

# Where the "found" money went

You can say good-bye to restraint, as government spending is back in style. Paul Martin's "prudent" fiscal projections end up leaving plenty of room for a year-end spending splurge, while allowing the finance minister to claim poverty in terms of room to cut taxes for the upcoming year. The battle against deficits is over, with surpluses lying ahead for the next two years, and the debt-to-GDP ratio likely to fall sharply. But the other legacy of the previous two decades, an overbearing Canadian tax system, has yet to be addressed.

The hallmark of past budgets from this finance minister has been a deliberate understating of future revenues, and the 1999 exercise was no exception. In fiscal 1997-98, actual revenue growth came in almost five times higher than Ottawa's initial projection. The February 1999 budget admitted to an extra \$6 billion in federal coffers for 1998-99 than projected in the previous budget. Another \$2 billion or so will be "found" when the final numbers are tallied this fall, pushing last year's surplus to \$5.5 billion. And it's the same story for 1999-2000. The 1999 budget claimed that almost no revenue growth lies ahead for the next two years, thereby low-balling the likely outcome by some \$17 billion.

If the past year is a guide, much of the upside revenue "surprise" will be spent, rather than returned to taxpayers in rate reductions or used for more rapid debt retirement. When the tax money rolled in, Ottawa allowed a \$7.6 billion overrun in 1998-99 program spending that left expenditures a far cry from the tight-fisted plan the finance minister tabled a year ago. As with the 1998 budget's millennium scholarship program, future spending (this time on health care) was conveniently backdated into the past year's results so as to avoid pressures on accounting surpluses down the road. Look for a repeat performance in February 2000, with Ottawa announcing the creation of new funds to invest (the

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preferred term for spending these days) in whatever next year's top program priority happens to be. Surpluses will be capped in the \$5 billion range, because there is no public support, or pressing need, for more rapid debt reduction.

Certainly there was ample evidence that Canadians wanted their governments to restore earlier cuts to health care funding, and the federal government has delivered on its pledge to answer that call. But of the billions in spending doled out in the budget, less than half was for health care. Where was the public outcry for more dollars for the space agency, or for business subsidies? Offered under the guise of promoting Canadian competitiveness, these programs don't look much different from other initiatives that have left Canada still badly trailing the United States in productivity growth.

## **A RECESSION-PROOF SURPLUS**

Global economic troubles provided this year's excuse for sticking with cautious budgetary projections and limited tax

relief. But, in contrast to the steep deficit climb seen in the early 1990s, economic downturn, the coming year's federal surplus is virtually recession-proof.

The 1992-93 deficit explosion came as high interest rates hit both debt service charges and economic growth on which revenues are based. Today's recession threat, small as it is, would be from global deflation, not a central bank attack on inflation with high rates. Rates would be more likely to fall in the wake of a recession in North America this year. The sensitivity of program spending to cyclical downturns has also been chopped with a new, less-generous employment insurance system and the fixing of some formerly countercyclical transfers to the provinces. The result of these changes: a recession that took real GDP growth to -2 percent in 1999 would still see the federal government in surplus as a decline in interest rates offset some of the revenue losses.

Similarly, the surplus is well insulated from adverse interest rates shocks. The share of federal debt financed at floating rates has been cut by a third since 1990. As a result, each percentage point rise in interest rate adds only \$1.0 billion to the federal deficit, versus \$1.8 billion in 1995. Business cycle and financial market risks no longer stand up as justifications for extreme caution in fiscal planning.

## **NO PROGRESS ON TAX COMPETITIVENESS**

While the budget trumpeted tax relief, it in fact made little if any progress toward unwinding past tax hikes, or closing the chasm between the Canadian and US tax systems. 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.

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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.

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 set-

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tle 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. ♦

## Canada's future is in the stars

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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 Min-

ister 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-