

BRITISH COLUMBIA'S HARMONIZED SALES TAX: A GIANT LEAP IN THE PROVINCE'S COMPETITIVENESS

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SUMMARY

British Columbia's harmonization of its sales tax with the federal goods and services tax (GST) will result in a giant leap in the province's competitiveness, both domestically and internationally.

By 2020, the combined effect of federal and provincial corporate tax cuts and sales tax harmonization is expected to increase the province's capital stock by more than \$14.4 billion and add 141,000 new jobs. Sales tax harmonization alone will account for an increase of \$11.5 billion in capital investment and a net increase of 113,000 jobs by the end of the coming decade.

British Columbia's tax reform, especially its adoption of the harmonized sales tax, also will reduce the marginal effective tax rate (METR) on capital for all industrial sectors and all sizes of businesses. Even though selected exemptions were provided to relieve some capital goods from the existing retail sales tax, sales tax harmonization will remove most taxes on capital purchases after July 1, 2010. Sales tax harmonization will reduce the METR on capital for large and medium-sized companies from 29.5% in 2009 to 21.6% in 2010, while additional corporate tax reductions will further reduce the METR to 20.5% in 2010 and to 17.9% by 2018. For small businesses, the METR will decline sharply from 24.7% in 2009 to 11.5% in 2010, primarily due to sales tax harmonization. With the reduction of the small business tax rate to zero in 2012, the METR on small business investment will decline further to 9.9%.

By 2018, British Columbia's METR on capital will be internationally competitive — lower than the current rate in Australia, France, Germany, Italy, Japan, South Korea, the United Kingdom, and the United States, about the same as in New Zealand, and only slightly above that in the Netherlands and China. It will also be lower than in all other provinces — notably including Alberta — except Newfoundland and Labrador, Nova Scotia, and New Brunswick, which have already harmonized their sales taxes with the federal GST.

INTRODUCTION

On 23 July 2009, British Columbia announced its plan to adopt a value-added tax by harmonizing its 7% provincial sales tax (PST) with the federal goods and services tax (GST) effective 1 July 2010. With this move, British Columbia will benefit from a sharp increase in capital investment and jobs, similar to the experience of other provinces that have reformed their antiquated sales tax systems. The change is perfectly aligned with an agenda to improve productivity for a province that faces an aging labour force that will grow more slowly compared to the past. This paper documents the impact of sales tax harmonization on capital investment, jobs, and incomes in British Columbia and estimates the substantial benefits that the province will realize from this giant leap toward competitiveness for its trade-exposed sectors.

British Columbia's harmonized sales tax (HST) will be an effective continuation of past policy initiatives to encourage capital investment and job creation in the province. In two earlier steps to enhance the province's international competitiveness, the B.C. government has been reducing the general corporate income tax rate, which was 16.5% in 2001, to 10.5% on 1 January 2010 (to be followed by a further 0.5% reduction 1 January 2011), and eliminated the corporation capital tax.¹ These changes, in combination with federal reductions in corporate taxes, will make British Columbia one of the most tax-competitive regimes in the world. The province's effective tax rate on new investment will decline from 29.5% in 2009 to 17.9% in 2018, a rate far below the 21.3% average of 20 major industrialized and emerging economies. With the creation of a much more competitive environment for capital investment, businesses will be more willing to invest in British Columbia, and with greater capital investment will come more jobs, which will attract more people to the province.

By 2018, when federal and B.C. corporate tax reductions and sales tax harmonization will be fully implemented, British Columbia will have a tax regime that is more attractive to capital than that of either Alberta or Ontario. While corporate tax reductions will have been helpful in achieving this aim, the largest aid to British Columbia's tax competitiveness will have been sales tax harmonization. With the elimination of the existing retail sales tax on capital inputs, British Columbia's effective tax rate on new capital investments will decline by 9.1 percentage points, which will represent almost 60% of the drop in the cost of capital for businesses in British Columbia over the next four years.

By 2020, the combined effect of the corporate tax cuts and sales tax harmonization will be to increase the capital stock by more than \$14 billion, which is expected to translate into an increase of 141,000 jobs. Sales tax harmonization alone will be responsible for an \$11.5 billion increase in the capital stock and an increase of 113,000 jobs by the end of the coming decade.

¹ Various targeted tax preferences have also been introduced or broadened; the largest incentive is the small business tax rate, which has been reduced from 4.5% to 2.5% over the past two years. British Columbia also plans to eliminate its small business corporate tax in 2012. The maximum amount of taxable income qualifying for the small business rate was increased from \$400,000 to \$500,000 on 1 January 2010.

All industrial sectors in British Columbia will benefit from sales tax harmonization. Some of the largest beneficiaries will be the construction, communications, business, and household services sectors, which will see their effective tax rates on new investment drop by much more than one third. Because British Columbia's PST was a deterrent to investments in machinery that the province's small businesses use intensively, that sector will also benefit substantially from sales tax harmonization as small business will see their effective tax rate on new investment decline by almost three-fifths, from 24.7% to 9.9%. Along with the removal of sales taxes on intermediate goods, British Columbia's businesses will be much more competitive in export markets since costs of production will decline. In short, sales tax harmonization will confer significant benefits to the British Columbia economy. Even though some particular business activities might not benefit directly from sales tax reform, the significant increase in business activity that will result from the reform will help all sectors of the province's economy.

A REVIEW OF BRITISH COLUMBIA'S NEW TAX COMPETITIVENESS POLICIES

By harmonizing the 7% provincial sales tax with the 5% federal GST (except for some differences, as explained below), British Columbia will remove \$1.9 billion in provincial sales taxes from business intermediate and capital goods and services. As with the GST, the resulting 12% HST will not apply to certain products and services, such as qualifying food, medical supplies, and exports. Also, point-of-sale rebates of the HST, similar to PST exemptions, will be provided for books, motor fuels, children's clothing, and some other items. Rebates will also be provided for new housing and to municipalities, schools, universities, colleges, hospitals, charities, and non-profit organizations. British Columbians will receive additional tax relief through the HST low-income tax credit, an increase to \$11,000 in the basic personal amount tax credit under the personal income tax, and a rebate of HST paid on residential energy costs.

Similar to the Ontario HST scheme, the British Columbia HST will have restrictions on certain input tax credits for specific inputs during the transition period. For example, large business (those with sales in excess of \$10 million) and financial institutions temporarily will be unable to claim input tax credits for energy (except where purchased by farmers or used to produce goods for sale), telecommunications services (other than Internet access and certain toll-free numbers), road vehicles weighing less than 3,000 kilograms (and parts and certain services), and certain hospitality costs. The restrictions will apply for five years and then be phased out over the following three years, although the government has indicated that full input tax credits will be phased in more quickly if the fiscal situation permits. Most PST on capital goods will be relieved with the introduction of the HST on 1 July 2010 — the existing PST on machinery will decline from its current rate of 3.7% to 0.4% and be removed entirely by 2018 — while the current 3.3% PST on structures will be eliminated.

A significant one-time benefit to the province will be \$1.6 billion in federal transition payments, which help fund public services such as health care and education to the equivalent of about \$400 for each British Columbia resident.

Initially, the sales tax reform will mean some reduction in revenues for the provincial government since increases in sales taxes paid on services sold directly to consumers will be slightly more than offset by reductions in sales taxes on business inputs and the other HST rebates and tax reductions outlined above. Since taxes on business inputs are shifted forward onto consumers, the removal of the embedded PST will mean that some products, such as automobiles and computers, actually will be taxed less under the new HST. At the same time, some previously untaxed services, such as haircuts, will be taxed more. The key reform, however, is that sales taxes on capital goods will be shifted to other products and services, which will strengthen British Columbia's investment climate, thereby raising capital investment and creating jobs.

In addition to sales tax harmonization, which will reduce taxes on capital, the British Columbia government plans to introduce further tax reductions that will make the province more tax competitive. As part of a package related to the adoption of its carbon tax, British Columbia's corporate income tax rate was reduced to 10.5%, effective 1 January 2010, and the rate will be reduced further to 10%, effective 1 January 2011.² In addition, the federal corporate income tax rate, which was 19% in 2009, will decline to 15% by 2012 (although the federal government will be phasing out certain tax preferences as it reduces the tax rate during this time). These reductions in corporate income taxes will further enhance British Columbia's investment climate.

EFFECTIVE TAX RATES ON NEW INVESTMENT

One way to measure the impact of taxes on investment decisions is to look at the marginal effective tax rate (METR) on capital.³ In deciding how much capital investment to undertake, a business will choose to invest in projects in which the after-tax rate of return on capital is high enough to attract financing from international markets. When maximizing the value of their shareholders' equity, businesses will invest in capital until the marginal return on it is equal to its cost. The marginal investment decision, therefore, is a project that earns an after-tax rate of return on capital that is just equal to the cost of raising capital from financial markets. Suppose a project earns a rate of return on capital equal to 7.5%, net of inflation and risk. With a METR of 33%, the after-tax rate of return on capital will be 5% (33% of 7.5% equals 2.5%, which subtracted from 7.5% yields 5%). If that rate of return is just sufficient to attract international investor capital (prior to the payment of any personal taxes, depending on where the investor lives), then the marginal project will be financed. Thus, any reduction in the METR on capital will make more projects attractive for business investments. For example, with an METR of 25%, any project with a pre-tax rate of return on capital at least equal to 6.7% (net of inflation and risk) would be acceptable.

² Other measures to recycle all carbon tax back to taxpayers through tax cuts include a 5% reduction in the rates for the two lowest personal income tax brackets.

³ The METR on capital — also referred to as the effective tax rate on new investment — has been used for policy analysis since the concept was initially developed in R. Boadway, N. Bruce, and J. Mintz, "Taxation, Inflation and the Effective Marginal Tax Rate on Capital in Canada," *Canadian Journal of Economics* 17 (1, 1984): 62-79; and M. King and D. Fullerton, *The Taxation of Income from Capital* (Chicago: University of Chicago Press, 1984).

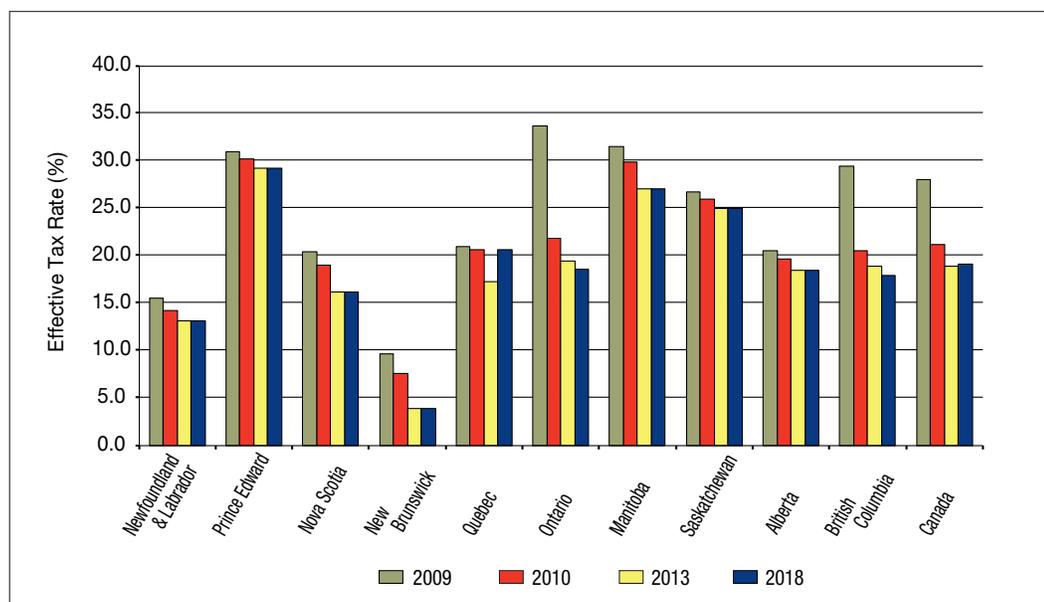
In the analysis below, the METR on capital is calculated as the annualized value of taxes paid at the corporate level as a proportion of the pre-tax rate of return on capital. Capital taxes and sales taxes on capital purchases are included; property taxes are not.⁴ METRs are estimated by asset and industry for non-financial sectors, excluding non-renewable resource companies (oil, gas, and mining). For international competitiveness, most of the focus is on medium-sized and large companies that raise capital from international markets, but the analysis also considers the impact of British Columbia's sales tax harmonization on small Canadian privately owned companies that are eligible for small business treatment (basically, companies with an asset size less than \$15 million).

THE HST AND CORPORATE TAX REDUCTIONS: THE EFFECT ON BRITISH COLUMBIA'S COMPETITIVENESS

The adoption of the HST, along with federal and provincial corporate tax rate reductions, will have a dramatic effect on British Columbia's competitiveness. As Figure 1 shows, the overall impact of both harmonization and corporate tax cuts will be to reduce British Columbia's METR on capital from 29.5% in 2009 to 20.5% in 2010 (largely due to the adoption of the HST), to 18.9% in 2013 (due to additional federal and provincial corporate tax cuts after 2010), and to 17.9% in 2018, assuming input tax credits are fully phased in by that year (if input tax credits are fully phased in sooner than 2018, the METR will reach 17.9% sooner). Thus, the total reduction in the METR — 11.6 percentage points between 2009 and 2018, a 40% cut — is quite significant.

⁴ Property taxes help pay for municipal services that reduce business costs. In principle, only property tax net of benefits should be included in estimates. Although net property taxes ideally should also be included, the variation across municipalities, industries, and special concessions make it impossible to do so even for individual provinces, let alone for other countries.

FIGURE 1: Marginal Effective Tax Rate on Capital for Large and Medium-Sized Businesses, by Province, 2009, 2010, 2013, and 2018



SOURCE: The School of Public Policy, University of Calgary.

Notes: The estimated marginal effective tax rates in 2010 assume the full adoption of all tax changes announced for 2010; the same assumption applies to future years when tax reductions are to take effect mid-year.

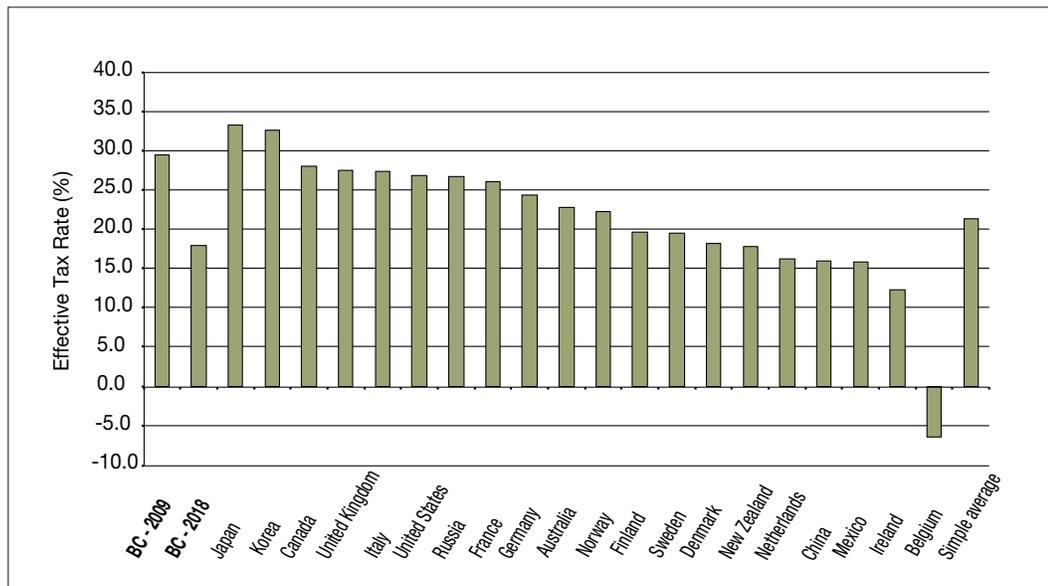
Indeed, by 2018, British Columbia’s METR on capital will be lower than that of all provinces except Newfoundland and Labrador, Nova Scotia, and New Brunswick, the three Atlantic provinces that have already harmonized their sales taxes with the federal tax and are eliminating their capital taxes applied to non-financial businesses; moreover, these three provinces also benefit from the 10% federal Atlantic investment tax credit, targeted at qualifying investments in resources and manufacturing industries.⁵ Notably, British Columbia’s METR on capital will be lower than Alberta’s by 2018, even though Alberta has no sales tax or capital tax and a similar corporate income tax rate to that of British Columbia. A major reason is that forestry and manufacturing industries receive preferential treatment with respect to capital cost deductions under the corporate income tax than do other industries. Forestry and manufacturing is a larger share of capital investment in British Columbia compared to Alberta.⁶

While one cannot presume that other provinces and countries will not alter their corporate tax rates over the next ten years (either raising or lowering them), at their current rates British Columbia will be more tax competitive not only in Canada but also internationally (see Figure 2). In 2009, British Columbia’s METR of 29.5% on capital was well above the average of 21.3% of 20 major industrialized and emerging countries, but by 2018 it will be below the existing average of those 20 countries and well below the current rate in Australia, France, Germany, Italy, Japan, South Korea, the United Kingdom, and the United States, about the same as in New Zealand, and slightly higher than in the Netherlands and China.

⁵ In addition, New Brunswick plans to reduce its corporate income tax rate to 8% in four years’ time.

⁶ For further details, see D. Chen and J. Mintz, “The Path to Prosperity: Internationally Competitive Rates and a Level-Playing Field.” C.D. Howe Institute Commentary 295 (Toronto: C.D. Howe Institute, 2009).

FIGURE 2: Marginal Effective Tax Rate on Capital, British Columbia, 2009 and 2018, and Selected Countries, 2009



SOURCE: The School of Public Policy, University of Calgary.

Notes: METRs in 2009 are based on existing tax systems, including temporary provisions such as the bonus depreciation for qualifying machinery investments in the United States, available until 2010, and accelerated depreciation for manufacturing equipment in Canada and British Columbia.

The Effect of Tax Reform on British Columbia's Industries

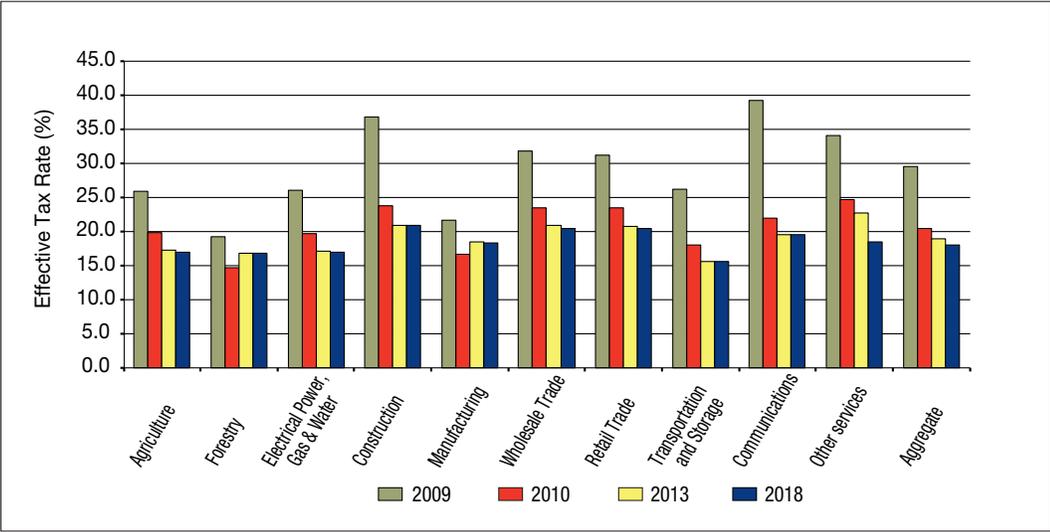
British Columbia's tax reform, especially the adoption of the HST, will reduce the METR on capital for almost all sectors in the province (see Figure 3). By 2018, the largest reductions will have come in sectors where the current business tax structure is heavily biased against investments — namely, construction (where the METR will fall from 36.8% to 20.9%), communications (from 39.2% to 19.5%), household and business services, or “other services” (from 34.1% to 18.5%), wholesale trade (from 31.7% to 20.4%), and retail trade (from 31.2% to 20.5%).⁷ When corporate taxes are not neutral among industries, they hurt the economy.⁸ One estimate of the cost of economic distortions arising from non-neutral corporate tax policies in Canada suggests that the tax system imposes an economic cost equal to 37 cents on each dollar of corporate tax collected.⁹ Non-neutral taxation also increases compliance and administrative costs. By 2018, however, British Columbia's business tax structure will be not only internationally competitive, but also more neutral and fair across industries. The tax system will interfere less with the allocation of resources among their most economically productive uses, allowing British Columbia to benefit from higher productivity.

⁷ The extent to which METRs are reduced will be affected by the impact of Ottawa's proposed elimination of temporary fast write-offs for capital in certain sectors as federal corporate income tax rates are reduced and by the eligibility of sectors for provincial sales tax exemptions.

⁸ See B. Dahlby, *The Marginal Cost of Public Funds* (Cambridge, MA: MIT Press, 2008).

⁹ M. Baylor and L. Beauséjour, “Taxation and Economic Efficiency: Results from a Canadian CGE Model,” Working Paper 2004-10 (Ottawa: Department of Finance, 2004).

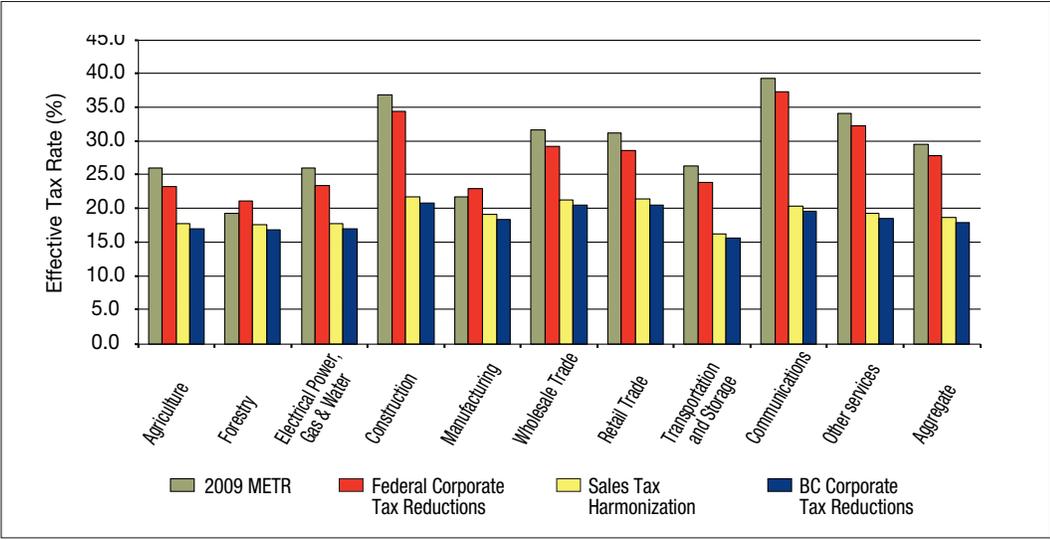
FIGURE 3: Marginal Effective Tax Rate on Capital, by Industry, British Columbia, 2009, 2010, 2013, and 2018



SOURCE: The School of Public Policy, University of Calgary.

As Figure 4 shows, most of the reduction in the METR on capital will come from sales tax harmonization. Federal tax reductions will reduce the METR from 29.5% to 27.8%, sales tax harmonization will reduce the METR from 27.8% to 18.7%, while British Columbia’s remaining corporate tax reductions will reduce the METR from 18.7% to 17.9%.

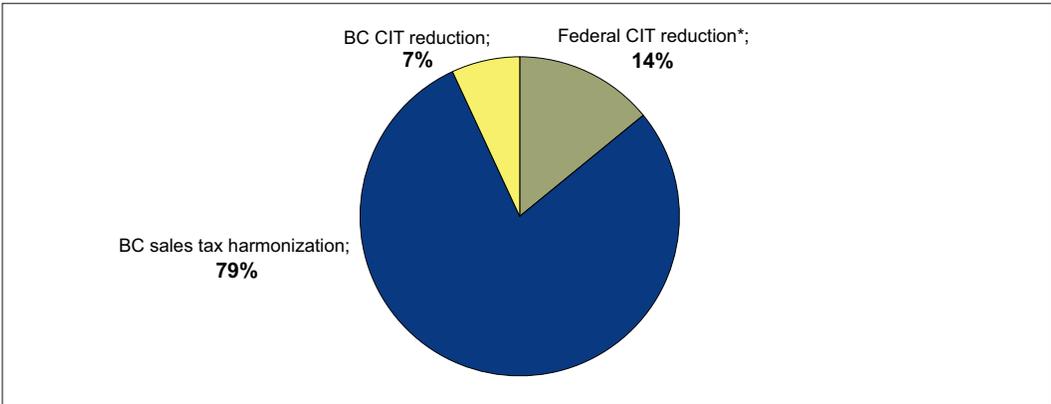
FIGURE 4: Contribution of Various Tax Changes to the Marginal Effective Tax Rate on Capital, by Industry, British Columbia



SOURCE: The School of Public Policy, University of Calgary.

Chart 1 shows that 80 percent of the reduction in the METR from 2009 to 2018 is due to sales tax harmonization. The rest is due to federal and provincial corporate income tax rate reductions.

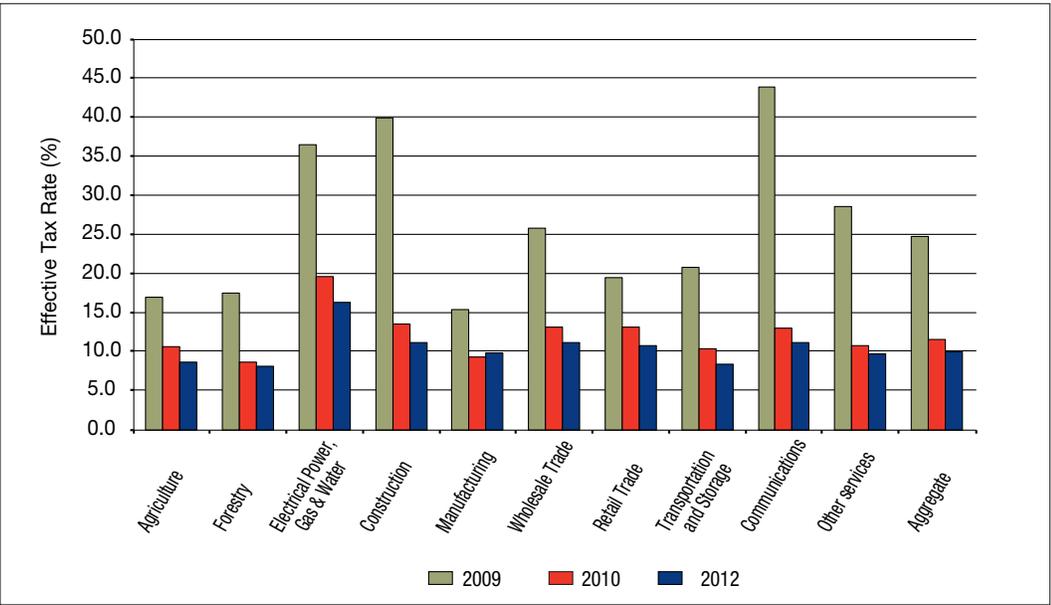
CHART 1: Decomposition of METR Reduction, by Source of Change, British Columbia, 2009-2018



The Benefits of Tax Reform for British Columbia’s Small Businesses

Medium and large businesses will not be the only beneficiaries of British Columbia’s tax reform; small businesses will also benefit, since they are even more intensive users of machinery and equipment in production than are large businesses. As Figure 5 shows, the METR on small business investment will decline sharply from 24.7% in 2009 to 11.5% in 2010, primarily due to sales tax harmonization, and with the elimination of the small business tax by 2012, the rate will drop to 9.9%. The sharpest reductions will come in the construction and communications sectors, followed by household and businesses services (“other services”). As with larger businesses, the competitiveness of the small business sector will benefit primarily from sales tax harmonization — indeed, the elimination of sales taxes on business inputs will more than halve small businesses’ tax burden on new investment.

FIGURE 5: Marginal Effective Tax Rate on Capital Investment, by Small Businesses, British Columbia, 2009, 2010, and 2012



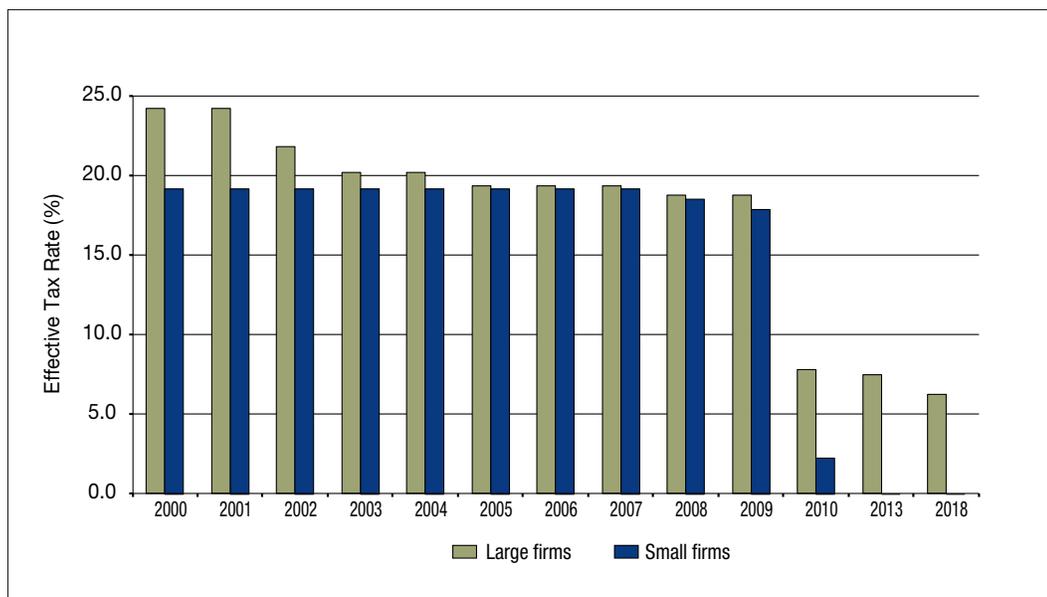
SOURCE: The School of Public Policy, University of Calgary.

SALES TAX HARMONIZATION: A GIANT LEAP FOR BRITISH COLUMBIA'S TAX COMPETITIVENESS

Over the past decade, British Columbia has taken a large number of steps to make its economy more tax competitive. These steps have included reductions in the general corporate income tax rate from 16.5% in 2001 to 10.5% today (with a planned further reduction to 10% by 2011). British Columbia has also eliminated its capital taxes and reduced property taxes, especially for major industries. But the most significant change is its sales tax harmonization, which will cause the marginal effective tax rate on capital to plummet in the coming year.

As Figure 6 shows, the provincial METR on capital for large and medium businesses will have declined from 24.2% in 2000 to 6.2% by 2018. The sharpest reduction in the provincial tax burden on new investments will occur in 2010 with the adoption of sales tax harmonization, from 18.8% to 7.8%. The second-largest drop in the effective tax burden occurred as a result of corporate tax reductions in 2002, but they had far less impact than will sales tax harmonization. For small businesses, the provincial tax burden has already declined sharply from 19.1% in 2000 to 2.2% in 2010, and by 2012 the tax burden on small business investment will be virtually eliminated.

FIGURE 6: Provincial Only Marginal Effective Tax Rate on Capital Investment, by Business Size, British Columbia, 2000-2018



SOURCE: The School of Public Policy, University of Calgary.

Notes: Excludes changes to federal corporate tax provisions.

The Effect on Investment, Jobs, and Incomes

Without a doubt, British Columbia's sales tax harmonization will be a game changer, promoting capital investment in the province and providing an opportunity for the private sector to create jobs and pay higher wages to workers.

The reduction in taxes on business capital inputs ultimately will benefit employees as businesses invest in capital and new technologies. Businesses, in any event, do not pay taxes, but pass the tax burden on to customers through higher prices (thus reducing the purchasing power of household income) and to investors and employees. In a small open economy such as British Columbia's, investors do not bear taxes on capital investment since owners of capital can choose to invest in jurisdictions with a higher net-of-corporate tax return on capital. Costs cannot be passed onto export markets since prices of most goods and services are determined by international markets. Therefore, any taxes on business costs must ultimately be borne by fixed factors in British Columbia through higher domestic prices or lower real wages paid to workers. To attract financing from investors, British Columbia's businesses must offer an after-tax rate of return on capital that is at least as favourable as can be obtained in other jurisdictions. Moreover, since owners of capital are not affected by taxes on capital investment, it is employees who largely bear the burden of such taxes. Further, taxes on investment impede the adoption of machinery and structures that improve incomes paid to workers, who are able to produce more products with the same hours of work. Recent economic studies suggest that taxes on investments by larger companies tend to fall on workers, who either are paid less compensation or face higher domestic prices on consumer goods they purchase.¹⁰

It has been suggested that British Columbia's adoption of the HST will raise product prices for consumers, but this is far from clear. Currently, the prices that consumers pay incorporate various hidden and embedded retail sales tax on business inputs that will be removed once the HST is implemented. Although it takes time for the elimination of taxes on capital goods to result in a decline in the prices charged to consumers,¹¹ past tax reductions by the provincial government (shown in Figure 6) are reducing the prices businesses charge today. And in the Atlantic provinces that eliminated retail sales taxes on business inputs when they harmonized their sales taxes with the federal GST, consumer prices fell.¹²

¹⁰ For the United Kingdom, see W. Arumlampalam, M.P. Devereux, and G. Maffini (2008), "The Direct Incidence of Corporate Income Tax On Wages," Working Paper 07/08, 2nd version (Oxford: Oxford University, Centre for Business Taxation, 2008); for the United States, see K.A. Hassett and A. Mathur (2006), "Taxes and Wages," working paper (Washington D.C.: American Enterprise Institute, 2006); and for Germany, see N. Aus dem Moore, T. Kasten, and C. Schmidt, "Do Wages Rise when Corporate Tax Rates Fall? Difference-in-Differences Analyses of the German Business Tax Reform 2000" (Berlin: Rheinisch-Westfälisches Institut für Wirtschaftsforschung, 2009).

¹¹ See Toronto-Dominion Bank Financial Group, "The Impact of Sales Tax Harmonization in Ontario and B.C. on Canadian Inflation," TD Economics Special Report (Toronto, 18 September 2009).

¹² M. Smart and R.M. Bird, "The Economic Incidence of Replacing a Retail Sales Tax with a Value-Added Tax: Evidence from Canadian Experience," *Canadian Public Policy* 35 (1, 2009): 85-97.

Of special note, corporate income tax rate reductions enable governments to collect tax on a much larger base, thereby reducing the potential revenue loss. Several recent studies have shown that businesses shift profits to jurisdictions with lower corporate income tax rates. With federal and provincial corporate tax rate reductions resulting in a combined corporate rate of 25% (down from 33% in 2009), multi-jurisdictional companies will be much more willing to shift profits into British Columbia, especially from foreign jurisdictions. One study finds that a one percentage point reduction in a province's corporate income tax rate leads to a 2.3% increase in the corporate tax base of multi-jurisdictional companies that allocate income across provinces and shift profits to the province from abroad, and to a 4.7% increase if they operate separate subsidiaries in Canada and abroad.¹³ Such profit shifting substantially reduces the overall revenue cost of corporate tax rate reductions.

A large number of studies have been undertaken to determine the sensitivity of capital investment to changes in the tax-inclusive cost of capital. One such study estimates that a 10% increase in the cost of capital reduces investment by 7%.¹⁴ The impact of taxes on foreign direct investment is even more striking, with a one percentage point decrease in the effective tax rate on capital estimated to lead to a 3.3% increase in foreign direct investment.¹⁵

Overall, the cost of capital for medium and large businesses in British Columbia will decline by 0.69 percentage points, from 4.94% in 2009 to 4.25% in 2018. Sales tax harmonization alone will increase the incentive to invest in the province significantly by reducing the cost of capital by 0.54 of a percentage point. This reduction in the cost of capital will have two effects: it will induce businesses to substitute capital for labour, and it will make businesses in the province more cost competitive, leading them to increase production as they become better able to compete in international and domestic markets. The latter effect is particularly important since businesses will hire more labour as they become more competitive. Under typical production decisions, increased demand for labour through production improvements will more than offset the reduction in labour demand as capital is substituted for labour. Taking into account both sales tax harmonization and planned corporate tax changes, 141,000 new jobs, equivalent to about 6% of the labour force, will be created by 2020,¹⁶ with sales tax harmonization alone responsible for 113,000 new jobs by the end of the decade.¹⁷ Reducing the cost of capital,

¹³ J. Mintz and M. Smart, "Income Shifting, Investment, and Tax Competition: Theory and Evidence from Provincial Taxation in Canada," *Journal of Public Economics*, 88 (6, 2004): 1149-78.

¹⁴ Canada, Department of Finance, "Corporate Income Taxes and Investment: Evidence from the 2001-04 Rate Reductions," *Tax Expenditures and Evaluation* (Ottawa: Department of Finance, 2007); Chen and Mintz ("The Path to Prosperity") find a similar result.

¹⁵ R. De Mooij and S. Ederveen, "Taxation and Foreign Direct Investment: A Synthesis of Empirical Research," *International Tax and Public Finance* 10 (6, 2003): 673-693.

¹⁶ These estimates assume that production takes place with constant shares of value added paid to employees and owners of capital (a "Cobb-Douglas" production). With this framework, a lower cost of capital causes capital demand to replace labour, which is more than offset by improved competitive demand (greater output) for British Columbia products. The substitutability of capital for labour reduces the demand effect for labour by a third.

¹⁷ This estimate assumes that any new employees hired by business can be absorbed from labour markets at the same wage costs as existing employees given the current state of unemployment and the willingness of employees to migrate from other provinces so long as British Columbia businesses offer competitive wages. If workers are not willing to provide more labour or, alternatively, are unwilling to migrate from elsewhere, fewer new jobs will be created but wages will rise sharply.

moreover, will increase incomes paid to workers. If one assumes that labour markets are slack due to unemployment,¹⁸ job creation will translate into \$4.4 billion more paid to workers, assuming an estimated salary of \$51,000 paid to each worker. This would be an increase in payments to workers equal to 3.9% of 2010 employment compensation levels. Sales tax harmonization and other federal and provincial corporate tax cuts are also expected to increase the nominal value of the capital stock held by the private sector in British Columbia (estimated at \$140 billion in 2010) by \$14.4 billion, or 9.8%, by 2020.¹⁹ Sales tax harmonization alone is estimated to lead to additional capital investment of \$11.5 billion by 2020, resulting in an 8.2% increase in the capital stock.²⁰

CONCLUSION

As a result of British Columbia's harmonization of its retail sales tax with the federal GST and other tax reforms, by 2020 the province's capital stock is expected to increase by \$14.4 billion and 141,000 net new jobs will be created. Sales tax harmonization will reduce the METR on capital for large and medium-sized companies from 29.5% in 2009 to 21.6% in 2010, while additional corporate tax reductions will further reduce the METR to 20.5% in 2010 and to 17.9% by 2018. For small businesses, sales tax harmonization will reduce the METR on capital investment from 24.7% in 2009 to 11.5% in 2010; once the small business tax rate is reduced to zero by 2012, the METR on small business investment will decline to 9.9%. By 2018, British Columbia's METR on capital will be lower than the current average of 20 major industrialized and emerging economies, and lower than all other provinces except the three Atlantic provinces that have already harmonized their sales taxes with the GST.

In summary, the tax reforms about to be implemented in British Columbia will have a profound effect on capital investment, jobs, and incomes in the province, representing a giant leap toward its becoming one of the most competitive economies in the world.

¹⁸ Alternatively, if one assumes that workers in British Columbia are fully employed, the demand for new workers would have to be filled by migrants from elsewhere. This would increase labour market tightness and bid up wages paid to workers.

¹⁹ The University of Toronto Focus model estimates that most of the response will take place in seven years, with 62% taking place within four years (information provided by T. Wilson).

²⁰ These results would be consistent with Michael Smart's estimates of the impact of harmonization in the Atlantic provinces, once one has taken into account the growth of the oil and gas sector that occurred around the same time; see M. Smart, "The Impact of Investment of Replacing a Retail Sales Tax by a Value-Added Tax: Evidence from the Canadian Experience," Working Paper 14 (Toronto: Institute for International Business, Rotman School of Management, University of Toronto, 2008).

About the Author

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Dr. Jack M. Mintz was appointed the Palmer Chair in Public Policy at the University of Calgary in January 2008.

Widely published in the field of public economics, he was touted in a 2004 UK magazine publication as one of the world's most influential tax experts. He serves as an Associate Editor of *International Tax and Public Finance* and the *Canadian Tax Journal*, and is a research fellow of CESifo, Munich, Germany, and the Centre for Business Taxation Institute, Oxford University. He is a regular contributor to *Canadian Business* and the *National Post*, and has frequently published articles in other print media.

Dr. Mintz serves on several boards including Brookfield Asset Management, Imperial Oil, Morneau Sobeco, Royal Ontario Museum and the Board of Management, International Institute of Public Finance. He was also appointed by the Federal Minister of Finance to the Economic Advisory Council to advise on economic planning and served as research director for the Federal-Provincial Minister's Working Group on Retirement Income Research.

Dr. Mintz held the position of Professor of Business Economics at the Rotman School of Business from 1989-2007 and Department of Economics at Queen's University, Kingston, 1978-1989. He was a Visiting Professor, New York University Law School, 2007; President and CEO of the C. D. Howe Institute from 1999-2006; Clifford Clark Visiting Economist at the Department of Finance, Ottawa; Chair of the federal government's Technical Committee on Business Taxation in 1996 and 1997; and Associate Dean (Academic) of the Faculty of Management, University of Toronto, 1993-1995. He was founding Editor-in-Chief of *International Tax and Public Finance*, published by Kluwer Academic Publishers from 1994-2001, and recently chaired the Alberta Financial and Investment Policy Advisory Commission reporting to the Alberta Minister of Finance.

In 2002, Dr. Mintz's book, *Most Favored Nation: A Framework for Smart Economic Policy*, was winner of the Purvis Prize for best book in economic policy and runner-up for Donner Prize for best book in public policy.

Dr. Mintz has consulted widely with the World Bank, the International Monetary Fund, the Organization for Economic Co-operation and Development, the governments of Canada, Alberta, New Brunswick, Ontario, and Saskatchewan, and various businesses and nonprofit organizations.

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