

HST will help B.C. become more competitive in many ways

BY JOCK FINLAYSON, SPECIAL TO THE SUN MAY 1, 2010



Writer says the HST's effect on the overall prices to consumers will be small because the cost of doing business will drop.

Photograph by: Ian Smith, Vancouver Sun, Special to the Sun

As debate over the Harmonized Sales Tax continues, little attention has been given to its implications in a broader macro-economic context. Some HST critics worry the tax will toss the economy back into recession. However, because the HST will replace an existing tax, the retail sales tax, there will be no increase in the tax burden: the provincial government expects to collect roughly the same amount of revenue as it does today. So households and businesses, in aggregate, should have the same total spending power as they do now. Consumer spending may fall slightly as more services become subject to sales tax, but outlays by businesses will rise and B.C.'s exports will increase.

What about the HST's impact on inflation? Because the tax applies to many services that currently do not incur the retail sales tax, consumers will pay higher tax-inclusive prices on a range of services such as haircuts, gym memberships, and restaurant meals. But the effect on the overall consumer price level will be small, for two reasons. First, the government has exempted a number of important household purchases from the HST, including groceries, gasoline, and home heating fuel. Second, the cost of doing business will decline once the HST is implemented. This is an important economic consequence of the HST, albeit one ignored by opponents of the tax.

For businesses, eliminating the retail sales tax and shifting to the HST will lower the cost of producing goods and services in B.C. by some \$2 billion per year. Clothing stores, car dealers, home builders, local manufacturers, health clubs, and restaurants, to cite a few examples, will see cost reductions (of varying size) as the sales tax they now pay on construction materials, fixtures, furniture, equipment, legal services, vehicles, computers, and a host of other "business inputs" is effectively eliminated under the HST. These cost reductions should show up as lower pre-tax prices charged to consumers.

Many people are skeptical that businesses actually pass on cost savings to consumers. But economic logic and the experiences of other jurisdictions confirm that this is what happens in a competitive marketplace.

More importantly, the HST will help to address three problematic features of the B.C. economy that have long depressed the growth of real wages and incomes: insufficient investment, sluggish productivity, and a weak export base.

Start with investment. Workers and entrepreneurs are more productive to the extent they have access to up-to-date tools, technologies, plant and equipment. This requires regular investment.

Unfortunately, on average, businesses in B.C. invest substantially less on a per employee basis than their competitors in peer jurisdictions. One reason for this is that B.C.'s existing sales tax sharply increases the effective tax burden on many of the "inputs" that companies typically invest in - equipment, technologies, construction materials, vehicles, the purchase of outside services, etc. By removing the burden of sales tax from business expenditures on such "inputs," the HST will create an economic environment more conducive to private sector investment.

What about productivity? Even if one assumes higher immigration levels, the growth of B.C.'s labour force will downshift to below one per cent per year within the next decade. As that trend unfolds, economic progress -i.e., growing the economic pie -will hinge on advances in productivity, rather than on adding more people to the workforce.

Nationally, it is recognized that Canada has fallen behind many other industrial countries on productivity; less well understood is how poorly B.C. has fared in this key area. B.C. trails Canada in output per hour worked, the basic measure of productivity; and it ranks last in the country in increasing productivity. Absent a better record on productivity, there will be little scope for future, broadly-based gains in real wages for workers. Economists of all political stripes agree that the HST will have a positive impact on productivity growth -mainly by making it more attractive and more economically feasible for companies to invest here.

Finally, the HST will significantly strengthen B.C.'s position as an export economy. Currently, the province's success as an export jurisdiction is undermined by the retail sales tax: it adds many hundreds of millions of dollars to the cost base of local exporters, few of whom can pass this cost on to their customers. With the HST, the sales tax burden on B.C. exporters will disappear. This change is urgently needed: in 2008, B.C. incurred a record \$14 billion deficit in its trade with the rest of the world

(proportionately, this was bigger than the US trade deficit). Without a stronger and more competitive export sector, the outlook for sustained economic growth in B.C. is grim.

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