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CanadaWatch

PRACTICAL AND AUTHORITATIVE ANALYSIS OF KEY NATIONAL ISSUES

A new cycle of investment begins

BY JUDITH MAXWELL

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A new era of social investment has finally begun after two decades of public sector restraint and restructuring. We must now turn the page from "getting our economic house in order" to "getting our social house in order."

There was not much controversy about what "getting the economic house in order" meant—reduced deficits and debt, lower interest rates, more employment, less inflation. But "getting the social house in order" is far less predictable. We are not aiming to go back to the golden era of the 1960s, but we are striving to meet the social needs of Canadians in an era when work, family life, and the age of the population are radically different from the 1960s. In short, we are building a new social paradigm for the 21st century.

With the benefit of hindsight, we can divide the post-war period into two big swings of the pendulum.

A GOLDEN ERA

From 1945 to 1975, the focus was on nation building. Governments—mainly the

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Canada's future is in the stars

BY DAVID STEWART-PATTERSON

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On January 1 of this year, Revenue Canada began taxing Hollywood movie stars working in Canada like Canadians. Instead of a 15 percent withholding tax, they were ordered to pay full Canadian rates.

American studio executives and Canadian film and television producers promptly descended on Ottawa. They argued that making movie stars pay Canadian taxes would lead those stars to refuse to work in Canada. And without American stars, 35,000 Canadian jobs and $2.3 billion a year in economic activity would end up on the cutting-room floor.

Three weeks later, Revenue Canada relented—temporarily, of course—while discussions are pursued toward a compromise.

Stars can work wherever they please. Movies and programs will be made where the stars want to work. David Duchovny may have been motivated by Vancouver's rain or the long commute from Los Angeles rather than by BC's taxes. Whatever his reasons, though, the star of *The X-Files* got what he wanted. Production went south, even though reports suggest the hit television series costs twice as much to make in California. Canada's lower costs pro-

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FEATURES

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Looking at the full scope of tax changes since the Liberals took office reveals a more sobering picture than this year's budget measures taken in isolation. The net impact of outright tax measures in the six Liberal budgets has been to reduce 1999-2000 personal taxes by $1 billion. Cuts to employment insurance contributions will also save individual taxpayers some $3 billion in the coming fiscal year. But elsewhere, the government's actions have pushed up CPP/QPP contributions, and its inaction on indexation, allowing inflation to push taxpayers into higher brackets, has raised tax burdens in each of the last six years. Add it all up, and the Liberal legacy has been to *increase* personal taxes by $5 billion for 1999-2000.

The elimination of the "temporary" 3 percent surtax (so temporary that it lasted more than a decade), and the increase in the basic personal exemption, paled in comparison with the spending programs announced at the same time.

That leaves a huge gap between Canadian and US tax burdens, amounting to 6 percent of GDP in 1998, that, if anything, could soon grow wider. South of the border, Washington is also in the midst of a budget debate centred on how to divvy up future surpluses, with the current fiscal year's black ink headed for more than US$100 billion. While Republicans may not get their proposed across-the-board 10 percent personal tax cut, they are unlikely to settle for only token rate reductions in a pre-election year document.

Canada's higher tax burden has been a key reason why disposable income growth has been so lacklustre. Real per-capita after-tax income has in fact fallen by more than 6 percent in the 1990s, in contrast to an 11 percent increase in the average American's spending power over the same period. Little wonder then that the Canadian economy has been dependent on currency depreciation and the resulting boost to exports for much of its growth in the 1990s.

This government may see tax cuts as largely an issue for the rich. But, in fact, it's not the rich that are most disadvantaged by the Canadian tax system. Our high marginal tax rates kick in at an income of less than $60,000, while a much more progressive tax system in the United States sees the highest rates start at an income of roughly seven times that amount. Canadians earning $30,000 to $70,000 pay 8 to 10 percent more of their income in taxes than Americans in the same bracket, while the richest Canadians face only a 5 percent disadvantage relative to their US counterparts.

The Liberals inherited a fiscal system that was plagued with massive deficits and an onerous tax system that weighed on economic growth. Much work has been done to address these problems and the 1999 budget was a missed opportunity to get on with the job.

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vide no consolation to the Canadians who lost their jobs when the star rode off into the sunset.

If Canadian politicians can understand and are willing to act on this logic as it applies to the movie business, why are they so reluctant to accept that it applies to any business in the post-industrial economy? Whether in entertainment, in research, or in corporate management, the very best can work wherever they wish—and job creation and economic growth flow from their choices.

THE COST OF LOSING OUR STARS

In his 1999 budget speech, Finance Minister Paul Martin said: "The test of good government is not to protect the privilege of the few. It is to provide opportunity for the many." But the way Canada taxes its "privileged few" is not just excessive—it damages the livelihoods and reduces the opportunities available to a host of other people.

Compounding the problem is Canada's definition of "privileged"—anyone earning more than about $70,000 (these days, roughly $45,000 in hard currency). Newly minted doctors and lawyers, PhD graduates, and young computer hotshots can all find themselves "rich" for tax purposes while still struggling to pay off their student loans. And they are even more mobile than the experienced managers, professionals, researchers, doctors, nurses, and others who have been fleeing to the south with their families in growing numbers in recent years.

On top of the loss of the billions of dollars of public money invested in the education of those who leave, this brain drain also has a significant impact on the tax base that supports Canada's vaunted social programs. Revenue Canada figures for 1996 show that the "privileged few" with incomes of more than $70,000 made up just 4.4 percent of tax filers and earned 21 percent of total income. But this group also paid 34 per-

cent of all federal income tax and 38.5 percent of provincial income tax, a total of $35 billion.

On average, for every 26,000 such Canadians who leave, roughly $1 billion is lost in federal and provincial income tax revenue each year thereafter. (This does not count all the property tax, sales tax, and other taxes they and their families pay.) In 1996, the United States accepted more than 52,000 temporary and permanent migrants from Canada on employment-based preferences—generally indicating highly skilled and well-paid individuals.

The real danger is not the short-term cost, but the long-term implications of exporting our magnets, the people whose reputations create a destination for others who want opportunities to work with the best in the world.

INADEQUATE TAX REFORM MEASURES

Mr. Martin would have you believe that there is little he can do without jeopardizing Canada's hard-won and fragile fiscal progress. Prudence is the wise course in uncertain times like these; but his post-budget musing that it could take another generation to make a meaningful dent in personal taxes seems timid stuff from the man who tamed a $42 billion deficit in just four years.

And while the minister declared in February that "there will be no rewind to the reckless spending of other people's money," his government has in the past two years restored almost half of all the spending cuts made since the beginning of his battle against the deficit. Personal income tax revenues, meanwhile, have been growing almost twice as fast as the economy and close to two and a half times faster than labour income. Canadians now pay far more in income tax than citizens of any other G7 country.

The 1999 budget did complete the elimination of the 3 percent surtax, but Mr. Martin has made it clear that the 5 percent surtax on high incomes is low on his priority list. Broadly based tax relief is something he seems determined to dribble out only marginally faster than bracket creep pushes personal tax bills back up. And corporate tax relief—despite the thorough work done by the Technical Committee on Business Taxation chaired by Jack Mintz—does not even appear to register on the federal radar screen.

Tax cuts alone cannot overcome all of the factors giving the United States a competitive advantage in attracting investment and jobs. But neither, as some people suggest, are broadly based tax cuts an assault on social programs or unfair to low- and middle-income Canadians. The tax gap does matter to all Canadians and not just to a few.

This too is cause for concern. Reform of corporate taxation cannot wait much longer. Just look at the stars once more—in this case, hockey stars. Canada has lost two of its National Hockey League teams already and the rest are lobbying hard for tax breaks. Canadian team owners say that, without fairer tax treatment, they will have no choice but to sell out to American buyers.

Canada's hockey teams have been able to mobilize a surprising degree of grassroots public support for their proposals. But if the future of the hockey business and all the jobs that flow from it depend on levelling the Canada-US tax rink, the same argument applies in many other industries whose success depends on the skills of their star players. The key difference between high-tech and hockey is that the former depends on intellectual rather than on physical skills, but in both cases the stars and their teams can play wherever they want—and are wanted.

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The latest federal budget pays lip service to tax cuts, but puts its money primarily into restoring old spending patterns. With the exception of its trickle of tax cuts and some of the money flowing into research, it does almost nothing to help Canada attract and retain the stars of the post-industrial age.

CONCLUSION

Canada must decide—and soon—whether it wishes to become little more than a base for the farm teams of the global knowledge economy, or whether it wants Canadians to be able to play in the big leagues without leaving home.

Whether on movie sets and hockey rinks or in research labs and head offices, global investments and well-paid work will flow primarily toward the pools of people with the skills companies need to succeed. And many of these highly skilled people will in turn seek their prosperity by following the stars.