

Tax and Subsidy Policies

A review of tax and subsidy policies in Canada and the United States leads us to conclude that the high degree of integration of their markets already creates substantial harmonization pressures. The relative ease with which Canadian firms and individuals can migrate to the United States constrains Canadian tax and subsidy policies, regardless of trade arrangements. Existing pressures have not, however, led to complete policy harmonization, any more than did similar pressures in the EFTA or the EC; rather, they are no more than a constraint on overly large divergences between the two countries' policies in these areas.

The formation of an FTA should not cause more than marginal changes in these very strong existing pressures. An FTA would cause some shifts in harmonization pressures in either direction. On the one hand, the ability to serve the North American market out of either country could lead to some movement of firms to the United States in order to take advantage of the substantially higher after-tax executive remunerations that are available there. On the other hand, it is a well-known result that a lowering of tariffs tends to make the payments to similar factors more equal across countries. Since there are important forces pulling in either direction, it is probably impossible to make an overall assessment of the balance of those forces since they can be identified only qualitatively.

One important pressure for further harmonization would come from calculating and administering border tax adjustments that would be required for Canada's manufacturers' sales tax. (A border tax adjustment is a tax rebate on exports at the border, since the tax is directed at consumption, not production.) The manufacturers' sales tax is already beset with administrative problems and negotiation of an FTA could accelerate pressures for revision or replacement of this tax.