JUNE 1999 • VOLUME 7 • NUMBER 3

Canada Watch

PRACTICAL AND AUTHORITATIVE ANALYSIS OF KEY NATIONAL ISSUES

A new cycle of investment begins

BY JUDITH MAXWELL

Judith Maxwell is president of Canadian Policy Research Networks, a non-profit think tank based in Ottawa, whose goal is to help make Canada a more just, prosperous, and caring society. You can visit CPRN at www.cprn.org.

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

A new cycle of investment, page 46

Canada's future is in the stars

BY DAVID STEWART-PATTERSON

David Stewart-Patterson is senior vice-president, policy and communications, with the Business Council on National Issues.

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-

Canada's future is in the stars, page 56

FEATURES

UNIVERSITÉ YORK UNIVERSITY

Canada Watch is a publication of the York University Centre for Public Law and Public Policy and the Robarts Centre for Canadian Studies of York University

A new cycle of investment continued from page 45

federal government at first, but in later times the provinces—adopted an unprecedented proactive approach to both economic and social policies. After the hardships of the Depression and the successful mobilization for the war, there were two challenges. One was to send soldiers and war industry workers "back to civil life." This amounted to one-third of the work force. The second challenge was to avoid another economic slump.

Building on the emerging consensus about Keynesian economic policies, governments took more responsibility for supporting economic growth and redistributing income. Over a 25-year period, the federal government reduced taxes, paid down its debt, and constructed a fairly comprehensive social safety net (pensions, medicare, some social services, and more generous unemployment insurance, for example).

No wonder we look back on this period as a golden era. Economic and social goals were more or less in harmony. Economic progress made it possible to invest in greater security for the lives of Canadians. Economic growth was strong, unemployment and inflation were low, and living standards increased considerably. It is no wonder that Canadians were hopeful and optimistic in those days.

The gears of economic growth, however, began to grind more slowly in the early 1970s. The oil shock provoked a period of higher unemployment and inflation (stagflation), budget deficits began to mount, and productivity slowed down. For a while, the pendulum in public policy paused. Then, when the 1981-82 recession hit hard and the federal deficit and unemployment rates went through the ceiling, a new era began.

THE STATE IN RETREAT

The notion of fine-tuning the economy was replaced by a much more market-oriented philosophy, and a more restricted role for the state. The era of spending cuts, deregulation, and the targeting of social programs began.

Now, finally, Canada is poised on the threshold of a new era in the balancing of risk between citizen and state. The fiscal crisis is largely behind us, and we have the luxury of planning ahead.

At the same time, the changing economic environment started to produce greater inequality. Employment began to polarize into good jobs and bad jobs. Wages for younger workers fell drastically in real terms. And we learned only recently that poverty became more concentrated in inner cities during the 1980s—mirroring the trend in American cities in earlier decades.

In the 1980s, policy advisers were bewildered by the rapid increases in welfare case loads and struggled to understand the "cost drivers" that were making longstanding social programs so expensive. Their policy changes primarily focused on cutting back on eligibility in order to control costs.

Meanwhile, the world economy was also changing fast. More open trading arrangements, including the Canada-US free trade agreement and NAFTA, increased import competition and cre-

A new cycle of investment, page 54

CanadaWatch

PRACTICAL AND AUTHORITATIVE ANALYSIS OF KEY NATIONAL ISSUES

EDITORS-IN-CHIEF

Daniel Drache, *Robarts Centre for Canadian Studies, York University*

Patrick Monahan, *Osgoode Hall Law School, York University*

MANAGING EDITORS

Cheryl Dobinson

Joanne Rappaport

COLUMNISTS THIS ISSUE

Judith Maxwell

David Stewart-Patterson

Daniel Drache

Andrew Jackson

John Loxley

Avery Shenfeld

Ken Battle, Sherri Torjman, and Michael Mendelson

Patrick Basham, Jason Clemens, Joel Emes, and Michael Walker

Andrew Sharpe

William Robson

PRODUCTION

WordsWorth Communications

CONTACT FOR INFORMATION

Canada Watch

227 York Lanes, 4700 Keele St.

North York, Ontario M3J 1P3

Phone (416) 736-5499

Fax (416) 650-4321

www.robarts.yorku.ca

ANNUAL SUBSCRIPTION RATES (6 ISSUES PER YEAR)

Institutions: $75

Individuals: $35

Students: $20

(Outside Canada, add $10)

Canada Watch is produced jointly by the York University Centre for Public Law and Public Policy, and the Robarts Centre for Canadian Studies of York University.

Printed in Canada

ISSN 1191-7733

Giving Mr. Paul a grade

BY DANIEL DRACHE

Daniel Drache is the director of the Robarts Centre for Canadian Studies and a professor of political economy at York University.

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.

Mr. Paul has finally got the message. Without a strong regulatory role for government, market forces know few limits.

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

Giving Mr. Paul a grade, page 50

Mr. Martin's budget versus the alternative federal budget

BY ANDREW JACKSON

Andrew Jackson is a senior economist with the Canadian Labour Congress.

WHAT IS A GOOD BUDGET?

A budget can be assessed on the basis of four broad criteria: the appropriateness of fiscal policy to the immediate economic circumstances; the contribution it makes to the longer-term growth of living standards; the impact on the social wage; and its effects on the efficiency and fairness of the tax system. Mr. Martin's 1999 budget can, from a progressive perspective, be judged to be very modestly positive, which makes it something of an exception to the dismal budgets of the past 20-odd years, which have been almost uniformly contradictory, and have cut deeply into both needed public investment and the social wage. However, the budget was "prudent" to a fault, and would have been much better if the minister of finance had more closely heeded the recommendations of the Canadian Centre for Policy Alternatives/Choices Alternative Federal Budget.

THE BUDGET AND MACROECONOMICS POLICY

Based on private sector forecasts, the budget anticipates real economic growth of just 2.0 percent in 1999 and 2.5 percent in 2000. This slowing of growth from 4 percent in 1997 and 3 percent in 1998 implies that the national unemployment rate will remain at or near 8 percent, the currently very high level of employment in precarious jobs will continue, and real wages will remain all but flat. Although partly insulated by the continuation of strong US growth and the recent depreciation of the dollar, the Canadian economy is clearly being affected by the still serious and deepening global economic crisis.

The government's basic response to changed international circumstances has been to "batten down the hatches" —that is, to loudly proclaim its commitment to rapid reduction of the debt as a share of GDP, to low inflation, and to "sound finance" generally in order to win the approval of "the markets." The budget aims to generate a large surplus in 1999-2000, the explicit $3 billion contingency reserve, plus a hidden surplus of some $6 billion, which will come from excessively pessimistic economic and revenue growth assumptions. Even on the basis of the forecast balanced budget, the debt is predicted to fall from 65.3 percent of GDP in 1998-99 to 63.7 percent of GDP in 1999-2000.

> **His heart may be with "knowledge economy" public investment initiatives, but the budget speech also noted that tax cuts should be part of a productivity agenda, and the dollars went to tax cuts.**

Recent budgets have greatly slowed growth and job creation by running very large operating surpluses (revenues minus program spending) of about 5 percent of GDP. Mr. Martin did slightly reduce fiscal drag in this budget, mainly by allocating the 1998-99 surplus to last-minute spending initiatives, and by very modestly reducing taxes in 1999-2000. Program spending for 1998-99 will be 12.6 percent of GDP—0.9 percent of GDP higher than forecast in the 1998 budget, even though federal revenues as a share of GDP will likely come in "just" 0.7 percent of GDP higher than forecast last year. Program spending in the coming fiscal year will be 0.5 percent of GDP higher than forecast last year, and may come in higher still if Mr. Martin again decides to spend his hidden surplus at year-end rather than apply it to debt. Overall, the budget is very mildly stimulative in macroeconomic terms. At least it did not make things worse, and it is notable that the tiny recovery in program spending is the first that has taken place in a non-recession budget since the mid-1970s.

In contrast, the 1999 alternate federal budget (AFB) would have boosted federal program spending in 1999-2000 by an additional $15 billion or about 1.7 percent of GDP compared with the actual budget, while leaving federal revenues unchanged as a share of GDP. (This is, in fact, an overstatement of the difference, since the actual budget shifted a major chunk of this year's program spending back into the last fiscal year.) Analysis by Informetrica Ltd. confirmed that the AFB would boost economic growth to 4 percent this year and to 3.5 percent next year. Because of faster growth and its impact on revenues, the budget would still remain in balance, and debt would fall even more rapidly. Most important, the stimulus to growth would have brought the national unemployment rate below 7 percent in 1999, and below 6 percent in 2000.

The core difference between the actual budget and the AFB in macroeconomic terms was that the AFB devoted the entire surplus to an immediate increase in program spending, plus the amount expected to arise as a dividend from the spending stimulus, while the actual budget runs a large hidden surplus of some $9 billion. The cost of excessive "prudence" will be felt in terms of much slower growth and higher unemployment.

THE BUDGET AND LONGER-TERM LIVING STANDARDS

As in previous Liberal budgets, the 1999 budget spoke to the importance of establishing a framework to promote longer-term economic growth through higher productivity. Aside from getting the macroeconomic fundamentals right, Mr. Martin stressed the importance of public investment in knowledge, skills, and innovation, further developing a major theme of the famous 1993 Liberal red book. His heart may be with "knowledge economy" public investment initiatives, but the budget speech also noted that tax cuts should be part of a productivity agenda, and the dollars went to tax cuts. The budget allocated very modest additional amounts to "creating, disseminating and commercializing knowledge"—$116 million in 1998-99, $198 million in 1999-2000, and somewhat more over the next two years—but it extended no new support for post-secondary education or training.

In recent months, the right has crusaded for tax cuts as the elixir that will deliver higher productivity growth, even though there is little evidence to indicate a connection. True, the low-tax United States has achieved higher productivity growth than Canada in the 1990s, but US productivity growth has generally been unimpressive compared with high-tax continental Europe. (The fastest rate of labour productivity growth in manufacturing among OECD countries in the 1990s was in the highest-tax jurisdiction, Sweden.) A recent survey of the literature on the respective contributions of public investment and tax cuts to long-term economic growth, by IMF staff economist Phil Gerson, found that well-targeted public investments are more growth enhancing than tax cuts. There are solid grounds to believe that this should be particularly the case in Canada, where the corporate sector has tended to underinvest in knowledge and in skills compared with the United States.

In recent months, the right has crusaded for tax cuts as the elixir that will deliver higher productivity growth, even though there is little evidence to indicate a connection. True, the low-tax United States has achieved higher productivity growth than Canada in the 1990s, but US productivity growth has generally been unimpressive compared with high-tax continental Europe.

Going beyond macroeconomic stimulus to more structural, growth-oriented policies, the AFB proposed to boost federal spending in 1999-2000 on post-secondary education ($1.5 billion); basic public infrastructure ($1 billion); research programs across the federal government; and training. The AFB also proposed a training tax on employers, sector-based training councils, and a national capital investment fund—an arm's-length public investment bank financed through small compulsory deposits from financial institutions and mandated to extend loan and equity investments in support of community, sectoral, and regional development initiatives.

The key point is that the federal budget spoke at some length to the importance of public investment in building a knowledge-based economy but did very little that could reasonably be expected to have a major impact on long-term prospects for economic growth and diversification. Nor did it do anything of significance to make economic growth environmentally sustainable. The AFB, again in sharp contrast, established a $1 billion Canadian atmospheric fund, financed from a "green tax" program, to undertake necessary transition investments in areas such as building and equipment retrofits for greater energy efficiency.

THE BUDGET AND THE SOCIAL WAGE

In his previous budgets, Mr. Martin cut federal program spending by almost one-third as a share of the economy, from 16.6 percent of GDP in 1993-94, to 12.6 percent last year. Deep spending cuts eliminated the deficit to a much greater extent than either growth or tax increases, and the burden fell heavily on the social wage through cuts in transfers to the provinces for health and social assistance, and cuts to UI benefits. In the process, the federal government virtually abdicated its role as a major actor in terms of social policy and, indeed, the introduction of a single cash transfer to the provinces—the Canada health and social transfer (CHST)—signalled precisely that intent.

Mr. Martin's budget, page 50

Giving Mr. Paul a grade continued from page 47

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 reexamination 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. 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 misfunction 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.

Ottawa's surplus is likely to grow and, therefore, Mr. Paul is going to have to put more money and resources into the social side of the economy. Voters will support the Martin budget of a "definite maybe."

Ottawa's surplus is likely to grow and, therefore, Mr. Paul is going to have to put more money and resources into the social side of the economy. Voters 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.

Mr. Martin's budget continued from page 49

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-

Mr. Martin's budget, page 67

The great money trick: The 1999-2000 Liberal budget versus the alternative federal budget

BY JOHN LOXLEY

John Loxley is a professor in the Department of Economics at the University of Manitoba.

INTRODUCTION

The 1999-2000 budget continues the tradition of previous budgets brought down by Paul Martin in understating revenues, exaggerating likely expenditures, and using bookkeeping sleight of hand to make it slippery and difficult to comprehend. Although it has been proclaimed as a "health care budget," it could more accurately be described as a "debt reduction budget" since, by the end of the year and contrary to the government's fiscal plan, there will once again be a large budget surplus. If this is not spent in some fashion currently not budgeted for, it will, by default, automatically be used to pay down outstanding debt. When compared with the alternative federal budget (AFB), the Liberal budget has clearly missed a golden opportunity to make a significant dent in the country's poverty and to rebuild important social programs. In doing so it has also passed up the opportunity to assert the more forward-looking version of the social union to be found in the AFB, thus continuing the drift to decentralization and provincial anarchy in the provision of social services.

THE FISCAL PLANS

Table one summarizes the fiscal plans of the Martin budget and the AFB. It is apparent from this table that the government's 1998-99 budget year will yield a surplus of at least $3 billion on account of the contingency provision and this will be used to pay down existing debt. In the AFB, this "surplus" would have been used to finance the outstanding pay equity grievance of public sector workers. As it is, pay equity will remain an outstanding claim on government money and can, therefore, be considered a debt.

The government has pandered to the anti-tax lobby. . . . The main beneficiaries of these tax breaks are middle- and higher-income groups.

The second point to note about the year just ending is that the government balances its books only by running a large surplus on the UI (it calls it employment insurance (EI)) fund. Were the government not taking in more than it pays out in benefits to the unemployed, there would be a budget deficit.

For the coming year, the government is planning a balanced budget but again, after making a contingency provision of $3 billion. It is, once more, the UI fund that is making a budget balance possible—the projected surplus being $4.9 billion. There are, however, strong reasons to believe that, at the end of the year 2000, the government will be running a surplus well in excess of the $3 billion contingency. To begin with, non-UI revenues are projected to increase by only $1.1 billion or by only 0.8 percent and UI revenues are projected to fall by the full amount of the recent premium reduction. But current-price GDP is expected to grow by 3.0 percent during the fiscal year and since the government itself claims that, for every percentage point increase in current-price GDP, federal revenues grow by $1.4 billion, then revenues appear to be understated by at least $3.1 billion ($3 \times \$1.4b - \$1.1b$).

On the spending side, the increase in UI benefits is highly unlikely while, as we shall see, program spending appears to be "padded" in some areas. Debt servicing charges suggest an increase in average borrowing costs from 7.10 percent in 1998-99 to 7.36 percent in the coming year (adjusting outstanding debt for only the $3 billion contingency surplus in 1999); but who is expecting interest rates to rise?

For these reasons, the 1999-2000 budget could end up in a surplus position to the tune of some $8 billion, all of which would be applied to debt reduction, unless the government once again indulges in the kind of creative end-of-year spending adjustments that gave us the millennium fund in 1998 and the Canada health and social transfer (CHST) supplement last year.

The fiscal plan of the AFB is much more straightforward. The budget is balanced but so is the UI fund, which is, for the first time, separated out and run as an independent fund. UI benefits are increased by raising coverage rates of the unemployed from their catastrophically low current levels, of around 30 percent, to 70 percent. Average benefit rates would be increased from less than 55 to 60 percent and clawbacks and

The great money trick, page 52

The great money trick continued from page 51

penalties for so-called repeat users would be abolished. Additional moneys would also be invested in training and in enriching maternity leave provisions. The AFB demonstrates that the call for a separate fund and for benefit enrichment by the trade union movement is one that can, indeed, be financed.

Second, the AFB forecasts much larger revenue growth than does the federal government, mainly because it funds a much higher level of both UI and program spending than does the federal government. This has the effect of raising employment and GDP and, in the process, government tax revenues. Unemployment would fall to less than 6 percent by the year 2000 (compared with more than 8 percent on government assumptions) and current-price GDP would grow by 5.8 percent in 1999 (compared with the 3 percent anticipated by government). Unlike the federal government, the AFB would spend the otherwise anticipated "surpluses." It would, however, keep the share of government revenue in GDP constant at about 15.5 percent.

Finally, the AFB would spend less on debt servicing because it would require the Bank of Canada to purchase 2 percent of the outstanding debt each year for 10 years. The interest earnings on these holdings would, in effect, be zero to the government.

Since there would be no debt reduction under the AFB, the share of debt in GDP would fall as the economy grew and would dip below 60 percent in the year 2000.

PROGRAM SPENDING

As in previous years, the AFB protects vital social programs in a series of social investment funds, each with its own funding formula and each with its own national standards (with provision for Quebec to negotiate separate arrangements). The main emphasis in this year's budget is expansion of the health care budget, by an additional $2 billion in federal transfers, another $2 billion for a national home care and community health program, and $0.5 billion for a national pharmacare program. In year two, transfers would rise by a *further* $4 billion. In contrast, the federal government has offered an additional $2 billion in transfers in the coming year, to a level that will be maintained in the following year, three-quarters of the cost being funded out of surpluses in the 1998-99 budget. This is a welcomed increase and shows the power of national protest and organization but it is insufficient to offset real cuts in health transfers in recent years and does nothing for health care restructuring or pharmacare. Neither is any additional money put into the CHST to offset past cuts to post-secondary education or to income support. Both of these are provided for in the AFB and, in the post-secondary education fund, provision is also made for the gradual replacement of student loans with grants.

Improving health is the watchword of this year's AFB with "health" being defined broadly. In particular, it is acknowledged that the biggest single determinant of health is income status. The AFB presents a package of spending increases and tax cuts for the poor that total some $20 billion. On the spending side (table 2), income support is increased by $2.9 billion, the national drug plan by $0.5 billion, the child care investment fund by $0.5 billion, UI benefits by some $6.0 billion, housing spending by $0.7 billion, retirement benefits by $1 billion, and youth employment creation by $0.4 billion.

Together with the growth in jobs mentioned above and the reductions in taxation on low-income earners outlined below, these measures would have the effect of reducing poverty in Canada from 20 to 14 percent over four years and cutting child poverty by more than 50 percent!

The AFB also makes provision for increased spending on services to First Nations people and people with disabilities, on regional and community development, the environment, and culture. The federal budget, on the other hand,

Table 1 Martin's 1999-2000 budget compared with the AFB fiscal plan

	Projected 1998-1999	Martin 1999-2000	AFB 1999-2000
		$ billion	
General revenue fund (excluding UI)			
Revenue	137.3	138.4	147.7
Spending			
Program spending	100.0	97.8	107.1
Debt service	41.4	42.5	40.6
Contingency	3.0	3.0	—
Total spending	144.4	143.3	147.7
Balance	−7.1	−4.9	0.0
Unemployment insurance fund			
Revenue	19.2	18.3	19.5
Benefits and other payments	12.1	13.4	19.5
Balance	7.1	4.9	0.0
Consolidated budget balance			
Revenue	156.5	156.7	167.2
Expenditure	156.5	156.7	167.2
Balance	0.0	0.0	0.0

Sources: Department of Finance, 1999, and Canadian Centre for Policy Alternatives/Choices, 1999.

contains no new major spending initiatives outside of health, though it provides funding for some new programs announced in earlier years for research, aboriginal services, and fisheries adjustment. The defence budget also increases by $0.4 billion. The category "General government services and other" in table 2 looks very high, suggesting once more that expenditure plans are being exaggerated.

TAXATION MEASURES

Nowhere is the contrast between the Liberal budget and the AFB more stark than on the tax policy front. The government has pandered to the anti-tax lobby by abolishing the surtax on those earning in excess of $50,000 a year, by increasing basic deductions for all taxpayers by $675, and by extending the child tax credit to middle-income Canadians. The main beneficiaries of these tax breaks are middle- and higher-income groups. The government feels that it made its gesture to the poor in 1998 when it abolished the 3 percent surtax on those earning less than $50,000 a year and increased the basic exemption for low-income earners by $500 a year. The cost of the 1999 tax breaks will be $1.5 billion in the coming year.

In comparison, the AFB recommended shifting no less than $8 billion a year to low-income earners by raising the GST credits for adults and children. This would be funded by *increasing* the taxes on wealthy Canadians through a wealth transfer tax on estates exceeding $1 million, by imposing two new income tax brackets on those earning in excess of $100,000, by closing a series of corporate tax loopholes, and by stepping up collection of outstanding taxes.

Though the AFB recommendations were tax neutral, in that there would be no increase in the share of GDP being raised by taxes, they would clearly have had dramatic effects on the after-tax income of low- and middle-income earners.

While the business community and right-wing think tanks have assailed the government for failing to cut taxes further, the social movements behind the AFB see no merit in across-the-board tax cuts and feel that putting money back into strengthening social programs has to be the top priority for the use of "surplus" funds. Tax cuts for the poor must, therefore, be funded by tax increases for the wealthy.

CONCLUSION

The AFB incorporates the measured demands of social movements across the country and has, in that respect, become the fiscal mouthpiece of the left. While it would be easy to dismiss the exercise as one of wishful thinking, a strong case can be made for its having

The great money trick, page 54

Table 2 Martin's 1999-2000 budget compared with the AFB program spending

	Martin 1999-2000	AFB 1999-2000
	$ million	
National social investment funds		
1. Health care fund	9,761	12,130
2. Post-secondary education fund	3,108	4,000
3. Income support fund	4,325	7,200
4. Child care fund	350	850
5. Retirement income fund	23,500	24,666
6. Housing fund	1,889	2,263
Subtotal	42,933	51,109
Equity participation foundation	–	200
Veterans pensions	1,970	1,840
Equalization	9,288	8,600
Transfers to territories	1,299	1,232
VRDP-disabilities	195	225
First Nations	4,334	5,000
Common security	12,085	12,808
Agriculture	1,976	2,200
Industry (inc. infra)	3,501	4,082
Environment	542	1,550
Transport	912	1,753
Natural resources	713	850
Fisheries	1,314	1,359
Immigration, etc.	759	900
Human and training (ex. VRDP, student loans)	1,046	1,245
Justice	3,609	3,275
Heritage/culture	2,652	2,825
General government services and other (net)	7,672	6,047
Contingency	3,000	–
Less CHST* transfer from 1998-99	–2,000	–
Total program	97,800	107,100
Unemployment insurance fund	13,400	19,500
Total spending program and UI	111,200	126,600

* CHST allocated among health, post-secondary, and income support in 1994-1996 proportions. CHST supplement to health only.

Sources: Detailed estimates for 1999-2000, Treasury Board Web site, and Canadian Centre for Policy Alternatives/Choices, 1999.

The great money trick continued from page 53

had an impact on some important items in the federal budget in recent years. The imposition of a "floor" below which the CHST would not fall, the backing away from the proposed seniors' benefit, and the abolition of the surtax on low-income earners are just some recent fiscal initiatives for which social movement activism, of which the AFB is but a small part, can take some credit.

In the current federal budget, pressure from social movements, organized labour, and consumer groups across the country led to the restoration of at least some of the cuts to health transfers. In the coming year, the main task facing social movements will be to develop even more persuasive arguments for the necessity to strengthen social programs, to offset what are likely to be increasingly histrionic calls by the business lobby for across-the-board tax cuts.

In the current federal budget, pressure from social movements,organized labour, and consumer groups across the country led to the restoration of at least some of the cuts to health transfers. In the coming year, the main task facing social movements will be to develop even more persuasive arguments for the necessity to strengthen social programs, to offset what are likely to be increasingly histrionic calls by the business lobby for across-the-board tax cuts.

A new cycle of investment continued from page 46

ated new export opportunities. World financial markets became highly fluid, and new technologies altered the way international business was organized.

It was the 1990-91 recession that finally provoked drastic action—first in the private sector, as industries began to deal directly with their lagging productivity and the intense pressures of world competition, and then in the public sector, as those fluid financial markets began to take flight from high-debt countries, including Canada.

Budget cuts were deliberately designed to reverse the role of government—shifting responsibility and insecurity back to citizens. Although the political rhetoric and the severity of the cuts varied from one part of the country to another, Liberal, Conservative, and NDP governments were all caught up in the process of "getting the economic house in order."

Hospitals were restructured, unemployment insurance became less generous, public pensions became more costly, social services were cut, and social programs became more and more targeted, leaving gaps in the social safety net. As people began to fall through those gaps, the social deficit increased.

The first food banks appeared in the late 1980s. By the late 1990s, homelessness was painfully evident on the downtown streets of most Canadian cities.

If the next budget addresses children, for example, it will require a well-articulated strategy for supporting parents in achieving healthy child development. No single budget could possibly "fix" the problem; we will need a 10-year agenda.

A NEW ERA BEGINS

Now, finally, Canada is poised on the threshold of a new era in the balancing of risk between citizen and state. The fiscal crisis is largely behind us, and we have the luxury of planning ahead. The federal budget each February has become one of the key levers for social investment.

Both the education budget in 1998 and the health budget in 1999 took important initiatives to direct money into starving systems. But they did not "fix"

A new cycle of investment, page 65

Where the "found" money went

BY AVERY SHENFELD

Avery Shenfeld is the managing director and senior economist at CIBC World Markets.

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 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.

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

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.

"Found" money, page 56

"Found" money continued from page 55

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 settle for only token rate reductions in a pre-election year document.

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.

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 continued from page 45

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 percent 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.

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.

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.

The social fundamentals

BY KEN BATTLE, SHERRI TORJMAN, AND MICHAEL MENDELSON

Ken Battle is president of the Caledon Institute of Social Policy. Sherri Torjman is vice-president and Michael Mendelson is senior scholar with the Caledon Institute.

Canadians have endured several years of tough fiscal medicine in the quest to slay the deficit. Programs were cut, taxes raised, and new spending put on hold—all in the name of "getting the fundamentals right." The fiscal fundamentals may be right—or at least getting there—but the social fundamentals are far from right and the 1999 budget moves only very slowly in restoring the social infrastructure.

MODEST SPENDING WON'T HURT

Spending more or taxing less will not endanger the struggle against the debt. The debt burden, as measured by the ratio of debt to gross domestic product (GDP), is falling rapidly and will continue to fall, even if the economy turns out to be relatively stagnant next year.

A debt model developed by the Caledon Institute looks at the impact upon the debt burden of two scenarios: modest and extensive spending and tax cuts. In both cases, the debt burden falls steadily and dramatically over the coming decade.

Even very large spending increases and tax cuts result in a debt-to-GDP ratio of 30 to 40 percent by 2008-09—still among the lower ranks in the G7. The debt burden is on a long-term downward escalator even if there is an economic downturn or, still worse, a recession. Although the budget begins to restore parts of Canada's social infrastructure, it can and should do much more.

HEALTHIER MEDICARE

The budget's injection of $11.5 billion into health care over the next five years will repair some of the damage of the sudden and huge cuts to health care ushered in as part of the Canada health and social transfer (CHST), which took effect in 1996. But despite the substantial increase in expenditure, the transfers still will not fully restore the pre-cuts level. Moreover, the Achilles' heel in the new transfer package is that it has not been indexed to keep pace with changes in inflation or economic growth.

The funds announced in the budget will ease some of the hospital horror stories—overcrowding, long waiting lists for surgery, bed shortages, and exhausted staff—that have dominated the headlines of late. And the new cost-sharing formula for the distribution of the CHST will resolve some of the unfairness inherent in the original formula. The budget redresses this problem by distributing the new money in the CHST so that, by the end of three years, every province will have an equal per-capita allotment.

However, new funds, even with a fairer distribution, will do little to tackle the fundamental problems in health care. The underlying structural problems will remain unaddressed unless there is a strategic reconfiguration of the health care system.

There is no clear process for determining the specific services that, in future, will be "insured" or financially covered under medicare. Additional funds may enable the purchase of expensive diagnostic and treatment technologies but will not resolve the problem of how to evaluate and keep pace with rapid technological change. And there is the pressing problem of how best to meet the health needs of an aging population.

SLEIGHT-OF-HAND TAX CUTS

The budget does not get the fundamentals right when it comes to the tax system. Following the pattern set in the 1998 budget, the 1999 budget bestows relatively small tax breaks that will lose ground to inflation as early as next year. Income taxes will dip a bit for a year, then resume their upward climb.

Following the pattern set in the 1998 budget, the 1999 budget bestows relatively small tax breaks that will lose ground to inflation as early as next year. Income taxes will dip a bit for a year, then resume their upward climb.

The small tax breaks are all fatally infected with the partial deindexation virus—the income tax system remains partially deindexed, as it has been since 1986. As a result, the tax reductions offer only temporary, modest, and—perhaps worst of all—sleight-of-hand tax relief.

Ottawa estimates that last year's tax reductions removed 400,000 low-income Canadians from the federal tax rolls, with another 200,000 taken off this year, for a total of 600,000. This is a

The social fundamentals, page 62

The Fraser Institute's reaction to the 1999 federal budget

BY PATRICK BASHAM, JASON CLEMENS, JOEL EMES, AND MICHAEL WALKER

Patrick Basham is the director of social affairs for the Fraser Institute. Jason Clemens is a policy analyst, Joel Emes is a research economist, and Michael Walker is the executive director of the Fraser Institute.

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.

> 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.

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

The Fraser Institute's reaction, page 60

The Fraser Institute's reaction continued from page 59

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.

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.

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.

Allegedly, the market has no place to shelter our most unfortunate fellow citizens. This is straw man rhetoric at its worst. The homelessness "crisis" in our major cities is clearly the result of government action, not market indifference.

Allegedly, the market has no place to shelter our most unfortunate fellow citizens. This is straw man rhetoric at its worst. The homelessness "crisis" in our major cities is clearly the result of government action, not market indifference.

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.

 continued from page 58

laudable achievement, but it still does not fully make up for the fact that more than one million working poor Canadians were pulled into the tax net as a result of more than a decade's worth of partial deindexation, which steadily lowers the tax-paying threshold.

GROWTH IN NATIONAL CHILD BENEFIT

The budget announces important improvements in the Canada child tax benefit that forms Ottawa's commitment to the federal/provincial national child benefit system.

The maximum benefit, which was previously increased from $1,020 to $1,650 for one child and $1,450 for each additional child in July 1996, rises again to $1,805/$1,605 in July 1999, and to $1,975/$1,775 in July 2000. The net family income level above which families do not qualify for the larger benefit for low-income families will increase from $25,921 to $27,750 in 1999 and to $29,590 in 2000. The budget also announced an additional $300 million to begin restoring losses in child benefits for non-poor families.

The budget demonstrates Ottawa's continuing commitment to the national child benefit, itself the first substantive model for the new partnership federalism embodied in the recent social union framework agreement. The provinces and territories, which reinvested the first $850 million increase in federal child benefits in a range of income programs and social and health services for low-income families with children, will have another $850 million to build on those initiatives and/or undertake new ventures.

UNEMPLOYMENT ASSURANCE

It is time to look yet again at one of Canada's most important social fundamentals: unemployment insurance. The budget makes reference to the small premium reductions introduced over the years. But serious problems remain with both its coverage and financing.

As a result of a series of changes, the rebranded program—employment insurance—paid benefits to only 41.7 percent of Canada's unemployed in 1997. No other social program has seen such a drastic slashing of its clientele. But reduced coverage is not the only problem. Workers who must leave the program earlier than ever and those who do not even qualify in the first place have no access to the training funds tied to the "active" labour market measures embedded in the program.

The 1999 budget takes some small steps toward restoring the social fundamentals, especially in its enhancement of funds for health care, child benefits, and modest tax breaks. But the social fundamentals have been thrown so far off course over the past few years that nothing less than deep structural reforms are required at this time.

DEAFENING SILENCE ON DISABILITY ISSUES

The budget did precious little in respect of disability issues. There were merely some small additions to the medical expense tax credit.

The lack of action on the program front is disheartening, given the landmark document that Ottawa signed in October 1998 with all the provinces (except Quebec). *In Unison: A Canadian Approach to Disability Issues* sets out a vision for advancing the disability agenda from the perspective of full citizenship for persons with disabilities. It is incomprehensible that the government could not find one single measure to support from this historic agreement.

OTTAWA SHELTERS ITSELF

The federal government's recent policy on social housing has succeeded only in sheltering itself from this pressing national concern. Ottawa can no longer hide from the fact that it should be playing a leading role in tackling this national crisis—an international embarrassment.

THE BOTTOM LINE

The 1999 budget takes some small steps toward restoring the social fundamentals, especially in its enhancement of funds for health care, child benefits, and modest tax breaks. But the social fundamentals have been thrown so far off course over the past few years that nothing less than deep structural reforms are required at this time. On this count, the 1999 budget falls short.

Federal budgets and equality in Canada

BY ANDREW SHARPE

Andrew Sharpe is the executive director of the Centre for the Study of Living Standards, Ottawa.

The discussion of equality generally centres around income distribution. But the concept of equality, or its opposite, inequality, is much broader, including equality with respect to economic security, availability of health care, and educational opportunities. Recent federal budgets have affected current trends in equality in all four areas.

INCOME EQUALITY

Income distribution is affected by trends in market income (employment earnings and investment income), government transfers, and taxes. Market income inequality for families has increased in the 1990s due to high unemployment and a shift in labour demand away from those with limited skills. At least up to 1995, this trend was offset by the government tax and transfer system, so there was no significant change in the post-tax distribution of income as represented by the Gini coefficient. In 1996, post-tax income inequality increased dramatically, reflecting in part large cuts to welfare payments by the Ontario government. Recently released data for 1997 show no major changes in income shares from 1996.

The largest federal government cuts in transfers have been in unemployment insurance (UI), now employment insurance (EI). These cuts have increased income inequality, but perhaps not as much as might be expected. This is because EI, unlike welfare, does not go predominantly to families in the bottom quintile of the population. Rather, EI payments are concentrated in the middle and upper-middle quintiles. This situation reflects the fact that, because of age, disability, or other factors, most families in the bottom quintile are not employed, and hence are ineligible for EI.

The federal transfer programs that are particularly important for low-income elderly Canadians are old age security and the guaranteed income supplement. These two programs have not been cut in nominal or real terms because both are fully indexed to changes in the consumer price index.

> Because of the child tax benefit, the combined full-year impact of the various tax measures of the 1998 and 1999 federal budgets is quite progressive for families with children.

A major program initiative of the Liberal government has been the introduction and enrichment of the child tax benefit. This program is redistributive in nature because it is targeted at low-income households. For example, the budget changes in 1998 and 1999 raise the maximum Canada child tax benefit in 2000 for families earning under \$29,590 to \$1,975 for the first child and \$1,775 for each additional child. These benefits represent a significant proportion of these families' incomes and will thus increase the income share of the bottom two quintiles significantly.

Because of the child tax benefit, the combined full-year impact of the various tax measures of the 1998 and 1999 federal budgets is quite progressive for families with children (see the table below). For example, a single-earner family of four with an income of \$13,500 receives a tax break equivalent to 6.4 percent of income, but the same family at an income of \$100,000 receives only a 0.9 percent cut. In contrast, the overall measures are only slightly progressive for elderly households and single individuals not affected by the child tax benefit.

In addition to the direct impact of transfers and taxes, government also has an indirect effect on market income distribution through employment policies, particularly macroeconomic policies. Low unemployment fosters income equality as the disadvantaged gain jobs, improving the relative income position of the bottom two quintiles. The restrictive federal budgets of the mid-1990s dampened economic and employment growth and hence contributed to greater income inequality. The most recent budgets have not been expansionary enough to offset the fiscal tightening of the earlier budgets and hence have not had much positive indirect impact on income distribution.

EQUALITY OF ECONOMIC SECURITY

The level of economic security enjoyed by Canadians varies by income group, with the rich obviously enjoying greater security than the poor. Two key determinants of economic security are the unemployment rate, which affects one's ability to find a job, and the generosity

Federal budgets and equality, page 64

Federal budgets and equality continued from page 63

of social programs such as EI and social assistance. In recent years, the federal government has dramatically cut EI, with the proportion of the unemployed receiving benefits falling to less than 40 percent from over 80 percent earlier in the decade.

According to an index of economic security developed by the Centre for the Study of Living Standards, the fall in EI coverage, combined with high unemployment and heightened fear of job loss, has resulted in a large increase in economic insecurity in the 1990s. This has produced greater inequality in economic security since it is persons at the bottom of the income distribution who are most at risk. Despite the improved economic situation and the large surpluses on the EI account, the federal government has chosen not to move to restore earlier levels of EI generosity.

EQUALITY OF ACCESS TO HEALTH CARE

Medicare has been a great success in making health care accessible to all Canadians. But cuts to the health care system in the 1990s have put the universality of high-quality health care at risk. For example, a number of medical services have been delisted and waiting periods to receive certain services have increased. These developments reduce equality of access to health care since it is much easier for the rich than for the poor to pay for delisted services and to circumvent waiting lists through personal connections or purchasing health services outside the country.

The 1999 budget has become known as the health care budget because it introduced a number of measures to strengthen the health care system, including transferring additional moneys to the provinces and territories for health care. While one may argue that this is still inadequate and fails to make up for earlier cuts, at least this new emphasis should in principle counteract any trend toward increased inequality in access to health care.

EQUALITY OF ACCESS TO EDUCATIONAL OPPORTUNITIES

The equality of access to educational opportunities in Canada has increased greatly in recent decades and is high from an international perspective. Indeed, according to OECD data, Canada has the highest enrollment rate in post-secondary educational institutions in the OECD. One development in the 1990s putting this accessibility at risk has been the large increases in tuition, particularly at the university level, since students from low-income families are more affected than students from high-income families.

The federal government has taken a number of measures to increase the affordability of post-secondary education through the establishment of the millennium scholarship fund and the enrichment of the registered education saving plan (RESPs), including the Canada education saving grant. These measures at least recognize the importance of equality of access to post-secondary education, and may contribute to offsetting some of the negative effect of tuition hikes on equality.

CONCLUSION

Due to both our poor economic performance and fiscal retrenchment, the 1990s has been a difficult decade for Canadians with regard to equality. The distribution of market income has become more unequal because of high unemployment and decreased relative demand for the services of the poorly skilled. Economic insecurity has increased because of high unemployment combined with major cuts in EI coverage. Equality of access to health care has been jeopardized by spending cuts and access to post-sec-

Impact of the 1998 and 1999 federal budgets for families with children (full-year impact as a percentage of income)

	Percentage of income		
Income	(1) typical one-earner family of four	(2) typical two-earner family of four	(3) typical single parent with one child
10,000	–	–	3.50
13,500	6.39	–	–
15,000	6.27	–	2.30
20,000	4.83	4.76	3.00
25,000	4.03	3.88	2.48
30,000	1.66	3.35	2.30
35,000	1.53	1.65	1.18
40,000	1.44	1.27	1.13
45,000	1.36	1.18	1.09
50,000	1.30	1.11	1.06
55,000	1.26	1.07	1.03
60,000	1.22	1.03	1.01
65,000	1.19	1.00	0.99
75,000	0.92	0.84	0.87
100,000	0.91	0.71	0.87

(The most important tax relief measures in the 1999 budget were the enrichment of the child tax benefit and the elimination of the 3 percent surtax for high-income individuals.)

Source: Column 1—table A7.4; column 2—table A7.5; column 3—table A7.6, The Budget Plan 1999, *February 16, 1999, Department of Finance.*

ondary education has been threatened by tuition hikes.

The federal government, after contributing to certain of these negative developments in the early and mid-1990s, now has a fiscal dividend that allows it to change direction. A number of the measures in the most recent federal budgets will increase equality in Canada — such as the enriched child tax benefit and additional funding for education and health. However, the federal government deserves much less credit in the area of equality of economic security because it has been unwilling to reverse the rise in the economic insecurity of Canadians resulting from its EI cuts. This area in particular should be a key priority for future action. Of course, much more remains to be done in all four of these areas and hopefully the government will follow through in future budgets to address these equality issues.

The 1999 budget has become known as the health care budget because it introduced a number of measures to strengthen the health care system, including transferring additional moneys to the provinces and territories for health care. While one may argue that this is still inadequate and fails to make up for earlier cuts, at least this new emphasis should in principle counteract any trend toward increased inequality in access to health care.

A new cycle of investment continued from page 54

either post-secondary education or health. Those fixes will be a long, hard slog in the years ahead. It will be a lot easier to modernize and adapt these systems when there is some discretionary money to invest. But it takes political will to move the money to the new priorities rather than feed the claims from the old ways of doing business.

And now the competition is on for prime billing in budget 2000. Will it be children? The environment? Productivity? Or tax cuts? Or will it be a combination of these priorities?

These theme budgets make sense if they enable governments to concentrate their resources on the implementation of a long-term strategy. If the next budget addresses children, for example, it will require a well-articulated strategy for supporting parents in achieving healthy child development. No single budget could possibly "fix" the problem; we will need a 10-year agenda. The same challenge holds for the other possible themes.

The new investment cannot take us back to where we were in the mid-1970s; it has to take us forward to where we should be in the 21st century.

The decisions about priorities should be selected to maintain harmony between social and economic goals. We all must recognize that the task we face on each of these issues is fundamental, difficult, and long term. The new investment cannot take us back to where we were in the mid-1970s; it has to take us forward to where we should be in the 21st century.

Although there are parallels with 1945, the challenges are rather different. Rather than "getting back to civil life," we will have to build a "civil society"—a society that shares risks and responsibilities and lives within its means.

The way people earn their living and the way they look after each other will be different going forward—as will be the role of the state.

Perhaps the most important lesson we can learn from the post-war period is to avoid the extreme pendulum swings. If the social budget gets over-extended, the pendulum will have to swing back. If the market-oriented philosophy is taken too far, the policies will not be politically sustainable.

In future, we want to keep both social and economic policies under the same roof, and resting on the same solid foundations.

Back from the grave and ready to party: Federal-provincial transfers in the 1999 budget

BY WILLIAM ROBSON

William Robson is a senior policy analyst with the C.D. Howe Institute.

The biggest news in the 1999 budget was the re-emergence of federal-provincial transfers in support of health, education and welfare from a near-death state. Rolled up in the label of the Canada health and social transfer (CHST), these grants were a major casualty of Ottawa's fiscal problems—chopped from a peak of nearly $18 billion in 1992-93 to less than $12.5 billion in 1997-98. The 1999 budget proposed to make the CHST more robust again, pumping it up to $15 billion over the next three fiscal years. Despite some griping about the accompanying proposal to distribute the money more equally on a per-person basis among the provinces, the main reaction from provincial leaders and the public was festive.

The talk of "renewing" and "restoring" surrounding this move highlights the fact that, in this latest round of federal-provincial grants, much that was old is new again. As the initial celebration fades, other relics from the past are sure to return to haunt us: friction over federal intrusions into provincial jurisdiction, bickering over incremental funding, and the overlap and duplication that inspires Canadians to complain about their federal system. However, previous experience also shows how to put those problems back to rest: transfer federal tax room, not money, to the provinces, to match better the revenue capacities and spending responsibilities of each level of government.

ADDRESSING THE "VERTICAL IMBALANCE"

The driving force behind past and present changes to Canada's federal-provincial fiscal arrangements is a "vertical imbalance" between the taxing powers and principal programs of the two levels of government. Thanks to fiscal arrangements from the 1930s and 1940s, Ottawa has had readier access to rapidly growing personal and corporate income taxes over the past half-century. Meanwhile, most of the fastest growing fields of spending have been provincial. This imbalance has generated two waves of new grants and transfers of tax room.

Ottawa has had readier access to rapidly growing personal and corporate income taxes over the past half-century. Meanwhile, most of the fastest growing fields of spending have been provincial. This imbalance has generated two waves of new grants and transfers of tax room.

In the early 1950s, Ottawa commenced cash grants to the provinces in support of universities, and later in the decade, cost-sharing grants in support of provincial health care began. Although the money was welcome, the erosion of provincial autonomy that came with it was not. In 1960 and again in 1965, Quebec balked at the grants, and negotiated a reduction—or abatement—of federal taxes in Quebec, allowing the province to fund more of these programs itself. Two years later, following the establishment of 50-50 sharing of provincial welfare costs under the Canada assistance plan (CAP), further abatements of federal corporate and personal taxes provided additional revenue-raising room to all provinces.

A decade later, in 1977, the established programs financing (EPF) agreements marked a new round. Under EPF, Ottawa provided cash grants according to each province's past spending on health and education, while the provinces asked for, and got, another transfer of personal income tax room. Five years after that, the 1982 EPF agreements put federal-provincial transfers for health and education into the framework that persists with today's CHST: an equal per-person "entitlement" composed of a notional tax transfer (the annual value of the room ceded by Ottawa in 1977) and cash, with differences in the cash provided to each province offsetting differences in the calculated yield of the taxes.

FISCAL PROBLEMS AND DISTRIBUTIONAL INEQUITIES

During the next decade and a half, the changed environment of chronic federal fiscal problems sapped the strength of the transfer programs. Ottawa repeatedly scaled back the formula governing growth in total EPF entitlements, which meant that the cash component (the difference between a slowly growing total and a more rapidly growing tax component) stagnated in aggregate and fell in provinces with more robust economies. Then the 1990 "cap on CAP" put a ceiling on welfare-related transfers to the three richest provinces. And when EPF and CAP payments were rolled together into the CHST in 1995, total cash transfers to the provinces dropped by one-quarter over two years, and the disparity among per-person cash payments to each province widened to the point where the transfers to the most favoured province (Quebec) were half again as large as those to the least favoured (Alberta).

Although the dwindling amount of cash in these transfers began to prompt speculation about when they would fade from the scene completely, it was not only their shrinking size, but also their ever-more-skewed distribution, that gave these transfers a deathly hue by the mid-1990s. The provinces that contribute disproportionately to federal coffers—Alberta, Ontario, and British Columbia—were getting steadily less. Since Canada already has a $9.5 billion-a-year equalization program that addresses the "horizontal imbalance" between the different provinces' revenue-raising capacities by topping up the budgets of the less well off, the CHST's tilt toward these same recipient provinces was undermining political support for transfers in the provinces whose citizens provided the bulk of the money.

Now that a budget surplus has given Ottawa room to increase the size of the CHST and reduce the disparities in cash payments to different provinces, federal-provincial transfers are back from the grave. Provinces are celebrating by pouring new money into health care and cutting taxes.

The pressure for more social spending—especially in health, where there is literally no limit to the demand for services provided free at the point of consumption—will still be strongest at the provincial level. But it makes no more sense now than it ever did for provincial governments to become more and more dependent on transfers from Ottawa to finance their programs.

GHOSTS OF THE PAST

If the past is any guide, however, what now looks new will soon begin to look old again. Ottawa still has a commanding position in raising personal and corporate income taxes, and the pressure for more social spending—especially in health, where there is literally no limit to the demand for services provided free at the point of consumption—will still be strongest at the provincial level. But it makes no more sense now than it ever did for provincial governments to become more and more dependent on transfers from Ottawa to finance their programs. Recycling the resources that go into hospitals, schools, and income support through Ottawa does not make citizens any healthier, smarter or wealthier—in fact, the reverse is more often the case, because the recycling blunts accountability, and injects additional political tension into a provincial service-delivery job that is already overwhelmingly complicated.

As Ottawa's surplus continues to grow, therefore, Canada's leaders should remember how transfers of tax room have eased the vertical imbalance between federal and provincial fiscal powers and responsibilities in the past. Provincial governments are going to need more resources and management flexibility in social programs over time. While a bigger CHST can deliver the former, only further transfers of taxing power from Ottawa to the provinces can deliver both. Without it, annual bickering over new money and the friction of federal-provincial overlap will soon spoil the party. Federal tax cuts may be the best way to keep our future festivities free from the ghosts of the past.

Mr. Martin's budget continued from page 50

ards and raising social assistance incomes to 60 percent of the poverty line immediately. The AFB also redirected the large UI fund surplus to UI benefits, rebuilding a program that now provides benefits to less than one in three of the unemployed. In short, the actual budget called an end to the cuts, but did very little to provide an assured funding base for the social wage.

THE BUDGET AND TAX FAIRNESS

Building on last year's initiatives, the budget adjusted the amount of income that can be earned free of tax, offsetting some of the recent impact of deindexation of the tax system to low inflation, and completed the elimination of the 3 percent federal surtax. In combination, the two budgets delivered a very mod-

Giving Mr. Paul a grade, page 68

Mr. Martin's budget continued from page 67

estly progressive federal tax reduction in percentage terms, with an average full-time worker getting a 5 percent tax cut ($300), high-income earners ($100,000 plus) getting about 3 percent ($800), and low-income earners ($20,000) getting a tax saving of about 9 percent ($200). In dollar terms, the savings from the elimination of the 3 percent surtax on high-income earners in the 1999 budget were large. Taxpayers earning more than $250,000—the top 0.4 percent—will save an average of $3,673 per year, and those earning between $150,000 and $250,000 will receive an average of $1,127. Mr. Martin resisted the call from the right for immediate, large, across-the-board, personal and corporate income tax cuts, but he has done little to increase the progressivity of the tax system. His "balanced" approach—which has resulted in significant tax cuts for very high-income earners—must be set in the context of rapidly growing income inequality in Canada. Those earning $100,000 and more were, after all, the only group to experience rising real pre-tax incomes in Canada in the 1990s.

Mr. Martin resisted the call from the right for immediate, large, across-the-board, personal and corporate income tax cuts, but he has done little to increase the progressivity of the tax system.

The AFB, yet again in sharp contrast to the actual budget, maintained the federal tax share of GDP, but introduced a tax on large wealth transfers between generations (additional revenues of $3 billion per year), introduced higher federal tax brackets of 32 percent and 34 percent for those earning more than $100,000 and $150,000, respectively, and closed some particularly unproductive corporate and personal tax loopholes. The proceeds were used to significantly increase tax credits for low-income households, with an additional $2,000 per child directed to households with incomes of less than $26,000. This progressive tax redistribution, combined with the AFB's improvements to social assistance, would cut the child poverty rate in half.

CONCLUSION

Mr. Martin's budget has been almost universally described as "modest" and "prudent." It is essentially a "stay-the-course" budget, tailored to the new realities of a post-deficit fiscal world. The best that can be said is that it moves us—ever so slightly—forward rather than backward in terms of dealing with such key issues as unemployment and precarious employment, long-term growth, environmental sustainability, social justice, and tax fairness. The progressive alternative, the AFB, would have represented a much bolder and decisive step forward, but it would not have meant returning to deficit financing. The price of "prudence" is higher unemployment, higher child poverty, and reduced living standards in the longer run.

More than ever, the choices cemented in federal budgets need to be thoroughly assessed and debated by progressives, or we may come to believe, with the Liberal government, that small gestures count for a lot, and that occasional doses of progressive rhetoric can compensate for doing very little in practice.