Will the HST deliver lower prices to consumers?

BY KEVIN MILLIGAN, VANCOUVER SUN   MAY 28, 2010

As the public continues to chew on the harmonized sales tax debate, one particular bone catches in many a person's throat. HST proponents claim that business savings from the HST will be passed through to consumers in the form of lower prices. The public seems very skeptical on this point. Economists can bring some insight to this heated debate.

First, though, let's take a quick primer on the HST. The provincial government collects about $5 billion a year from the provincial sales tax. A significant part of this revenue comes from tax on business inputs -- things like tires for delivery trucks and computers for their workers. These costs end up embedded in the prices we pay -- we just don't see them. With the coming of the HST, taxation of business inputs will end. Soon, businesses will get a credit for every HST dollar they spend. Ending the taxation of business inputs provides a fountain of tangible benefits. The HST will lead to more investment and jobs, less complexity for companies and less bureaucracy in Victoria.

Even HST opponents don't seem to deny these benefits. Their ire, instead, is focused on changes in what is taxed under the HST, and who is paying the tax. The HST will cover some goods and services that weren't covered by the PST, such as haircuts and carwashing. These newly covered items will bring in about $2 billion in revenue. Offsetting this revenue increase is the new input tax credit for businesses, which will cost about $2 billion. If the tax credits are passed through completely to consumers, then the HST will be a wash for consumers as a whole -- $2 billion up and $2 billion down.

On the other hand, if businesses just use the tax credits to pad their profits by $2 billion, consumers will face a steeper tax burden. Understanding pass-through is obviously pivotal to the HST debate.

What do economic textbooks tell us happens when business costs drop? The answer depends on the degree of competition in a particular market. When customers have many choices, any business that passes its tax savings on to its own prices will steal customers from its competitors. If other competitors try to keep prices high, they face the loss of customers and profit.

In this way, profit-loving companies are forced through competitive pressures to pass on the savings. Businesses do not pass savings through to be nice. They do it because they want to maintain their market share and hold tight to their profits. Of course, if a market is dominated by a single business, the absence of alternatives for consumers means that the competitive pressure to reduce prices is absent. How much pass-through we can expect depends on the competitiveness of markets and how price-conscious B.C. consumers will be.

Textbook lessons can fall apart on the way from the lecture hall to the street. In this case, however, there is substantial, real-world evidence on the question of pass-through. In France in 1999, the tax rate on home repair services fell from 20.6 per cent to 5.5 per cent. A recent study showed that more than three-quarters of this tax break was passed on to customers. The pass-through didn't happen by government regulation or edict. The drive for profit led companies to do it in order to maintain market
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