C.D. Howe Institute
Institut C.D. Howe

OpEd

Economist at centre of HST drama speaks out

September 8, 2010, The Province – Finn Poschmann

As British Columbians engage in a fiery storm of words over who said what and when about sales tax reform and the harmonized sales tax, amid accusations about the import of a report I co-authored for the C.D. Howe Institute in 2008, there's something we should probably contemplate. The world is changing, and jurisdictions like Ontario and B.C. have had to face up to competitive pressure at home and abroad.

First, the backdrop. Suppose a province is facing a sluggish economic outlook: while real estate might be looking pricey, which is good for people who have houses and jobs, manufacturing employment is shrinking instead of rising and wages are stagnant; the forestry sector is tottering like an old cedar; provincial output per person is falling relative to neighbouring provinces; business investment in new plant and equipment is shrinking relative to neighbouring provinces and relative to G-7 competitors; and, to top it off, the province is sliding into "have not" status, qualifying for equalization payments from the federal government.

If you thought I was describing Ontario in the past decade, you would be correct. And if you thought I was describing B.C. in the past decade . . . you would be correct.

Becoming a have-not province, from the perspective of the federal equalization program, as B.C. did a few years back and Ontario now is, is a sobering event for a province's political leadership. The downward shift reflects a decline that stretches past the events of a year or two, and speaks to the longer-term need for change.

Of the economic indicators I mentioned, business investment is singularly important. Investment intentions -- spending on plant and equipment -- define businesses' views of the economic outlook. Businesses that see growth on the horizon invest in the facilities they need to meet future demand. And that process not only drives growth, it puts the tools in workers' hands that they need to improve their productivity, and in turn to build their incomes. Business investment means growth, jobs and better wages for workers.

Except, in Ontario, businesses have not been investing at the pace they might, as measured in dollars of plant and equipment per worker. Not long ago, Ontario businesses were spending barely three quarters of the dollars per worker that other developed economies were spending, and less than the Canadian average. Not only that, the ratio has been falling. B.C.'s relative position has been a little better than Ontario's, but the trend is still for the worse. And investment per worker that is falling relative to other provinces means the province's future competitive outlook, not only today's, will be poorer than it could be.

Economist at centre of HST drama speaks out

September 8, 2010, The Province – Finn Poschmann

That is why change is in the cards. In Ontario, the provincial government reversed course and started lowering, not raising, business tax rates. That is what economists tell governments they should do if they want to stop jobs and growth from being driven elsewhere, to investment-and job-friendly jurisdictions.

The Ontario government also took the plunge on sales-tax reform. Ontario's antiquated sales tax layered on business costs, often hiding in the costs of things that businesses need to buy to produce their goods and services, making exports more expensive than they should be and killing jobs along the way. Ontario was encouraged in its choice by the experience of the Atlantic provinces in the late 1990s, when sales-tax reform preceded a significant pop in investment per worker and a brighter business outlook.

Much has been made of a C.D. Howe Institute study that showed the potential for a minor hesitation in growth before the investment-and income-boosting effects of the tax reform kicked in. That study considered the situation in Ontario, which chose a different route to harmonization than B.C. has done, and evaluated conditions several years ago, when the indirect effect of the reform on prices might have prompted the Bank of Canada to raise interest rates more than otherwise. Neither of those circumstances applies to B.C. today. Even if they did, moreover, the adjustment to the tax is small and quickly over, while the benefits are large and permanent.

With Canadian and offshore competitors lowering taxes and implementing smarter ones in pursuit of jobs and growth, it's no surprise that B.C. should see the writing on the wall and change course as well. Even better, the combined HST rate that B.C. residents pay on most goods and services has gone to 12 per cent from 13. Federal financial support to smooth the transition has clearly made reform in B.C. easier to contemplate and more affordable.

The world is shifting away from antiquated provincial retail sales taxes, and toward smarter systems like the HST.

As C.D. Howe Institute research has consistently shown, lower, smarter taxes make good policy, and that is why B.C., like Ontario, is now on a smarter course.

Finn Poschmann is Vice-President, Research, at the C.D. Howe Institute in Toronto.