



Commentary

FRAMING THE DEBATE ON THE HST

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On July 1, Ontario will replace the combination of the 8% provincial sales tax (PST) and 5% Goods and Services Tax, a federal tax, with the Harmonized Sales Tax (the HST) at a rate of 13%. Most would observe that the sum of 8 and 5 is 13. Why does this matter? The vital question: is the rate of 8% the right rate?

The first observation is that we need taxes to pay for public services. If we want roads, courts, schools and hospitals and welfare expenses that are paid for by the government, there must be taxes. The question is not whether there will be taxes but what kinds of taxes will be used.

A very central idea is that the taxes we select should let people choose to buy the things that make them happiest. There are only a few exceptions to this rule. Society puts a big tax on tobacco and alcohol to discourage consumption. Someday there may be a big tax on carbon to discourage consumption. But in general, we want taxes that leave people making the choices they would make without the tax.

Think about the choice between buying a new gym outfit and paying a fee to visit the gym. Both might lead to a healthier person if the new outfit is part of the decision to visit the gym more often, at least in your mind. Under the PST and GST, the outfit is taxed at 13% and the gym visit is taxed at only 5%. There is no obvious reason why the tax system should favour the gym visit. Perhaps the old outfit is tattered and smelly. Under the HST taxes will not affect the choice between



the outfit and the visit. That is a good thing and that makes the HST a better tax than the old PST/GST combination. There are other reasons why the HST is better as well. Since business paid PST on inputs, it favoured simple production processes. The HST will be less complicated for retailers since there are fewer exemptions.

So what is the right issue to discuss about the HST? The right debate is whether the choice to leave the provincial portion of the HST at 8%, the old rate for the PST, was a good choice. Over time, is the total revenue from the new tax larger or smaller than the total revenue from the PST? The best guess is that for 2011, without the temporary payments, all of the changes associated with the HST will leave total provincial revenue about the same. The temporary payments are funded by an increase in the deficit. Since the faster growing sectors of the economy are the additional parts covered by the HST, it seems very possible that over time the HST will raise more revenue than the PST when levied at the same rate. Will all of that extra revenue be used to further lower income taxes? Will the total tax rate in the province rise or fall in the next 4 years? Some will say: taxes need to rise because of the provincial deficit. Since the deficit is provincial spending minus provincial revenues, the deficit could also be reduced by reducing spending or spending growth. If the level of spending were to be cut or even the level of spending growth were cut substantially, could the provincial portion of the HST be 7%. What is the right level of spending per student in education? What is the right level of pay and pensions for public sector workers? If these are too low, should the provincial portion of the HST be 9%? The adoption of the HST is a done deal and it is a good thing. What is the right rate for the HST is the important question, not its adoption?