Brief to the Pre-Budget Consultation of the Commons Finance Committee

Presented by the Face of Poverty Consultation

Government budgets should focus on supporting programmes to meet the priority needs of Canadians and on the government's capacity to finance those programmes.

Unfortunately, the terms of reference for the 2012 pre-budget consultations focus the discussion on cuts to balance the budget without raising taxes. This is misguided because 1. Many important programmes need to be expanded, 2. There is currently no economic or social reason to move quickly to a balanced budget, and 3. Tax cuts for some continue to reduce the government's capacity to reflect Canadian values and meet Canadians needs.

Members of Parliament must ask how our economy, with per capita income doubling in the last 35 years (Finn, 2011), can no longer afford the programmes of earlier, less prosperous times.

Why Now?

Are Canadians demanding cuts to programmes or to taxes? No. For decades, polls have shown that we are willing to pay higher taxes to enhance government services, especially for health, education and social assistance. Our concerns about taxes are the increasing unfairness of the tax system. Taxes have been shifted from corporations to people and from rich to poor (Lee, 2007). Those tax cuts (*not* social programmes) were - and are - largely responsible for budget deficits and mounting debt (Mimoto and Cross, 1991).

Are cuts and balanced budgets necessary to promote economic growth? No. The financial crisis of 2008 clearly demonstrates that unregulated markets can cause chaos in people's lives and pro-active government is therefore necessary. As another financial contagion would affect other countries' ability to buy Canadian exports, this is not the time for slashing government.

Do our deficits threaten Canada's international competitiveness? No - Canada's deficit/debt situation is the envy of most nations. Canadian governments' debt (60 % of which is provincial debt) relative to GDP is 33.7 %, less than half that of the U.S. and only 54 percent of the OECD average (Jackson, 2011). Moreover, government deficits as a proportion of GDP are lower and falling faster in Canada than the OECD average or in the U.S., our major trading partner.

Jackson notes that our "real" rate of unemployment - adjusting for labour force dropouts and involuntary part-timers – was 10.7% in June. Cutting government spending deprives Canadians of needed services and weakens our still fragile economy.

Low Taxation – Relative to what?

The question is not "how high are our taxes?" but "what needs are met by the taxes we pay?". Taxes are the price we pay for a civil society.

Canada's taxes are not high by international standards – we are in the middle of the pack of OECD countries. While higher than U.S. tax levels, ours cover a large portion of the costs of medical care; these are mainly private expenses in the U.S. All Canadians are covered by publicly funded health care whereas 1 of every 7 Americans is without health insurance! Moreover, medical outcomes in Canada are generally superior –even Cuba has a lower infant mortality rate than the U.S. The OECD countries with taxes higher than ours generally provide more support for education, training, social assistance, and the environment but they also tend to outperform the Canadian economy.

Of course, the Canadian benchmark for many comparisons is the United States. Our corporate profit taxes are lower than in the U.S. Why do federal and provincial governments claim we need lower profit taxes? Cuts to our corporate tax rate do not help U.S. companies. U.S. subsidiaries' Canadian taxes can be used as a tax credit against their U.S. parent's profit taxes. Thus, every dollar less they pay in Canada is a dollar more in their U.S. profit taxes and the beneficiary of our tax cut is the U.S. treasury! The Canadian government loses revenues but corporations still expect investment subsidies, infrastructure, and public education and health care from the government.

For decades, personal tax cuts have favoured the wealthy. But these are the same people who benefitted from economic growth, especially the top ten percent of income earners. The result is that the wealthiest five percent of Canadians now pay about the same proportion of their income as the poorest ten percent, and less than middle-income Canadians (Lee, 2007).

This erosion of tax fairness is the result of both moving taxation away from the income tax, our only progressive tax, and diluting the progressivity of the income tax itself. Income tax "reform" removed the upper tax brackets and provided exemptions to some kinds of income - the kinds received primarily by the wealthy.

Tax deduction and tax credit programmes, such as the RRSP and child fitness tax credit, respectively, disproportionately benefit high income people.

Tax deductions favour the wealthy because they reduce the amount taxed at the highest rate. Also, the wealthy have enough income to participate to the maximum whereas low-income Canadians spend almost all their incomes on current necessities. In 2007, two thirds of the top two percent of Canadian tax filers reported RRSP deductions, compared to only one quarter of all filers. This top group, with incomes of $150,000 and above, claimed 18 percent of the RRSP deductions or 9 times their proportion of the population (CRA, 2010).[1]

A tax credit applies the same tax rate for all. However, low-income Canadians have less ability and less incentive to participate because they cannot get the maximum tax savings on non-refundable tax credits. Thus a high-income family can afford to enroll their children in athletic programmes and claim

[1] Of course, RRSPs simply delay but effectively lower tax payments whereas Tax Free Savings Accounts avoid income taxes entirely – and the lost revenues will never be known, unless governments require information on principle and returns when payouts are made.

all of the tax credits against their income taxes; the poor can do neither. If tax credits were refundable, low-income Canadians would be at less of a disadvantage.[2]

A blatant gift to the wealthy is the 50 percent "inclusion" rate for capital gains income. Only half capital gains need to be included as taxable income. In 2007, the top two percent of Canadians declared 64 percent of all capital gains – 32 times their weight in the population. If all capital gains income were taxed for those with income of $150,000 or greater, the Federal Government in 2007 would have raised an extra $3 billion! Reducing the inclusion rate from 75 to 66 to 50 percent is a clear example of how the progressivity of the income tax system has been eroded and tax revenues lost. Similarly, RRSPs generated a loss of tax revenue from the top two percent of about $2 billion in 2007. [3] As most provinces accept the federal programmes, provincial revenues would be increased by about 45 percent of the federal increase if the taxation of RRSPs and capital gains were changed.

What do Canadians get for their taxes? We get medical care and education systems of which we are justifiably proud – but worried about. Our social support systems are anemic relative to many European countries. Much of our infrastructure needs improvement and expansion, including affordable housing and daycare facilities. We need remediation for the environmental damage of the past and policies to convert to an environmentally sustainable economy for the future. The Government's cut of 43 percent from the budget of the Canadian Environmental Assessment Agency (Lesley, 2011)is precisely the wrong approach. We need more, not less, government.

This is not to say that there is no place for cuts. While improvements are necessary in the salaries of our military personnel and in support for veterans, there appears to be no reason to spend billions on "Cadillac" fighter/bombers – why should the defense of Canada require *bombers*? Or why should we subsidize fossil fuels, such as the tar sands, or nuclear energy , instead of encouraging alternate, renewable energies which can often be produced and used?

Sustain Economic Recovery

Our fragile recovery will be hurt by reducing government expenditures in the economy. A budget's goal should be the health of the real economy – its ability to meet our needs. Too much attention is paid to volatile and secondary financial indicators such as stock prices and (debt/GDP) ratios.

Government expenditures on infrastructure are important for medium-term job creation and long- term needs. However, the short-term impact is relatively small, especially for the most vulnerable in our communities. Infrastructure programmes to help the vulnerable, such as affordable housing and expanded inter-urban transit systems, should be given priority.

[2] Refundable means that someone who is eligible for a $500 tax credit but only pays $300 in taxes would receive a refund of the difference, $200.

[3] Special tax treatment, known as "tax expenditures" because they affect the government's budget in the same way as an expenditure, are also available on a massive scale for corporations. Kierans (1973) estimated that these concessions reduced taxes on large corporations' profits (at least half of them foreign) to about 1/3 their nominal level but were worth very little to small (mainly Canadian) companies. Reducing corporate tax expenditures would increase government revenues.

Improved government support, such as social assistance, put money directly into the hands of the most vulnerable who will spend it immediately, creating demand for goods and services and jobs supplying them. This requires designated increases in funds to provinces. While employment insurance tends to provide more support to the non-poor than the poor, it too should provide easier access and higher support levels.

Create Quality, Sustainable Jobs

To create quality, sustainable jobs in an environmentally sustainable economy requires a healthy, better educated, more highly skilled, and strongly motivated work force. It requires a level of certainty for both labour and business to invest in education and new capital, respectively. It requires research and development to efficiently produce the goods and services to meet our future needs.

Many believe that massive foreign investment is necessary, but this is a two-edged sword. Foreign direct investment (FDI – where a foreign company controls a Canadian operation) is a "quick" fix, but does not necessarily generate the conditions for sustainable jobs. A foreign company setting up in Canada may respond to subsidies but may lack knowledge of our resources and institutions and thus import both its initial capital and its operating supplies. Moreover, our past dependence on foreign investment accounts for much of the limited amount of R&D done privately in Canada. University and government research will continue to be important.

Reliance on foreign investment increases uncertainty and insecurity. Employment in foreign subsidiaries tends to be more volatile in recessions, and firms attracted to Canada by subsidies are also likely to move when higher subsidies are offered elsewhere.

Thus, our focus should not be on attracting foreign companies nor on expanding our exports. After all, the reason we need exports is to finance our imports. We need imports because we are not efficient at producing those goods – why not?

The focus of creating quality, sustainable jobs should be on how to meet the needs of Canadians, especially the most vulnerable. We can meet our needs directly, producing the goods and services in Canada. Or we can meet our needs indirectly, exporting to others and importing the things we need. When we meet our needs directly, we become more expert in those industries and may develop them into export markets. Thus success in meeting our own needs can lead to more exports -exports are a measure of our success, not its source.

In short, the government needs to do more, not less. This is true for the short run, in the face of international financial instability. It is also true of the long run because of the need to reverse the trend toward increasing income inequality resulting, in large measure, from tax policies which favour the wealthiest Canadians. We should NOT exhort *everyone* to tighten their belts or to expect less from government. Those who have gained the most should tighten *their* belts but many Canadians deserve more opportunities to meet their needs. A more compassionate, sustainable economy is possible.

Recommendations

The above discussion raises a myriad of policy implications and recommendations. Following the request for only three, ours would be:

1. Reduce and remove tax expenditures on individuals, e.g., capital gains and RRSPs, and on corporations, such as fossil fuel subsidies.
2. Direct infrastructure expenditures to directly benefit our most vulnerable citizens, e.g., affordable housing, daycare facilities.
3. Greatly improve income support programmes. A Guaranteed Annual Income would be best but measures such as making tax credits refundable and increased transfers to the provinces, designated for health, education, and social assistance.

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