DE-FUNDING THE WELFARE STATE

BY NEIL BROOKS

Over the past fifteen years, business interests and conservative governments around the world have launched intense and sustained ideological and political assaults on big government. Yet modern welfare states have proved surprisingly resilient to such attacks. Although there are other explanations for the durability of social programs, one significant barrier to retrenchment has been the apparent fact that many citizens value the economic security, social equality, and community cohesion that government programs provide.

Perhaps frustrated by efforts to convince citizens of the evils of big government, the Ontario Conservative Government has now launched an unprecedented effort at systemic retrenchment. It plans to simply de-fund the welfare state. Even though billions of dollars of spending cuts will be required just to balance the provincial budget, and another $2.2 billion to offset reduced federal government transfers, the Ontario Government has promised a $5-billion tax cut.

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The Dominion Bond Rating Service has estimated that, with the provincial tax cut, the Ontario Government will have to reduce spending by almost $10 billion in order to achieve a balanced budget in 2000-01. If health care costs are excluded (and the Government has committed to maintain health care costs at their present levels), this is equivalent to a cut of about one-third across all other spending areas. This reduction in government-provided services is unprecedented.

Instead of debating the merits of the additional reduction in government services — and the moral, social, and economic consequences of a dramatic shift from the public to the private ordering processes for allocating services essential to human development — the Conservatives have proceeded with their effort to de-fund the welfare state by preaching the virtues of a tax cut. The arguments the government has made in support of tax cuts are patent nonsense. Nevertheless, since they were put forward — it would appear with a straight face — by a couple of commentators in the last issue of *Canada Watch*, it seems worthwhile reviewing briefly why they are either misleading, conceptually incoherent, without empirical support, or morally reprehensible.

MISLEADING ARGUMENTS

Ontarians are overtaxed.

The claim in support of the tax cuts is frequently phrased in terms of Ontarians having hit the tax wall. Taxes are the price that citizens pay for public goods and services. Therefore, as with prices for private goods and services, the only sensible question to ask about taxes is whether people are getting good value for their money. Nevertheless, in determining whether taxes are "too high," comparisons are commonly made with other jurisdictions. By this standard, in spite of the misleading impression given in the popular press, Canada is a low-tax country. In 1993, total revenues collected in Canada amounted to 35.6% of gross domestic product (GDP). This was more than 2 percent below the average for industrialized countries (38.7%), and almost 5 percent less than that for the European Community countries (40.5%). Indeed, if Canadian governments had only been collecting the same amount of tax revenue as the average European country from 1975 to 1993, all levels of government in Canada would have large surpluses, instead of a debt.

Taxes have been increasing faster in Ontario than in other jurisdictions.

The Ontario Government made this assertion in its 1995 Fiscal and Economic Statement. However, whether taxes in Ontario or Canada have been increasing faster than in other jurisdictions depends upon over what period the increase is measured. For example, between 1979 and 1993 taxes in Canada as a percentage of the GDP increased almost 5 percent, while in the average industrialized country the increase was only 4.4 percent. However, what makes this comparison misleading is that, because of the large tax reductions in the late 1970s by the federal liberal government (which started the debt ball rolling), taxes were lower in Canada in 1979 than at any time over the previous 25 years.

If another baseline is chosen, say 1974, then taxes in Canada increased by only 2.3 percent to 1993, almost the smallest increase among industrialized countries (in the average industrialized country they increased by 6.8 percent over this period). Moreover, the OECD has estimated that taxes in Canada in 1994 were only 32.1% of GDP, 1.2 percent less than they were in 1974; no evidence here that Ontarians are overtaxed.

In 1993, taxes paid in Ontario, as a percentage of the provincial GDP, were 0.7 percent above the average of all provinces and territories. Taxes paid in Ontario have always been slightly higher than the national average as a percentage of the provincial GDP, but this was the narrowest margin in the previous 30 years. Moreover, taxes collected by provincial governments alone as a percentage of provincial GDP have always been below the national average in Ontario. Indeed, in 1993, taxes levied by the provincial government in Ontario were 1.5 percent below the national average, lower in relative terms than they had been in 35 years.

By comparison to the United States, taxes are high in Ontario and Canada.

By international standards, the United States is a low-tax country. In most years, taxes collected by governments there amount to only about 30% of the GDP. But this comparison is misleading because a much larger percentage of health and education costs are paid for in the form of prices in the United States than in Canada. If the additional amounts that Americans pay for these services in the form of prices are added to their taxes, then Americans actually pay more than Canadians for what might be described as public goods. And the fact that Americans pay about 4 percent more of their GDP for health care than do Canadians suggests not only that they cannot distribute these services more equitably through the private sector, but that they cannot do it nearly as efficiently as the Canadian public sector.

INCOHERENT ARGUMENTS

The present level of taxes cannot be afforded.

This common refrain used to justify tax cuts is conceptually incoherent. Most public goods provided by government and financed by taxes, such as health and education services, are necessities. Therefore, reducing the government supply of these services will not mean that people are no longer paying for them; it will simply mean that instead of paying for them through taxes and having them provided by the public sector, they will be paying for them in the form of prices and have them provided through the private sector.

Similarly, when the government says that we cannot afford public child and elderly care services, presumably they are not saying that we can no longer afford to look after our children or the elderly. What they must mean is that, instead of spreading the cost of these services equitably through the tax system across the entire population, we should leave them to be borne by women who, by and large, provide these services unpaid in their own homes. Thus this misconceptualization of the reasons for not providing these services through the public sector obscures a rather vicious moral judgement.

Reducing taxes will increase personal choice.

The Conservatives frequently justify their proposed tax cut by arguing that allowing people to keep more of their earned income will increase their personal choice and freedom. The most fundamental flaw underlying this argument is that it assumes people only have preferences as individual consumers of private goods and services. But people have preferences not only as consumers but also as citizens — preferences about the kind of society they want to live in. Many people do not want to live in cities, for example, that force vulnerable people to sleep on the streets and beg, or that are polluted and congested with cars, devoid of libraries and other public facilities, or in which they are unable to walk the streets at night because of the fear of crime. As citizens, people also have preferences about engaging in democratic deliberation, reducing their dependency on the marketplace, families, and charity, and enriching the density and quality of the network of human relations in society. The only way they can pursue these preferences is collectively through governments by paying taxes. The Conservatives' notion about what choices are important to people reflects an utterly impoverished view of what it means to be a human being.

Moreover, in another obvious way, taxes in fact greatly increase the amount of freedom in a society. In a market economy, to have money is to have freedom. Canadian governments transfer over 60 percent of the taxes they receive to families in need in the form of pensions, child credits, social assistance, compensation for work-related injuries, and so on. Thus, while it might be said that taxes restrict the freedom of those who pay them, they greatly enlarge the freedom of those who receive the consequent transfer payment — undoubtedly with a huge net overall increase in liberty.

Taxes are an unjustified interference with private property.

Conservatives sometimes talk about tax cuts as if their effect would be to allow citizens to keep more of the earnings to which they have a moral claim, since they earned them in the marketplace. They seem to suggest that the distribution of income that results from the application of the rules of contract and property law should be treated as presumptively just. Yet the rules which regulate the marketplace are every bit as politically and socially constructed as tax rules. Therefore, it is difficult to discern why their distributive consequences should be treated as entitlements.

FACTUALLY INCORRECT ARGUMENTS

Tax cuts are necessary to create jobs.

Whenever questioned about their tax cut, the Conservatives routinely repeat their mantra about it being necessary in order to create jobs. They have even claimed that by the fifth year, the cut will have created 780,000 jobs, although no one knows the origin of this number and they admit there are no studies to support it.

> *Tax cuts of almost any size are dwarfed by the economy's massive and continually changing face-lifts.*

The argument that tax cuts will create jobs is straightforward Keynesian economics. If taxes are cut, people will have more disposable income. With more disposable income, people will buy more and that, in turn, will put people to work producing, distributing, and selling goods and services. And since more people will be at work and earning more, there will be a multiplier effect as they, in turn, use their own income to purchase even more goods and services.

Even in their traditional Keynesian form, most tax cuts have been found wanting as policy instruments to create jobs. First, the amount of stimulus required to give a large economy like Ontario's a boost is enormous. Even if the government cuts taxes by \$4 to \$5 billion, by 1998 personal income in Ontario is likely to be \$300 billion. The tax cut would thus increase disposable income by only about 1.5%. While not insignificant, this increase is substantially less than the normal rate of increase in personal income due simply to economic growth. Moreover, the stock market can rise or fall by this amount within a day and, over longer periods of time, the real estate market can affects people's wealth even more dramatically. Tax cuts of almost any size are dwarfed by the economy's massive and continually changing face-lifts.

Second, particularly in these relatively insecure economic times, it is not clear that most of the tax cut would in fact be spent. Much is likely to be saved or used to pay down debts. To the extent that the tax cut is saved, it cannot have the effect of creating demand for goods and services and, therefore, jobs.

Third, most economists are sceptical of the ability of provincial governments to pursue macroeconomic policy to create consumer demand in their economies. There are two reasons for this scepticism. One is that provincial economies are so open to trade and investment that much of the increased disposable income will be spent on goods and services produced outside the province. That is, in economic terms, there are too many leakages making it unlikely that increased disposable income will increase demand in the province. The second reason for scepticism is that provinces have no control over monetary policy. Thus, to the extent that the tax cut works to stimulate the economy, the federal government might simply negate it through tight monetary policy.

Fourth, if the government truly believed a tax cut could increase disposable income and therefore jobs, the income tax would be the last tax to cut. Most economists agree that, if you want to increase spending activity, you should cut taxes that fall on low- and middle-income families (who

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consume most of their income), and preferably taxes that are tied to people's actual spending behaviour. Thus reductions in sales taxes would be much more effective at stimulating the provincial economy than cuts in income taxes.

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But all of this standard economic analysis is irrelevant to the Ontario tax cut because it is not, nor was it intended to be, a countercyclical stimulus. This is because the government is cutting taxes at the same time as it is cutting expenditures. Thus, while the tax cut might result in the creation of some jobs, the reduction in government expenditures will result in a loss of jobs. If tax cuts had the same impact on employment in the economy as expenditure cuts, the net effect would be a wash. Disposable income would go up because of the tax cuts, but would go down because of the expenditure cuts. However, it will not be a wash. The evidence is that, for example, a $1 billion tax cut would create considerably fewer jobs than would be lost by a $1 billion government expenditure cut. This only makes sense since expenditure cuts result directly in the loss of jobs. Some economists even predict that equivalent expenditure cuts would result in the loss of 3 to 4 times as many jobs as tax cuts would create.

Tax cuts are necessary to encourage economic growth.
The other distinct economic argument the government has made for the tax cut is that it is necessary in order to ensure long-term economic growth. They have suggested that high taxes, particularly those on the rich, have dangerously diminished their desire to work, fatally discouraged their incentive to save, and impaired new sources of investment. This is the familiar trickle-down or supply-side theory of economics.

No one believes this argument, and the only people who assert it are the rich and their political allies. Countless studies have been done on the effect of taxes on labour supply and saving behaviour but, in spite of economists' desire to find such an effect, no significant effect has been found.

In its 1995 Fiscal and Economic Statement, the Conservative Government stated, "When tax levels are high, a tax reduction can permanently increase the growth rate of GDP by changing investment incentives" (at 88). They "proved" this claim with the aid of a graph on which they had plotted taxation and economic growth rates in a number of industrialized countries, and which purported to show that lower taxes lead to higher rates of economic growth. This graph was at first a bit of a mystery to me because most studies find just the opposite, namely, that countries with high taxes have tended to have higher rates of economic growth. Two aspects of the graph are misleading. One is that it included Japan, which indeed is a low-tax country with a high rate of economic growth. Most analysts, however, exclude Japan when they do such cross-national studies, since it is not only an outlier on the graph, but its economy is also very different than that of most other countries. In particular, many of the elements of economic security — such as a degree of employment security — that are provided in other countries by governments, have been provided in Japan by large corporations. In fact, when you take Japan off the government's graph, the opposite result — showing a correlation between higher taxes and higher rates of economic growth — is reached.

A second misleading aspect of the graph is that the drafters used the average rate of taxation from 1960 to 1990 and compared that to the average rate of economic growth in the listed countries. Yet over that 30-year period taxes and growth rates varied dramatically in many countries. It would make more sense to examine the increase in taxes over, say, a ten-year period, and compare that with economic growth over the next ten-year period. When you do that, for almost any period, you discover a correlation between high taxes and economic growth.

If the Conservatives were really interested in long-term economic growth, they would be investing in exactly what they are tearing down, infrastructure and human capital, poor children in particular.

MORALLY REPREHENSIBLE ARGUMENTS

Tax cuts are necessary to revitalize civil society.
The Conservatives have suggested that cutting back taxes and reducing government services would revitalize family life and the voluntary sector, and that these institutions would provide the services now provided for by government and paid for by taxes. This is a morally reprehensible argument. Suggesting that the vulnerable should rely more upon their family members for assistance even appears inconsistent with the most basic premise of traditional conservative philosophy, namely, that people ought to be responsible for their own actions. It is one thing to say that parents should assume more responsibility for their children, but surely the moral case for victimizing their children if they do not is less clear.

The voluntary sector is equally inadequate to provide for those who have been harmed by the dynamism of the market economy: it invariably satisfies only particularized impulses, it is unaccountable to its beneficiaries, it is unprofessional, and it is woefully incapable of filling the gaps left by government programs.

We all benefit from the operation of a free market economy. Since we all benefit from the system, we have a moral obligation to compensate those who necessarily sustain losses, such as those who lose their jobs and are unable to find work because of the inevitable workings of a dynamic market economy. This moral obligation cannot be satisfied by insisting that vulnerable citizens should have to rely upon their families or other people's altruism.

The arguments that the Conservatives have made to justify their 30-percent tax cut are so patently absurd that their real agenda must be apparent to everyone: to shift power from ordinary Ontarians, where it can been exercised through democratically controlled public institutions, to wealthy business people where it will be exercised exclusively through private markets.

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