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An Analysis of a Regressive Budget

THE November 1981, budget was the federal Government's first and last major effort at tax reform since the Benson Iceberg of 1971. It marked a serious attempt to make the tax system more equitable.

The approach was to reduce the top marginal rates to give a greater incentive to work, save and invest, while at the same time financing the reduction and making the tax system fairer by eliminating many tax preferences.

Unfortunately for the success of this bold exercise, the tax measures introduced exhibited a number of technical flaws. This was inevitable given the great difficulty of designing detailed tax changes in secret without taxpayer feedback.

The budget's technical flaws contributed to its undoing. But it was more than this. Business groups, trade associations and tax practitioners supported by the financial press used the technical problems as ammunition in mounting a concentrated attack on the fundamental philosophy of the budget.

The result was a restoration of many of the tax preferences, which, combined with the reduction in the top marginal rates, served to undermine the progressivity of the tax system. This is demonstrated in Table 1, which shows the impact of the November 1981, budget measures for typical taxpayers in 1982.

The lesson of the November 1981 budget was not lost on the Government. Consultations with the private sector on tax changes became the order of the day. A green paper on the budget process extolling the virtues, of consultations was released in April 1982.

Consultations were engaged in before the June 1982, budget and the October economic and financial statement. A white paper containing proposals for indexed deposits and loans and an Indexed Securities Investment Plan was published, and a committee headed by Pierre Lortie was set up to study the proposals.

The most ambitious pre-budget process of consultations; was undertaken by. Finance

Minister Marc Lalonde before his April 19 budget. These consultations paid off for business groups which participated. Besides calling for expanded business tax incentives, they urged the Government to reduce the deficit.

In his budget, the minister responded to these two seemingly contradictory concerns by raising taxes on everybody but business by more than enough to reduce the deficit by the desired amount, thus leaving enough money to finance new corporate tax breaks.

By 1986-87, net tax increases included in the budget amount to $3 billion and corporate tax cuts $815 million. The burden of this tax bill falls on the ordinary taxpayer through increased personal income and sales taxes and the retention of the Canadian Owner ship Charge.
In contrast, business groups were rewarded by the implementation of several of their key recommendations. These include, most notably: the Indexed Security Investment Plan, the extended carry-back and carry-forward of business losses, and the proposal for a larger tax credit for research and development

The ones hardest hit by the budget are low- and middle- income working Canadians. The largest proportionate share of the budget's personal income tax increases will be paid by this group.

The fact is carefully camouflaged in the budget papers, which contain a table showing the progressive impact of the budget's personal-income tax measures. The table, part of which is shown as the right panel in Table 2, is correct as far as it goes, but is misleading as an indicator of the budget's impact by income class.

The largest single personal income tax increase announced in the budget is the modification f to the federal tax reduction of $200. In 1984, this tax reduction will be phased out for higher income individuals with the federal tax reduction diminished by 10 per cent of basic federal tax in excess of $6,000, This is estimated to raise $455 million in 1984-85. In the left panel of Table 2 this measure accounts for $200 of the total tax, increases for single taxpayers in the top two income groups and for $400 of the total tax increases for married taxpayers in the same group.

While in 1984 the phasing down of the federal tax reduction affects only upper income taxpayers, as shown in the left panel of Table 2, in 1985 the tax reduction is decreased to $100, and in 1985 and subsequent years the tax reduction is decreased to $50. The decrease in the reduction touches lower- and middle- income taxpayers.

This is not shown in the left panel of Table 2, since it does not occur until 1986. However, the budget table on revenue impact indicates that this measure alone will raise $2.1 billion in 1986-87 or almost four times the 1984-85 figure. It more than accounts for the budget's net personal income tax increase in 1986-87.

A better indication of the impact of the budget measures at different income levels is provided in the right panel of Table 2. It shows the hypothetical tax change that would occur in 1984 assuming the full phasing down of the federal tax reduction to $50, which is scheduled for 1986.

As can be seen, the budget raises taxes proportionately much more for low and middle income earners, particularly for single taxpayers with no dependents.
The actual budget impact is even more regressive than suggested by the adjusted figures.
Another measure which is not fully reflected in the budget table is the maintenance of the 1981-82 family income threshold for the child tax credit.

This weighs disproportionately on the middle income married taxpayer with children. Eventually, assuming the continuation of inflation, it will result in the elimination of the child tax credit for all those with the lowest real incomes.

The budget table is also deceptive because it treats the repeal of the $100 standard deduction the same way it would treat an exemption. This creates, the impression that the, budget changes bear more heavily on upper income taxpayers than is actually the case.
In fact, only lower- and middle- income earners use the standard deduction. Upper income individuals almost always itemize their charitable donations and medical expenses.
The only conclusion that can be drawn from an analysis of the budget's personal income tax measures is that they are regressive. This reinforces other regressive elements, such as the sales tax increase and business tax incentives, and comes on top of large increases in unemployment insurance contributions announced in October.

It represents a further movement in the direction of a less progressive tax structure.
Almost a year and a half afterward, the reaction to the November 1981 budget continues.

There is a fundamental issue at stake here which cuts to the heart of politics in a democratic state. It is who has influence over the budget. The Government tried tax reform prepared under the cloak of budgetary secrecy and was forced to retreat in the face of powerful opposition mobilized by business groups.

Opening up the budget process. and engaging in more extensive consultations was seen as a way of. maximizing input before the event and thus avoiding the repetition of another November budget. This in itself is a good thing.

The problem is to ensure that all points of view are given equal consideration. This was not the case in the budget. The most numerous and best prepared pre-budget submissions came from the business community.

In contrast, except for the Canadian Labor Congress's brief, which was good and recommended tax cuts for low- and middle- income earners to stimulate the economy, the quality of the briefs from labor was low and devoid of constructive suggestions.

Public interest groups, with the exception of the Canadian Council on Social Development, did not submit detailed briefs. Against this backdrop, it is understandable why the budget is pro-business and decreases the progressivity of the tax system.

A way must be found to get a broader degree of public participation in the budget process. Public interest groups, economic research organizations and other concerned citizens must take a more active role. Otherwise, budgets will continue to reflect business input.

TABLE 1

Federal and Provincial tax changes in 1982 from November, 1981, budget

Earned income (dollars)	1982 tax change (dollars)	1982 tax change (percentage change)
Single taxpayer — no dependents		
7,500	0	0
10,000	0	0
15,000	0	0
20,000	43	1.2
25,000	146	2.8
30,000	225	3.2
50,000	—410	—2.5
75,000	—1,145	—4.0
100,000	—2,256	—5.3
Married taxpayer — two dependents under 18		
7,500	0	0
10,000	0	0
15,000	—200	—29.0
20,000	—200	—9.8
25,000	—134	—3.8
30,000	—29	—0.6
50,000	—496	—3.5
75,000	—1,231	—4.6
100,000	—2,172	—5.4

TABLE 2

Federal and Provincial tax changes for typical taxpayers in 1984 as a result of budget measures

Earned income	1984 tax change from budget papers		Hypothetical tax change in 1984 Assuming full implementation of modification to federal tax reduction	
(Dollars)	(Dollars)	(Percentage change)	(Dollars)	(Percentage change)
Single taxpayer — no dependents				
7,500	—44	—13.9	106	32.4
10,000	—26	—2.9	124	13.6
15,000	14	0.7	164	7.5
20,000	29	0.8	179	5.1
25,000	33	0.7	184	3.6
30,000	36	0.5	187	2.7
50,000	245	1.6	244	1.6
75,000	250	0.9	250	0.9
100,000	250	0.6	250	0.6
Married taxpayer — two dependents under 18				
7,500	—36	—	—35	—5.0
10,000	—37	—	—36	—5.4
15,000	—6	—5.6	296	281.9
20,000	8	0.6	312	22.2
25,000	11	0.4	315	11.2
30,000	169	3.8	472	10.7
50,000	376	2.9	476	3.7
75,000	481	2.0	486	2.0
100,000	481	1.3	486	1.3