

The Harper revolution: Fiscal conservatism—Yes, no, maybe

The 2011 budget will likely only be remembered as an excuse to call an election, because of a 1.5 percentage point reduction in the corporate tax rate; a trivial economic reason but, for some, an important political reason.

If there is an election, there will likely be little debate over the fiscal policy the government has been following since it was first elected in 2006. The reason is that it is very difficult to identify a clear set of fiscal principles that the Conservative government has been pursuing. Instead, the government has adopted a version of the old adage, "Believe what I say and ignore what I do."

IS HARPER A FISCAL CONSERVATIVE? IN WORDS ONLY

If by a fiscal conservative one means a person who wants to reduce the size of government through less government spending, lower taxes, balanced budgets, and lower debt burdens, then Stephen Harper is clearly not a fiscal conservative. Strangely enough, the only prime minister that comes closest to meeting this definition is Jean Chrétien from 1993 to 2001.

The only policy action that Harper has implemented consistent with being a fiscal conservative has been to lower taxes. The other essential elements of the definition have been completely ignored. Program expenses have increased significantly, surpluses have been eliminated, and the deficit has reached record levels in absolute terms, with accompanying increases in the debt. The target of reducing the debt-to-GDP ratio by 2012–13 has been pushed beyond the current five-year planning track.

DO DEFICITS MATTER TO HARPER? NOT REALLY

If you listen to Harper's rhetoric, then deficits matter and he is committed to

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eliminating the deficit and running ongoing surpluses. During the 2008 election, Harper stated categorically that his government would never record a deficit, and the economy would not go into a recession. The Minister of Finance, in his November 2008 economic and fiscal update, produced a fiscal forecast showing surpluses as far as the eye could see.

Well, the rest is history, as the saying goes. The Harper government inherited a surplus of over \$13 billion in 2006–7. By 2008–9, the government recorded a deficit of almost \$6 billion thanks to cutting the GST by two points. By 2009–10, the deficit reached \$55.6 billion, in part because of the recession, but also in part because of Harper's temporary conver-

sion to Keynesian economics by virtue of being a member of the G20 and by outdoing every other country in the amount of stimulus provided.

The real issue going forward is whether the Harper government regards the deficit as a serious problem that requires significant cuts to government programs and/or revenue increases to eliminate it. The answer is, it does not. This was clear in the 2010 budget, where the government showed a small surplus five years out, based largely on economic growth, as the spending reductions announced were largely not credible.

The government has rejected the analysis of the Parliamentary Budget Office (PBO), the International Monetary Fund (IMF), and others, that the deficit includes a significant structural component that will not be eliminated without significant expenditure cuts and/or revenue increases. Recently, the PBO released an update of its fiscal projections, which showed a structural deficit of \$10 billion in 2015–16. Normally, one would hope that a fiscally conservative government would not hesitate to take tough actions to eliminate a structural deficit. This government, on the other hand, has rejected the existence of a structural deficit, without any analysis, and intends to rely on attrition of public sector employees to reduce government costs, and on economic growth to eliminate the deficit.

Equally problematic is the refusal of the government to acknowledge the growing fiscal imbalance that will emerge in the second half of the decade from the impact of the ageing population on increasing government spending and reducing potential economic growth. The February 2011 report of the PBO sets out the fiscal implications of these developments.

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DOES HARPER FAVOUR LOWER TAXES? ABSOLUTELY

Clearly, this is the one area where Harper has fulfilled his Conservative principles. What Harper will be remembered most for will be the two-point reduction in the GST, which pretty much wiped out the surpluses the government inherited and which is primarily responsible for the structural deficit we have today. Income taxes were reduced not by cutting middle rates but by providing targeted “boutique” tax preferences, such as those to assist the participation of young people in sports. The personal income tax system is now littered with special tax preferences. With regard to corporate tax cuts, the Harper government extended the plan initially implemented by the Liberal government in 2000. The result was that total tax revenues as a share of GDP fell from 16.3 percent in 2006–7 to 14.3 percent in 2009–10.

It is unfortunate that Harper chose to cut the GST. When the GST was implemented, it was always the intention to shift the burden of taxation onto the GST and to lower the burden on personal and corporate income tax. By doing so, this would favour savings and investment and economic growth. Harper has done the exact opposite.

Indeed, if Harper had not cut the GST by two points, the corporate income tax could be cut further, while at the same time the government could have sufficient revenue to eliminate the structural deficit that currently exists.

DOES HARPER FAVOUR LOWER SPENDING? NOT REALLY

Between 2006–7 and 2009–10, total program spending increased by 13 percent, rising from 13 percent to 16 percent of GDP, largely because of the stimulus spending and cyclical factors. It is expected to fall back to about 13.5 percent of GDP by 2015–16, but this means that the underlying growth in program spending is in line with the growth in nominal GDP. In the 2006 election, Harper promised to keep the growth in

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program spending to no more than the growth in population and inflation.

Prior to the 2010 budget, the Harper government said that it would not cut major transfers to the provinces or to persons. Recently, it has said that spending on research and health would also be protected. It has, therefore, excluded more than half of program spending from cuts to eliminate the deficit, leaving it to rely primarily on cuts to direct spending. In the 2010 budget, the growth of defence spending was cut and the level of spending on international assistance was frozen. The operating budgets of government departments were frozen for two years. The 2011 budget is expected to outline how the government intends to find these latter savings. The government has indicated it will not be necessary to make major cuts to programs to realize these savings. However, experience has demonstrated that across-the-board administrative savings are not sustainable.

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WILL HARPER BECOME A FISCAL CONSERVATIVE? PERHAPS

The next test of Harper’s fiscal conservative credentials (assuming that Harper is still in power) will come in the 2012 or 2013 budget. The current legislation with respect to federal support under the Canada Health Transfer (CHT) and Canada Social Transfer (CST) expires on March 31, 2014. New legislation will be required

to authorize any payments after that date.

Although originally stating that transfers to provinces would be protected, the Harper government is now indicating that the provinces should not count on these transfers. In previous budget documents, the government has emphasized the need to clarify the roles and responsibilities between federal and provincial governments. This statement suggests that the preferred option would be to cut the growth of CHT and CST and “download” the problems of an ageing population onto the provinces.

This may not be very easy. A significant reduction in transfer payments to the provinces would open up issues with respect to equalization and coordination of federal–provincial tax policies. The provinces could not easily cope with a major cut in transfer payments.

There is of course an alternative, which is simpler and less disruptive to federal–provincial relations. The federal government could simply restore the two points to the GST. However, this would violate one of Harper’s fundamental conservative principles, which was not to increase taxes, regardless of how ill advised from a fiscal and economic perspective such a tax cut was. It would mean a larger budget and larger role for the federal government in the economy.

However, stranger things have happened in the past. “Believe what I say and ignore what I do” is the dominating operating principle of the Harper government when it comes to fiscal policy.

The reality is that Harper has shown the kind of flexibility in applying fiscal conservative principles that is needed to stay in power. After all, that is what politics is all about. 