Business Page

GST may cause inflation at first

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It is a fact that sales tax increases add to consumer prices.

Why, then, does Finance Minister Michael Wilson say his new goods and services tax will not fuel inflation?

Inflation happens when people pass on price increases like hot potatoes. The cost of heating oil rises, so factories raise the price of wholesale goods to retailers. Retailers in turn raise the price to consumers.

Consumers, meanwhile, are being hit from more than one side. They are paying higher prices because the cost of making and selling goods is rising. They are also paying higher prices for home heating oil. So they respond by demanding higher wages, or by charging more for their services. It's a vicious circle.

This vicious circle is crucial to inflation getting out of hand. This is what happened in response to the two big oil price increases by the Organization of Petroleum Exporting Countries in the 1970s.

If one group somewhere along the price chain had absorbed the price shock rather than passing it on, inflation never would have soared to 12.8 per cent in 1980. The result was interest rates of 22.75 per cent and the worst recession since the 1930s.

OPTIMISTIC VIEW

Mr. Wilson seems to be betting that we have learned our lesson and we won't make the same mistake with the GST. John Crow, governor of the Bank of Canada, agrees with him.

Speaking to students at Carleton University in Ottawa last week, Mr. Crow explained that inflation is a sustained increase in the general price level over a period of time. It is not a one-time jump in prices, as will happen with the GST.

As long as workers don't ask for higher wages and manufacturers pass on the savings they will enjoy under the new tax system, all will be well, Mr. Wilson and Mr. Crow believe.

They may be optimistic. It all depends on the economic environment in which the new tax comes to be. If growth is booming in 1990, the GST will indeed fuel inflation. If growth is slow, as many forecasters expect, people will simply pull in their horns, spending less to escape the tax's reach.

A similar argument applies to higher interest rates. The high cost of money adds to inflation on the one hand while curbing it on the other. Again, it is a question of how long the higher prices are sustained.

OPPOSITE EFFECT

As prices rise in response to higher interest rates, people buy fewer goods and services. Weakening demand forces prices down again.

The ebb and flow of supply and demand paints a different picture for the GST, one in which prices may dip, or glide along unchanged, rather than soar. Services will cost more so people will use them less. They will eat in restaurants less, for example. Restaurateurs, seeing their business shrinking, may decide to absorb the GST rather than pass it on.

More likely, though, the GST will be mildly inflationary, but the inflationary effects will be offset by the high cost of money. Unfortunately, high interest rates add to the federal deficit. So whatever money the government brings in in new taxes will be offset by what it pays out to service the national debt.

Only when interest rates fall will taxpayers benefit from the full effects of Mr. Wilson's budget-cutting and tax-reform measures.

35th birthday

Varian celebrated its 35th anniversary with about 350 of its employees on Thursday, Oct. 12. Attending the celebration were the five longest serving employees with a combined service of 164 years. From left to right Mike Szwec, Norm Long, Marg O'Flaherty, Bill McDonald and George Bent, and on the far left, Joe Caldarelli, the general manager.