

useful in explaining the wide consensus among tax specialists that the FST ought to be abolished.

A) Narrow Base

To begin with, the FST is very narrowly based. It applies to barely 1/3 of total consumer spending on goods and services. About 40% of revenues from the tax are accounted for by five commodity groups only: tobacco, alcohol, gasoline, automobiles and automobile parts. The tax, therefore, distorts consumer choices, by favouring some commodities over others, and discriminates against households with greater preference for the taxed commodities relative to households with stronger preferences for commodities that are not taxed.

The narrow tax base also implies that the tax rate must be high to achieve the government's revenue objectives. High rates do not only compound the inequities between taxed and tax-free commodities, they increase incentives for efforts to avoid or evade the tax. Administration of the tax system by the tax authorities thereby becomes more difficult and compliance by taxpayers more costly.

To a large extent, the narrow base of the FST reflects deliberate policy decisions to leave certain items out of the base as a means of improving the distributional impact of the tax. The exclusion of food, clothing and footwear can probably be explained on this basis. Exclusion of most services from the base, however, cannot be so explained. Services are disproportionately consumed by higher income households, and their exclusion from the tax base makes the tax more regressive. Since services, however, are sold directly to consumers, a tax imposed prior to the retail level obviously cannot cover most services. The exclusion of services, therefore, is an inherent feature of the FST.

B) Wide Variation in Effective Tax Rates

The application of the tax at an early stage in the production and distribution process creates a host of other problems as well. As already explained, for most goods the FST is generally levied at the manufacturer's or importer's level. Consequently, it does not generally apply to the wholesale and retail margins that go into the determination of the final selling price. The effective tax rate at the retail level, therefore, will vary depending on the size of these margins, or the mark-up from the manufacturing to the retail level. A product where the post-manufacturing level mark-up is low will be taxed more heavily than one where the mark-up is high. As a result, the tax on finished products can be highly variable, even among competing products. A 1984 survey conducted for the Department of Finance found that the range between the lowest and highest effective tax rates exceeded 500%, i.e. items taxed at the highest rate bore a tax rate more than four times the rate borne by the most lightly taxed items. Effective tax rates varied widely even among similar products. Among autoparts, for example, effective tax rates varied by more than three times; similarly for cosmetics and for office supplies. Thus the FST favours — in arbitrary and unpredictable ways — some manufacturers over others, and brings about a pattern of final selling prices which differs