

Consumer Impacts of BC's Harmonized Sales Tax:

Executive Summary

Even before its implementation, British Columbia's HST has been fraught with controversy and misconceptions—and these concerns continue to today. The public has been particularly troubled that the HST is a “tax grab,” with a large shift in tax burdens from businesses to consumers. Fuelled by vocal opponents and the highly visible nature of the tax, the public has perceived that the HST bites deeply into their pocketbooks.

This study takes a careful look at the impact of the HST on BC consumers and households. Based on the evidence, I conclude that the HST is not a “tax grab” and that its overall impact on the prices including taxes paid by consumers is very modest. Using Statistics Canada's monthly survey of BC prices through December of 2010, I have been able to compute the first estimate of the HST's actual impact in BC. My analysis of the consumer price index (CPI) finds that the HST resulted in a 0.6 of one percent increase in overall consumer prices in BC. This finding indicates that the average consumer is now paying just one additional dollar for every \$165 of spending. My estimate is relatively robust to variations in time period and methods of controlling for inflation, and it matches another study's estimated 0.6 of one percent CPI impact for Ontario's HST.

This small rise is at the low end of projections done by diverse organizations and economists in advance of harmonization. A key reason for the small measured impact on the CPI is that the HST replaced the province's former Retail Sales Tax (RST) and the federal Goods and Services Tax (GST), with no change in the total tax rate for most components of consumer expenditures. Only 17 percent of total consumer spending in BC became newly taxable. However, surveys find that more than half of all respondents mistakenly believe the tax rate has gone up with the HST for a range of consumer items that actually had no change in tax.

Another reason for the HST's small effect on overall consumer prices is that prices of a number of items have fallen slightly since the implementation of the HST. Public skepticism on this point is widespread. Admittedly it is difficult for consumers to identify small price cuts across a vast array of goods and services—whereas it is easy to see the HST, which is printed clearly on every sales receipt. But the different operation of the HST relative to the RST offers good reasons to expect the prices of some items to decrease post-HST. In this study I report on data that confirms that businesses have in fact passed through to consumers large amounts of their tax savings with the HST.

Poorly understood by the public is the differential operation of the HST relative to the RST that it replaced. I explain how the HST's removal of \$1.9 billion from the \$2.5 billion that businesses paid under the RST affects consumer burdens. Businesses passed along these so-called “embedded” taxes in the form of higher product prices for their customers. With the RST the effective tax rates—including the embedded taxes hidden in product prices plus the tax paid at the cash register—were higher than 7 and 0 percent, respectively for taxable and tax-exempt items. By eliminating the embedded taxes, harmonization has reduced the effective tax rates to a true 7 percent on taxable goods and a true 0 percent on

“zero-rated” goods (such as basic groceries). The HST also has a category of tax-exempt items (such as rental accommodation) with embedded taxes remaining, but it is just 30 percent of consumer spending versus 71 percent for the RST.

The reduction of effective tax rates on a large range of goods and services under the HST provides a major offset to the increased tax rates on goods and particularly the many services that became newly taxable for BC. A major critique by HST opponents, endorsed in surveys by the general public, is that the removal of embedded taxes from business will not pass through to consumers in the form of lower prices. My statistical analysis of the actual CPI data through December 2010 confirms that pass-through of the business savings has been large and rapid. Using as a control the inflation rate in the other western provinces, I find that in the month spanning the HST implementation (June to July) BC's CPI rose by 1.0 percent. In the next five months through December 2010, BC's CPI fell by nearly 0.5 percent, for a net total impact on BC's consumer prices (excluding energy) of just 0.6 percent. Tests for the impact on selected categories of consumer expenditures affected in different ways by the HST also showed generally sensible patterns, with restaurant meals rising 6.5 percent between June and December.

Since most of the previously embedded taxes were removed with the HST, the net burden on BC consumers was essentially the \$600 million of RST that had been imposed on goods and services produced in BC and sold outside the province. Importantly, the \$600 million in tax savings on BC-produced exports should not be viewed as a gift to either business or out-of-province purchasers. Lower costs for BC firms due to the HST allow our businesses to compete more successfully in global markets and in the rest of Canada, which means more investment and jobs in the province. For companies selling products with prices fixed in world markets, the savings from the HST translate into improved profitability, which also yields more investment and jobs in BC over time. Moreover, the lower costs for BC firms permit them to compete better with non-BC firms for in-province sales of goods and services, further raising the impetus for increased investment and employment in BC.

Another concern voiced by some HST critics is the regressive nature of the tax. While economists agree that sales-type taxes generally take a larger share of incomes for lower income households than for higher income households, a relevant consideration is whether the HST is more regressive or less regressive than the RST it replaced. My examination of the consumer data finds that lower income households spend larger shares of their budgets on categories of consumer goods and services that have experienced small price decreases, while higher income households spend more in areas with large price increases. This suggests that, contrary to widespread expectations, the HST is less regressive than the RST. In addition, the provision of HST credits to lower income households plus an income tax cut that disproportionately benefits moderate income households further makes BC's harmonization less regressive than the RST. The lowest income households are actually better off with the HST than they had been with the RST.

This study also suggests policy options to mitigate the relatively small, but still real, impact of the HST on most BC consumers. One option is to cut the HST rate by one percentage point, which I estimate would reduce the CPI by more than 0.5 percent,

offsetting most of the 0.6 percent increase in the overall CPI impact of the HST computed in this study. The \$800 million annual cost of this cut could be reduced by more than half by revoking the HST's compensatory measures and trimming the BC rebate for new housing. Another option would be to eliminate BC's transfer tax of 12 percent on private car sales. The government's hike in that tax from 7 percent was justified as part of the harmonization, but the entire tax runs contrary to principles of tax equity, neutrality with dealers, and not taxing again exchanges of previously taxed goods. If implemented together, these two options would fully insulate the average BC consumer, irrespective of income levels, from the impact of the HST. Another measure the government might consider is to expand the use of "tax-inclusive" pricing where posted prices have the HST included, starting in the food services sector. Consumers can encounter the HST multiple times a day—such as when buying their morning coffee, lunch, and an afternoon snack. Although tax-inclusive pricing does not reduce the burden of the HST, it would help lower the "irritant factor," and it still would leave the HST far more visible than the massive hidden tax burden that existed under the RST.

If the HST is abolished, British Columbians will face significant costs. While we could expect a 0.6 percent reduction in the cost of living, low-income households would lose their provincial HST credits. Also, the province would be faced with having to return the \$1.6 billion that the federal government provided to assist with the HST transition. It is not clear where this money would come from, but for illustrative purposes repaying the feds would be equivalent to raising the reinstated RST by 2 percentage points (from 7 percent to 9 percent) for a year. With the HST replaced by a return to the RST, the province would also need to reinstate its own sales tax collection agency, at a taxpayer cost of \$30 million per year for administration plus another \$50 million per year for compensating firms collecting RST. Businesses would undergo a disruptive and costly transition back to the old RST system, with much of those costs being passed through as higher prices to consumers. But by far the biggest economic cost of returning to the former RST would be the loss of future investment and jobs for British Columbians and an erosion of the province's competitiveness.

Jonathan R. Kesselman
Canada Research Chair in Public Finance
Professor, School of Public Policy
Simon Fraser University Vancouver