The Fraser Institute's reaction to the 1999 federal budget

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One of the most regrettable features of the 1999-2000 federal budget is that the government missed an important opportunity to provide meaningful tax reductions and has instead sent the message to Canadians that the government knows how to spend taxpayers' money better than taxpayers themselves. In the context of what has been happening in the Canadian provinces and jurisdictions around the globe, this outlook is anachronistic.

TAXATION AND THE PRODUCTIVITY GAP

Although the budget does provide modest tax relief, the net implication is that "Tax Freedom Day" will come only about one day earlier for the average family. (Tax Freedom Day, calculated annually by the Fraser Institute, is the calendrical analogue of the average tax rate and is the day in the year when Canadians start working for themselves rather than to pay their tax bill.)

The failure to provide significant tax relief will make unattainable the goal of enhanced productivity, which the government may or may not have as an objective depending on whether we do or do not have lacklustre performance at the moment. The OECD, for its part, has recently documented Canada's lagging productivity and traced it, in part, to our higher tax rates.

Whether the OECD or the Finance Department is correct about the productivity issue, it is a cold, hard fact that, while Canada had the 8th lowest top income tax rates in 1990 (of OECD countries), in 1997 Canada was in 17th place as our overall tax rates rose while those in other countries fell. Relatively speaking we are taxed more heavily today than we were in 1990. That recognition in combination with the copious rhetoric emanating from Ottawa with regard to the damage done by high tax rates should have been good for some significant tax relief. Whatever the correct level of taxation might be, it is hard to find anybody these days who argues that Canada should be trying to increase its taxes relative to those prevailing elsewhere. But that is what has happened and continues to happen as the result of this budget.

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In terms of its impact, perhaps the most important omission in the budget was the failure of the finance ministers to produce a change in the capital gains arrangements. Capital gains taxes in Canada remain nearly double those in the United States. The implication is that the after-tax reward from creating a successful startup company in the increasingly important high-tech sectors dramatically favours a US location and US citizenship. As a recent conference at the Fraser Institute found, there is a significant drain of human capital into the United States—the very high capital gains taxes here do not help this situation.

Although Canada's payroll tax rates (CPP, EI, and workers' compensation) are low compared with other OECD countries, and Mr. Martin is at pains to point this out to anybody who will listen, the same is not the case for total taxes payable on labour income. The average effective tax rate on labour income in Canada is 29 percent while in the United States it is 23 percent including income tax and social security contributions. The voluminous literature on the impact of taxation suggests that taxes do distort decisions made by economic actors and it is highly unlikely that we escape significant impact on employment and labour supply as a consequence of this tax wedge.

An issue that should be of concern to us all, and certainly should have drawn the attention of the finance minister, is what has been happening to Canadian incomes.

The productivity gap has produced significant losses for Canadians' incomes. Income per person in the United States is $36,634, which is 30 percent above the Canadian level of $28,234. Over the last decade Canadian income per person grew by 7 percent while it grew 17 percent over the same period in the United States. If Canadian

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productivity had grown at the US rate since 1979, Canada's income per person would be $7,000 higher today.

In part, the reason for this lag is that the United States employs more of its population in productive effort and appears to do so with greater effectiveness. It is inconceivable that this outcome is not at least partially due to the different tax regimes that exist in the two countries.

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SPENDING AND THE CREDIBILITY GAP

The auditor general in the 1998 auditor general's report noted that, "Business firms cannot depart from objective accounting standards established by the Canadian Institute of Chartered Accountants, to hide losses or divide profits. Parliamentarians should expect no less from the government." The auditor general then refused to certify the government's accounts.

Unfortunately, this budget contains further accounting irregularities of the same kind that give the impression that the spending of the government is not increasing. The budget presents program spending as $108.8 billion in 1997-98 and $111.2 billion in 1999-2000. Making adjustments for deviations from standard accounting practice yields program spending of $106.3 billion in 1997-98 and $113.2 billion in 1999-2000. The government figures project a relatively "flat" profile while the other calculation demonstrates a two-year increase of 6.5 percent.

The source of this discrepancy is, as John Crosbie used to say, jiggery pokery. Expenditures that will be made in the future are "booked" during the base year to artificially boost current expenditures in that year while at the same time reducing expenditures in future years to make spending there seem lower than it really is. The quality of the budget document is significantly depreciated by this sort of cheap trick.

Most of the increased expenditure will go to the provinces as part of the new arrangements between the federal government and the provinces. Most of the increased provincial income is earmarked for health care spending. In fact, the budget was widely referred to as the health care budget. Unfortunately, the most predictable and likely outcome of the budget effort in this area is to create disappointment on the part of those Canadians who might have felt that this large national expenditure would actually make a difference to the sort of health care services that they receive.

For those of us who try to examine the impact of budget changes, there is nothing new about the strategy of throwing more money at the "health care problem." In fact, the various attempts of the provinces to deal with health care issues by increasing or decreasing the amount of funding, in conjunction with the Fraser Institute's annual survey of hospital waiting lists, enable us to estimate the likely impact of the increased federal funding on health care. The estimate is that the $3.5 billion increase in health care funding will, at best, reduce the median waiting time for surgery by about three days. The current median wait for surgery is 6.8 weeks. This reduction in waiting in most jurisdictions will simply go unnoticed.

THE MARKET ECONOMY AND THE IDEOLOGICAL GAP

One of the most astounding features of this year's budget was the unprovoked attack that the finance minister launched against the "free market." If Paul Martin is as conservative a finance minister as many on both the political right and left think he is, then why did he choose to disparage the free market economy during his February 16 budget speech?

As the cornerstone of democratic capitalism, an economic marketplace, according to Mr. Martin, is able to "do many things and . . . do them well. But, there are many things [that markets] cannot do."

Namely, "markets cannot provide quality health care to all of us when we are sick." Markets "cannot prevent the gap between rich and poor from becoming an unbridgeable gulf." And markets "cannot deal with the root causes of homelessness." After all, markets "do not . . . deal with the common good. Therefore, [the government] must."

The Fraser Institute now works with institutes in 53 countries to produce an index that measures the extent to which countries rely on markets to get things done. Many of these institutes are in countries like Russia and China, which are trying to expunge the sort of rhetoric in which Mr. Martin indulged. If they had heard the budget speech, they would have responded with gales of laughter because countries all over the world are converting to the market system because the facts are firmly on its side.

Let us consider health care. As the Fraser Institute's *Economic Freedom of the World* rankings—based on published data, not mere opinion—clearly reveal, infant mortality rates are lowest and life expectancies are longest in the world's most economically free, most marketized countries. In contrast, those countries whose economies are most riddled by government interference, ownership, and expropriation suffer from the worst health care statistics.

In the case of income inequality and poverty the facts are also inconvenient. Contrary to Mr. Martin's comments and to Prime Minister Jean Chrétien's recent utterances at the World Economic Forum in Switzerland (namely, that the gap between the rich and the poor is growing at an unacceptable rate), the good news is that poverty and inequality are less of a problem today than they've ever been.

For example, in 1951, one in every three Canadians lacked the income needed to afford the basic necessities of life, such as adequate food, clothing, and shelter. Today, after much privatization, the attempt to rely more on markets, and a firm resolve by most jurisdictions not to repeat the statist sins of the past, the number of truly needy Canadians has fallen dramatically to just one person in 25.

Neither the latest Statistics Canada data nor a recent C.D. Howe Institute study found any trend toward increasing income inequality in this country. It's true that the Canadian middle class is shrinking. But not because more Canadians are falling into poverty. Rather, in net terms, a significant number of formerly middle-class families are moving up the income ladder into the top tier.

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Homelessness has two root causes. The first is the so-called deinstitutionalization (that is, the compulsory release into the community) of mentally ill patients. This cruel policy was successfully promulgated by progressive health care and social workers whose collective social conscience was much larger than their collective common sense. It has produced a homeless population that is predominantly (if not entirely) composed of the mentally ill and the drug and/or alcohol addicted.

The second cause is government-imposed rent control legislation. The capping of private rents predictably reduced the available supply of affordable, low-cost housing throughout our major cities. For example, William Tucker's rigorous analysis of the American experience with homelessness demonstrated the existence of rent control as the factor influencing the size of a city's homeless population.

Mr. Martin is correct in arguing that markets don't explicitly deal with the "common good." Theoretically, in a free market, individual, private acts of exchange and cooperation take place within a competitive, non-coercive economic environment producing social outcomes far more efficient, prosperous, and equitable than any government-driven alternative. Therefore, the common good is implicitly realized, a theory whose implications have been felt by converts to capitalism the world over.

ECONOMIC FREEDOM— THE BASIC ISSUE

Overall, the 20th century has been an experiment in policy priorities. The experience of Canada and of countless other countries shows that if a country chooses equality of economic outcome over economic freedom or economic opportunity, it ends up with less of both. However, when a country chooses economic freedom over economic equality, the result is more of both.

Comparisons of Canada with the top 10 economically free countries in the world show clearly that Canada is primarily a market economy. However, just as clearly they show that Canada's tax regime and the extent of government spending is too high for us to realize our potential. In pandering in this budget to those within his party who want to see that their prospective leader has a heart of pure statist pedigree, Mr. Martin is giving up quite a lot. Just as the health care sector is sacrificed to aid Mr. Rock's bid, the standard of living that we all enjoy is lessened by Mr. Martin's bid.

The sadness that transcends the budget discussion is the fact that the constituents to whom both Mr. Martin and Mr. Rock appeal with their state-enhancing gambits will be distinctly worse off as a result. Such an outcome and its cause, rather than debate about whose estimates of productivity are correct, ought to be the central policy discussion as we enter the new millennium.