

# Giving Mr. Paul a grade

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This special issue of *Canada Watch* analyzes and reviews the 1999 federal budget. Facetiously it is called "Giving Mr. Paul a Grade" by some of the leading economic think tanks in Canada.

Readers will not be astonished that the budget falls cleverly between two opposing camps—the pro-market, less-state, less-tax-oriented economists who take Mr. Paul to task for not imposing deep income tax cuts or cutting back social programs and the equity-minded, spend-the-social-dividend, bring-back-the-state economists who want to mend Canada's frayed social bond.

By definition, budgets are about compromise, nuance, details upon details, and incremental change. At least when the Liberals came to power this was the benchmark of good governance. And yet, in the first budget as well as the second and the third, the Martin Liberals demonstrated that budgets were powerful tools to change Canada's institutions and social programs not by "stealth" but by in-your-face cuts. Social spending and transfers to individuals were chopped by over 40 percent. Support for health, education, and welfare were the principal targets and spending in these areas dropped from \$18 billion in 1992-93 to less than \$12 billion in 1997-98.

Agreeing to spend over \$15 billion on rebuilding Canada's health system over the next three years might mark the beginning of the great U-turn. Unfortunately, nothing is quite that simple. Martin put a lot of money back into health care but little into the equally important areas of education and welfare programs. Worse still, Canada's UI system now covers only 45 percent of those who need it. So there is every reason to believe that Mr. Paul rates only a "definite maybe" as far as his social priorities are concerned. He is still wedded to the belief that efficiency and free trade are the policies of choice.

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## THE RETURN OF THE PUBLIC: SOME EMPIRICAL EVIDENCE

Yet the numbers do not tell the whole story. In this budget, the minister of finance chose to strengthen the non-market side of the economy and reject corporate Canada's agenda of cutting taxes in order to cut spending. Fifty-two percent of the fiscal surplus supported social cohesion measures, 38 percent went to debt reduction, and only 10 percent to reducing income taxes.

Compared with the social market economies of Western Europe, Ottawa is not a big spender today, nor was it 10 years ago. The truth is that across OECD members, state spending is up even in those countries where government spending is not large. The trend is toward bigger government, not statelessness, and this trend has been almost universal. In 1997, *The Economist* found that when one examines where governments are spending in industrial countries as a group, public spending fell only in one category—that of public investment—from an average of 3 percent of GDP to 2 percent. In contrast,

transfers to persons and businesses rose consistently, and spending on interest and debt doubled.

These numbers tell us that, in all jurisdictions, public services are a primary site of public culture. Income support benefits to the unemployed, the disabled, single parents and, most important, the elderly are the most important causes for state expansion. Services such as education, health, and social transfers as well as defence and law and order remain the work of government. Deficit and debt payment represent less than 5 percent of GDP of all government spending. It is very odd indeed that government spending has grown fastest when the pressure on the public authority from elites has been to cut rather than to spend.

When NAFTA was signed in 1994, Ottawa imposed the deepest cuts of any G7 country in the '90s—cutting spending from 51 to 42 percent of GDP. In contrast, when Washington tightened its belt, it cut spending hardly at all from 34.5 to 31.0 percent. It is no wonder that Canadians have found this difficult to swallow. Spending cutbacks have reduced the effectiveness of Canada's social security net, already weakened by Ottawa's rigid application of monetarist principles, but it is still more advanced than anything in the United States. Canada's commitment to a redistributive model of federalism remains the defining difference between the two countries.

The fact is that the smaller Canadian state is not converging to the US model even though Canadian social cohesion is under tremendous stress. Rather, it is a smaller version of what it was in the golden age of Keynesianism. Canada is a high spender compared with the United States but a low-end welfare state compared with the social market economies of Europe. Even with deep integration, Canada's public domain is smaller than it once was, but it is still larger and better

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resourced than its US counterpart. Total government taxes and other revenues in Canada reached about 43 percent of GDP, while the US figure has remained at 30 percent since the early 1970s.

Market-driven globalization has paradoxically created a larger state and also the need for a smarter one with more institutional capacity. As the global crisis has deepened and financial volatility increased, the Washington consensus model is in question and many of its former supporters have called for a re-examination of the framework. Its operative premise was that decentralized markets were highly efficient engines of growth and that the incentives of free market price signals could promote a virtuous cycle of individual, self-seeking behaviour that reflected the standards of neoclassical welfare economics. In a world of costless information, minimal transaction costs, and fully competitive markets, the price mechanism was alleged to reflect the true value to society of all the uses of its resources. From this perspective, all people have to do is follow the incentives that "full-price information signals provide."

### RETHINKING THE FUNDAMENTALS

This minimalist conception of economic management has been marked by too much waste, too many unreachable targets, too little long-term public investment, and, too often, the unproductive use of the state's resources. Mr.

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Paul has finally got the message. Without a strong regulatory role for government, market forces know few limits. The difficult issue that no amount of economic theorizing can adequately explain is why market signals malfunction and produce suboptimal results. Even when high-quality training and day care are indispensable to the optimal functioning of market forces, the private sector fails to respond and invest in these strategic goods. The record of decentralized market approaches in the area of social intervention has been, to state the obvious, a failure. Political systems are attractive, efficient, and indispensable when they can generate a consensus that social intervention is needed and markets can be organized in more effective ways when the state is present rather than absent.

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will support the Martin budget of a "definite maybe." They are increasingly resistant to the idea that tax cuts are the answer and the recent experience in Ontario has demonstrated that public opinion wants an end to the chaos in schools and hospitals.

Public opinion has sided with the argument that, in a globalized economy, there are few advantages to having a smaller state presence when all governments are having to confront a range of intractable distributional issues. The very idea of a strong public has moved from the edge of the envelope and is now a fundamental concern both for international organizations such as the World Bank and many national governments. Shifting priorities from cutting to spending initiatives calls for reinvesting in the social market side of the economy. Even in Anglo-Saxon economies, the state is back. And this time, anyway, Mr. Paul is not out of step. ♦

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The centrepiece of this year's budget was, of course, an \$11.5 billion reinvestment in health care transfers. However, despite headline multiyear numbers and a one-off distribution of last year's surplus funds, the cash floor of the annual CHST transfer increases by only \$2.5 billion, and the federal share of public spending on health rises insignificantly. While a welcome injection in the context of the immediate crisis, the

budget did not address the heart of the problem—the declining federal share of both public and total spending on health care. In contrast, the AFB, in line with the proposals of the Canadian Health Coalition, set a schedule to increase the federal share to 25 percent to re-establish the federal government as the guardian of medicare and a major player in the future evolution of a growing public system.

Beyond a tiny addition to the Canada child tax benefit, the budget did almost nothing to alleviate growing poverty and income insecurity. In contrast, the AFB re-established a separate transfer to the provinces for social assistance and social support services, with almost \$3 billion of new funding as the basis for setting national stand-

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