed only manufactured goods, and left services — which represented an increasingly dominant part of the economy — exempt. But the MST was a hidden tax. It was levied on companies before goods hit the store shelves, and then it was built into the selling price.

“If I remember correctly, our polling numbers showed that only about 10% of Canadians knew of its existence,” says Hugh

Segal, who was Mulroney’s chief of staff in the early 1990s. “As a result, shortly after [the GST replaced the MST] our party went from about 29% in the polls to close to 9%.”

In other words, the Conservatives were punished for bringing in a much fairer tax (the GST) which everyone saw, and were not given credit for eliminating an unfair tax (the MST) since people never knew it existed in the first place. The fact that the GST still exists today in more or less its original form — despite its unpopularity, and the Liberal’s promise to eliminate it when they took office in 1993 — is an indication of its effectiveness as a public policy tool.

Although people hate paying it, the federal government is addicted to the revenue it generates, and no serious political party has proposed its abolition. But the GST’s advantage over the tax it replaced is that





people see it on their receipts every time they buy a product. That means they know that they are paying it. The Conservatives would almost certainly have lost the 1993 election even without the GST; however, the defeat would not have been so resounding. In fact, you could argue that the tax was the final straw that led to the obliteration of that party as an effective political force in Canada.

Since then, other political parties have taken note of the pitfalls of making hidden taxes more visible. For example, Finance Minister Paul Martin had a wonderful opportunity to redress the balance between hidden and apparent taxes when he announced his tax cuts in October of last year. Instead, conscious of his need to get the maximum credit for the cuts, the vast majority were made in areas that were visible to the general public, such as personal income taxes.

The second problem with hidden taxes is that there is ample evidence to indicate that they are regressive — that is, they affect the poor and the middle classes more than they do the rich. To understand how, it is important to remember that most hidden taxes — corporate, payroll and capital taxes — are levied on businesses that then build these taxes into the price of the products they sell. And since the rich spend a smaller proportion of their income on goods and services than the poor, they are less affected.

In that sense, corporate taxes have the same effect as sales taxes. For example, food items were exempt from the GST, but food retailers pay a slew of hidden taxes, which they then build into the price of the food they sell to consumers. The result is that a huge portion of the cost of the food we eat is made up of taxes that are used to fund government services. And taxing food is just about the most regressive tax imaginable.

Regulatory regimes such as marketing boards, and utility and rail monopolies are even more damaging than hidden taxes. At least with hidden taxes, if you dig hard enough you can figure out what

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their cost is. Take Hydro-Quebec's electricity monopoly, for example, which restricts pulp and paper companies from setting up their own cheaper power sources. There is no way for the average taxpayer to find out how much of the cost of the paper products he or she buys is going to subsidize Hydro-Quebec employees.

As a matter of public policy, getting rid of hidden taxes and replacing regulatory restrictions with direct subsidies to specific industries would put things more above board, and make it easier for voters to decide where, and how much, money should be spent by governments. But as long as special interest groups want to keep the cost of their subsidies secret, and hidden taxes are used as a backhanded way of taxing the poor, don't expect action any time soon.

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