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Deferring Federal Taxes: Illustrating the Deficit Using the GST

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Summary

- It is sometimes difficult for everyday Canadians to grasp the size of the federal deficit—estimated at $26.6 billion for 2019-20—because of its sheer size.

- This bulletin, along with subsequent planned instalments, aims to give Canadians that context by calculating what the federal GST rate would have to be to in order for the federal budget to balance in 2019-20.

- The calculations account for both the GST itself and the related GST credit, which is designed to mitigate the effects of the GST on low-income families. As the GST rate is adjusted in this analysis, so too is the related GST credit.

- If the federal government decided to raise the revenues it needed to pay for its spending instead of deferring those taxes to the future through deficits (i.e., borrowing), the GST rate (currently 5 percent) would have to rise to 9 percent.

- This calculation is not intended as a policy recommendation but rather an illustration of the degree to which the federal government is deferring taxes to the future rather than fully taxing today to pay for its current spending.

Introduction

The 2015 federal election marked a potential long-term change in federal fiscal policies, that is, the policies related to government spending, taxes, and borrowing (both annual deficits and overall debt). Beginning in the early 1990s there was a general consensus across the country that transcended political parties whereby government fiscal policies should entail limited and prioritized government spending, competitive taxes, balanced budgets, and declining debt (see Clemens, Lau, Palacios and Veldhuis, 2017). Such consensus lasted through the 2009 recession up to the 2015 election, which saw the introduction of an entirely new set of federal fiscal policies.[1] To varying extents these policies had emerged previously in a number of provinces. Specifically, the new government introduced large increases in new spending, higher taxes, and borrowing to finance the new spending (see FinCan, 2015 and FinCan, 2016).

This bulletin aims to help Canadians better understand the nature of these changes in federal fiscal policies, specifically with respect to how increased spending is being financed. An increase in government activity can be financed in one of two ways: higher taxes or borrowing.[2] Put simply, governments can either tax today, or they can tax tomorrow in the form of borrowing today.

[1] See, for instance, the 2015 Liberal Party Platform: https://www.liberal.ca/wp-content/uploads/2015/10/New-plan-for-a-strong-middle-class.pdf.

[2] While this essay focuses on two options to finance government activity (higher taxes or borrowing) there is a third alternative; the government can impose regulations on individuals and businesses such that they directly incur the costs of the government activity.

As recently as 2014-15, Canada was essentially in a balanced budget position meaning that the revenues the federal government collected were sufficient to cover Ottawa's planned spending and interest payments on the debt (see FinCan, 2016). Since 2014-15, however, the federal government has incurred deficits due to its increased discretionary spending. The most recent budget (2019), for instance, indicated a deficit this year alone (2019-20) of $26.6 billion rising to $28.1 billion next year.[3] To put this figure into perspective for everyday Canadians, the $26.6 billion deficit equates to approximately $708 per Canadian. Relative to other measures, the 2019 deficit represents 7.8 percent of the total federal revenues, or 1.2 percent of the size of the economy (GDP).

This bulletin puts the deficit in context by calculating the GST rate that would be required to balance the budget. Put differently, this bulletin determines the GST required such that revenues collected today would be sufficient to pay for spending today with no additional borrowing. This is not a policy recommendation calling for a higher GST; rather, it is a mechanism by which to help Canadians understand the degree to which we are deferring taxes to the future (i.e., borrowing) rather than taxing ourselves today to fully pay for current government spending.

We chose to focus on the GST over other potential taxes, such as personal or business income taxes, because it is visible to all Canadians

[3] Please note that this analysis uses the 2019-20 federal deficit, before the impact of COVID-19. Put differently, these figures reflect the Fall *Economic and Fiscal Update*, 2019 (see FinCan, 2019a). The $26.6 billion includes a risk adjustment of $1.5 billion (excluding the risk adjustment, the deficit is $25.1 billion).

and they are aware that it is a tax that finances government spending.

Methodology

The federal Goods and Services Tax (GST) is a value-added tax collected on most goods and services sold in Canada. It is a sales tax, and therefore a tax on consumption because it only applies to the purchase of covered goods and services, meaning that savings are exempted from the tax.[4] The GST rate is currently 5 percent.

To determine the GST rate that would be needed for the federal government to balance its budget in 2019-20, this essay relies on Statistics Canada's Social Policy Simulation Database and Model (SPSD/M, v. 28.1).[5] The SPSD/M provides static estimates. In other words, it does not include behavioural responses to the changes that will be mentioned below. For instance, the model does not assume that people's consumption will change if the government imposes a higher GST rate.

The approach we took to determine the rate of GST necessary to balance the budget is based on an iterative series of calculations. The first calculation, referred to as the "status quo," calculates total net federal tax revenues (total tax revenues less total transfers)—including the GST at 5 percent as well as the related GST credit—to create a baseline for net federal tax revenues.

It is important to recognize and include the effects of any change in the GST rate on the related GST credit—a tax-free payment that helps families up to a certain income level (currently $37,789) to offset a portion of the GST they pay. The intent of the GST credit is to mitigate the degree to which low-income families incur GST costs.

The GST credit is calculated based on family income and the number of dependent children. Currently, a single person earning less than $37,789 in income is eligible for a GST credit of $290. As incomes move higher than $37,789, the tax credit is reduced by 5 percent until the value of the tax credit reaches zero. [6]

Table 1: Assumptions for Status Quo and Alternative Scenario

Assumptions	Status Quo	Alternative Scenario
GST rate	5%	9%
GST credit reduction level ($)	37,789	37,789
GST credit amount for filer ($)	290	522
GST credit amount for spouse ($)	290	522
GST credit amount for dependant ($)	153	275

Source: Calculations by the authors based on SPSD/M.

[4] For a general discussion of the economic costs of different taxes, and in particular why consumption taxes like the GST incur the lowest economic costs see Clemens, Veldhuis, and Palacios (2007).

[5] Disclaimer: This analysis is based on Statistics Canada's Social Policy Simulation Database and Model. The assumptions and calculations underlying the simulation results were prepared by the authors and the responsibility for the use and interpretation of these data is entirely that of the authors.

[6] Again, this analysis does not account for any policy changes in response to COVID-19.

Increasing either the adult or the child benefit amount increases the total value of the benefit and thus increases the GST credit transfer to the families. Such an increase in the GST credit benefit necessarily reduces the net amount of revenues collected from the GST.

We then calculated a set of "alternative scenarios" to determine the GST rate and corresponding GST credit amount that would generate the revenues needed to offset the projected deficit and achieve a balanced budget in 2019-20.

Please note that in each of the iterations, the federal GST credit amounts increase proportionately to the increase in the GST rate. In other words, the tax credit in the alternative scenarios is increased as the GST rate is increased to ensure a higher valued tax credit such that lower-income families are not made worse off than under the status quo. For instance, a single person earning less than $37,789 in income would be eligible for a tax credit of $522 if the GST credit was to be raised to 9 percent (compared to $290 at the GST's current 5 percent rate).

Summary of findings

Under the status quo, using the current 5 percent GST rate and the corresponding GST credit, the government raises $89.9 billion in total net federal tax revenues. The deficit in 2019-20 is projected at $26.6 billion (FinCan, 2019a). For the GST to raise sufficient revenue for the government to balance its budget, the GST rate and corresponding tax credit would need to rise to 9 percent. Table 1 summarizes the status quo and the necessary assumptions that lead to the 9 percent GST rate. With a 9 percent GST rate, the federal government would expect to raise $117.4 billion in net federal tax revenues (an additional $27.5 billion) and would reach a budgetary surplus of $0.9 billion in 2019-20.

Conclusion

If the federal government decided to balance its budget—in other words to raise the revenues today required to pay for spending today—the GST rate would have to increase from 5 percent to 9 percent. Again, this analysis is not intended as a policy proposal. Its intention is to provide an illustrative example of the type of tax increase that would be needed to balance the federal budget.

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