

CHAPTER 1 – PRICE EFFECTS

The implementation of the GST is expected to exert a number of price effects. First, the GST is expected to cause the overall consumer price level to rise, although to what extent is unclear. Much of this chapter is devoted to an assessment of the factors which affect the passthrough (to the consumer) of the tax savings from the elimination of the FST, a critical ingredient in the determination of the GST's impact on prices. While it is clear that the GST will impose a 7% tax charge on many retail prices of goods and services, effective FST rates vary widely and the exact amount of tax included in the retail price is not entirely certain. It is therefore difficult to determine what the precise impact on prices will be.

The implementation of the GST will also cause relative prices to change. Industries such as manufacturing and telecommunications, which are now being charged a high rate of tax, should expect the shift in tax structure to lessen the tax cost, and thus, all other things being equal, to lower prices. On the other hand, industries, such as those in the services sector, which have previously not faced a federal sales tax burden other than the FST charged against their business inputs, should experience higher prices.

Finally, while the GST is expected to result in some tax-induced inflation, most of the evidence presented to the Committee minimized the probable magnitude of this effect. As mentioned above, it is of critical importance for the successful future performance of the domestic economy that a wage-price inflationary spiral be avoided.

A. Transfer of Tax Savings to the Consumer

As the FST is removed, and replaced by a value-added tax collected at the retail level, potential savings will accrue for buyers of products whose tax component is lowered. Such goods as automobiles, appliances, furniture and other durable goods should exhibit price decreases, but only if the FST is passed through. As was implied above, a crucial element in ensuring that the transition period is successfully managed is a major passthrough of the tax savings generated by the removal of the FST. The likelihood of an adequate passthrough, in turn, depends critically on the state of competition in various economic sectors.

Will competitive market forces ensure that a healthy portion of the tax savings is passed on to consumers? The response from witnesses to this question was generally positive. Most suggested that consumers would benefit extensively from the removal of the FST, since an adequate level of competition was to be found in most markets. It was claimed that it is difficult for firms to defy the market if they are facing competition. Companies that attempted to retain the tax savings and add this to their profit margins would run the risk of losing their market share; without this strong customer base, a firm would soon find its