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FISCAL AND TAX COMPETITIVENESS

The Time is Still Right for BC's HST

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- Replacing British Columbia's retail sales tax with the HST improved the province's investment climate. Estimates of the impact anticipate more than 100,000 additional jobs over the coming decade.
- The change made the taxes that were previously embedded in business costs, and therefore invisible to consumers, explicit at the cash register. But the total price to consumers hardly budged because the lower business costs flowed through to consumers.
- Consumption taxes like the HST in BC impose smaller burdens on the economy per dollar of government revenue than alternatives such as old-style retail sales taxes or taxes on personal and business incomes.
- For these reasons, BC residents are well served by the new HST.

The British Columbia government's spring 2009 provincial budget introduced, effective summer 2010, a harmonized sales tax (HST); meaning that instead of paying a 7 percent retail sales tax – which was eliminated – and a 5 percent federal Goods and Services Tax (GST), BC residents pay a single, harmonized tax of 12 percent, with 7 percent as the provincial portion. The provincial government since has announced its intention to drop the provincial portion to 6 percent in 2012 and to 5 percent by 2014, which would bring down the HST rate to 10 percent.

This tax change, now the subject of a referendum, brought British Columbia into line with reforms elsewhere in Canada – New Brunswick, Nova Scotia and Newfoundland and Labrador made the shift in 1997, and Ontario did so in 2010, while Quebec modeled its sales tax on the GST when it was introduced in 1991. The shift to a value-added taxes mirrors patterns in most of the developed world, and helped move the province from being a high tax, investment-unfriendly jurisdiction, to one which is domestically and internationally competitive – a more attractive home for investment and jobs.

Impacts on Investment and Prices

Provincial retail sales taxes, of the sort now abandoned by British Columbia, impair growth because they tax business inputs: capital goods and other products and services used in production. When one taxed input is used in another taxed input, these taxes can cascade, making the total taxes on different goods and services arbitrarily and confusingly different. The HST addresses this problem with credits against taxes paid earlier in the production chain. Introducing the HST will, by 2018, have brought the province's tax rate bearing on each dollar of new business investment below the average of most other industrialized countries, and bring British Columbia's rate below those in most of the rest of Canada's, including Alberta's (Mintz 2010).

Key to the case for the HST is the potential for improved business investment. British Columbia has struggled to provide its workers with new plant and equipment at the same rate as workers in other provinces and developed countries: based on investment intentions before the HST's implementation, for every dollar of new capital investment enjoyed by the average Canadian worker in 2010, the average BC worker would enjoy 90 cents. For every dollar of new capital enjoyed by the average worker in the OECD, the BC worker would enjoy only 84 cents, and for every dollar of new capital enjoyed by the average US worker, the BC worker would enjoy only 70 cents (Busby and Robson 2010).

Economic analyses, such as Dungan, Mintz, Poschmann and Wilson (2008), show that the lower tax burden can be expected to boost business capital investment, raising labour productivity, and with it workers' wages. The growth outlook improves permanently – Smart (2007) showed that HST reform in the eastern provinces in 1997 supported an 11 percent increase in real per capita business investment – and the export outlook improves, too, because the HST removes taxes previously embedded in the cost of exported goods and services.

The impact in British Columbia may not be so large – the province's Independent Panel (2011) anticipated 4 percent increase in investment in machinery and equipment by 2020 – but the impact is nonetheless positive and significant; owing to the sales tax change, Mintz (2010) estimated that by 2020 the job impact of the reform would mean 113,000 more jobs than otherwise.

The HST's impact on prices tends to be misunderstood, and one charge routinely leveled at the HST is that the wider range of goods and services subject to the new tax raises overall consumer prices. What this line of argument misses, however, is that the range of newly taxable items is not large – less than a fifth of consumer spending in British Columbia (Kesselman 2011), and that removing the retail sales tax embedded in business inputs caused many other prices to fall.

In the eastern provinces after the 1997 change, the prices of some things, like household goods and services, and health and personal care, fell more than others, and overall consumer prices fell by an amount that roughly matched the tax impact (Smart 2007). And British Columbia already has experience with the HST – after the initial bump, price declines in 2010 brought down the net rise in consumer prices to 0.6 percent (Kesselman 2011), indicating that business savings have quickly passed through to consumers. The HST impact on prices, on a year-over-year monthly basis, will have washed through by the second half of 2011.

The distributional impact of reform can also be contentious, because sales taxes are generally considered to be tougher on low-income households, for whom ordinary household spending takes up most of the budget, and on whom it is therefore assumed that the HST has a negative financial hit. In practice, however, the HST in British Columbia has brought lower prices for things that account for a larger share of spending by low-income households than by other families. Combined with exemptions, such as for home heating, and rebates, the reform's financial impact on low-income families is positive, not negative (Kesselman 2011).

What Makes a Good Tax Base?

In economic terms, a consumption tax as a source of revenue, when designed as a value-added tax like the HST, is a better base than personal or corporate income taxes.

The reason is that in terms of net benefits to society, not all tax reductions, or increases, are equal. Taxpayers respond to tax rate changes by adjusting their work, saving and investment behaviour, with distortive consequences for economic activity and welfare. Taxation's impact on savings, investment and labour decisions, for example, means that the social cost of raising an additional dollar in corporate income tax revenue in British Columbia is more than $11 per dollar of tax revenue. The cost of raising an extra dollar of personal income tax is $1.80, and the cost for an extra dollar of sales tax on consumption is only about $1.10 (Dahlby and Ferede 2011). In other words, it would make little sense for the provincial government to raise, or forego lowering, personal and corporation income taxes, while lowering sales taxes.

Impact on Government Revenue

After concerns about price impacts, a common objection to British Columbia's reform is its perception as an immediate provincial revenue raiser, or what opponents have called a tax grab – the Independent Panel (British Columbia 2011) estimated that the it will produce about 13 percent more revenue than the PST it is replacing. This static estimate does not reveal the impact of the long-term gains from heightened business investment and, accordingly, jobs and growth. A higher level of economic activity will generate more tax revenue, to finance public services, at a lower tax rate than would otherwise be needed to finance the same public spending. As it stands, the government's proposed 2 point rate reduction, by 2014 will reduce the provincial portion of HST revenues by about 29 percent, transforming the so-called tax grab into a 16 percent reduction. As discussed above, however, if it was desirable to lower the tax burden on individuals, reductions in the personal income tax rate would be more beneficial to society – because personal income taxes are a costly way to raise tax revenue – than an HST rate reduction.

The Case for Reform

British Columbia's sales tax reform in 2010 brought the province into a modern tax era. The HST has improved the province's outlook for investment and growth, lightened the tax burden on low-income families, while delivering the revenue needed to finance public services. The provincial government should continue to pursue this route to enlightened tax reform.

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